

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 JUNE 30, 1999

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NO. 1-13726

CHESAPEAKE ENERGY CORPORATION
(Exact name of registrant as specified in its charter)

OKLAHOMA 73-1395733
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

6100 NORTH WESTERN AVENUE 73118
OKLAHOMA CITY, OKLAHOMA (Zip Code)
(Address of principal executive offices)

(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

At August 12, 1999, there were 97,117,473 shares of the registrant's \$.01
par value Common Stock outstanding.

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
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CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

ASSETS

| | JUNE 30, 1999 | DECEMBER 31, 1998 |
|--|---|---|
| | ----- (UNAUDITED) (\$ IN THOUSANDS) | ----- (UNAUDITED) (\$ IN THOUSANDS) |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 27,553 | \$ 29,520 |
| Restricted cash | 1,442 | 5,754 |
| Accounts receivable: | | |
| Oil and gas sales | 14,379 | 13,835 |
| Oil and gas marketing sales | 17,474 | 19,636 |
| Joint interest and other, net of allowance for doubtful accounts of \$3,244,000 and \$3,209,000 | 9,288 | 27,373 |
| Related parties | 13,501 | 15,455 |
| Inventory | 4,877 | 5,325 |
| Other | 2,446 | 1,101 |
| | ----- | ----- |
| Total current assets | 90,960 | 117,999 |
| | ----- | ----- |
| PROPERTY AND EQUIPMENT: | | |
| Oil and gas properties, at cost based on full-cost accounting: | | |
| Evaluated oil and gas properties | 2,218,839 | 2,142,943 |
| Unevaluated properties | 45,190 | 52,687 |
| Less: accumulated depreciation, depletion and amortization | (1,622,378) | (1,574,282) |
| | ----- | ----- |
| 641,651 | 621,348 | |
| Other property and equipment | 78,477 | 79,718 |
| Less: accumulated depreciation and amortization | (39,399) | (37,075) |
| | ----- | ----- |
| Total property and equipment | 680,729 | 663,991 |
| | ----- | ----- |
| OTHER ASSETS | 29,221 | 30,625 |
| | ----- | ----- |
| TOTAL ASSETS | \$ 800,910 | \$ 812,615 |
| | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT) | | |
| CURRENT LIABILITIES: | | |
| Notes payable | \$ -- | \$ 25,000 |
| Accounts payable | 18,649 | 36,854 |
| Accrued liabilities and other | 34,189 | 46,572 |
| Revenues and royalties due others | 22,490 | 22,858 |
| | ----- | ----- |
| Total current liabilities | 75,328 | 131,284 |
| | ----- | ----- |
| LONG-TERM DEBT, NET | 958,118 | 919,076 |
| | ----- | ----- |
| REVENUES AND ROYALTIES DUE OTHERS | 11,137 | 10,823 |
| | ----- | ----- |
| DEFERRED INCOME TAXES | 4,880 | -- |
| | ----- | ----- |
| STOCKHOLDERS' EQUITY (DEFICIT): | | |
| Preferred stock, \$.01 par value, 10,000,000 shares authorized; 4,600,000 shares of 7% cumulative convertible stock issued and outstanding at June 30, 1999 and December 31, 1998, entitled in liquidation to \$230 million plus earned but unpaid dividends of \$11.2 million and \$3.2 million at June 30, 1999 and December 31, 1998, respectively | 230,000 | 230,000 |
| Common stock, 250,000,000 shares authorized; \$.01 par value; 105,552,613 and 105,213,750 shares issued and outstanding at June 30, 1999 and December 31, 1998, respectively | 1,055 | 1,052 |
| Paid-in capital | 682,506 | 682,263 |
| Accumulated deficit | (1,130,998) | (1,127,195) |
| Accumulated other comprehensive income (loss) | (1,101) | (4,726) |
| Less: treasury stock, at cost; 8,503,300 common shares at June 30, 1999 and December 31, 1998, respectively | (29,962) | (29,962) |
| Less: treasury stock, at cost; 3,600 and 0 preferred shares at June 30, 1999 and December 31, 1998, respectively | (53) | -- |
| | ----- | ----- |
| Total stockholders' equity (deficit) | (248,553) | (248,568) |
| | ----- | ----- |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT) | \$ 800,910 | \$ 812,615 |
| | ===== | ===== |

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

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)
(IN THOUSANDS, EXCEPT PER SHARE DATA)

| | THREE MONTHS ENDED JUNE 30, | | SIX MONTHS ENDED JUNE 30, | |
|---|--------------------------------|-------------|------------------------------|-------------|
| | 1999 | 1998 | 1999 | 1998 |
| REVENUES: | | | | |
| Oil and gas sales..... | \$ 68,272 | \$ 75,639 | \$ 120,078 | \$ 125,880 |
| Oil and gas marketing sales..... | 12,620 | 33,671 | 26,491 | 60,195 |
| Total revenues..... | 80,892 | 109,310 | 146,569 | 186,075 |
| OPERATING COSTS: | | | | |
| Production expenses..... | 11,183 | 14,673 | 25,175 | 22,567 |
| Production taxes..... | 2,798 | 2,621 | 4,788 | 4,165 |
| Oil and gas marketing expenses..... | 11,673 | 33,705 | 24,958 | 59,966 |
| Impairment of oil and gas properties..... | -- | 216,000 | -- | 466,000 |
| Impairment of other assets..... | -- | 10,000 | -- | 10,000 |
| Oil and gas depreciation, depletion and amortization..... | 24,233 | 43,900 | 47,386 | 75,242 |
| Depreciation and amortization of other assets..... | 1,972 | 1,922 | 4,138 | 3,302 |
| General and administrative..... | 3,268 | 5,134 | 7,292 | 9,514 |
| Total operating costs..... | 55,127 | 327,955 | 113,737 | 650,756 |
| INCOME (LOSS) FROM OPERATIONS..... | 25,765 | (218,645) | 32,832 | (464,681) |
| OTHER INCOME (EXPENSE): | | | | |
| Interest and other income..... | 2,967 | 2,571 | 3,840 | 2,795 |
| Interest expense..... | (20,259) | (18,665) | (40,149) | (29,353) |
| | (17,292) | (16,094) | (36,309) | (26,558) |
| INCOME (LOSS) BEFORE INCOME TAX AND EXTRAORDINARY ITEM..... | 8,473 | (234,739) | (3,477) | (491,239) |
| INCOME TAX EXPENSE..... | 326 | -- | 326 | -- |
| INCOME (LOSS) BEFORE EXTRAORDINARY ITEM..... | 8,147 | (234,739) | (3,803) | (491,239) |
| EXTRAORDINARY ITEM: | | | | |
| Loss on early extinguishment of debt..... | -- | (13,334) | -- | (13,334) |
| NET INCOME (LOSS)..... | 8,147 | (248,073) | (3,803) | (504,573) |
| PREFERRED STOCK DIVIDENDS..... | (4,026) | (4,025) | (8,052) | (4,025) |
| NET INCOME (LOSS) AVAILABLE TO COMMON SHAREHOLDERS..... | \$ 4,121 | \$(252,098) | \$ (11,855) | \$(508,598) |
| EARNINGS PER COMMON SHARE (BASIC AND ASSUMING DILUTION) | | | | |
| Income (loss) before extraordinary item..... | \$ 0.04 | \$ (2.29) | \$ (0.12) | \$ (5.35) |
| Extraordinary item..... | -- | (0.12) | -- | (0.15) |
| Net income (loss)..... | \$ 0.04 | \$ (2.41) | \$ (0.12) | \$ (5.50) |
| WEIGHTED AVERAGE COMMON AND COMMON EQUIVALENT SHARES OUTSTANDING | | | | |
| Basic | 97,049 | 104,462 | 97,049 | 92,504 |
| Assuming dilution..... | 101,450 | 104,462 | 97,049 | 92,504 |

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

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

| | SIX MONTHS ENDED JUNE 30, | |
|---|------------------------------|--------------|
| | 1999 | 1998 |
| | ----- (\$ IN THOUSANDS) | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net loss | \$ (3,803) | \$ (504,573) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | |
| Depreciation, depletion and amortization | 49,923 | 77,542 |
| Impairment of oil and gas assets | -- | 466,000 |
| Impairment of other assets | -- | 10,000 |
| Deferred taxes | 326 | -- |
| Amortization of loan costs | 1,601 | 1,002 |
| Amortization of bond discount | 35 | 56 |
| Gain on sale of fixed assets and other | 98 | (368) |
| Extraordinary loss..... | -- | 13,334 |
| Equity in (earnings) losses of equity investees | (35) | 285 |
| Bad debt expense | -- | 516 |
| | ----- | ----- |
| Cash provided by operating activities before changes in current assets and liabilities | 48,145 | 63,794 |
| Changes in current assets and liabilities | (579) | (44,074) |
| | ----- | ----- |
| Cash provided by operating activities | 47,566 | 19,720 |
| | ----- | ----- |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Exploration, development and acquisition of oil and gas properties | (85,787) | (433,379) |
| Proceeds from sales of oil and gas properties | 17,387 | -- |
| Investment in preferred stock of Gothic | -- | (39,500) |
| Proceeds from sales of other assets | 1,306 | 4,404 |
| Long-term loans made to third parties | (511) | -- |
| Other investments | 325 | -- |
| Repayment of long-term loan | -- | 2,000 |
| Additions to other property and equipment | (65) | (5,183) |
| | ----- | ----- |
| Cash used in investing activities | (67,345) | (471,658) |
| | ----- | ----- |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from long-term borrowings | 14,000 | 658,750 |
| Payments on long-term borrowings | -- | (474,166) |
| Proceeds from issuance of preferred stock | -- | 222,781 |
| Purchase of treasury stock | (53) | (17,831) |
| Cash received from exercise of stock options | 240 | 101 |
| | ----- | ----- |
| Cash provided by financing activities | 14,187 | 389,635 |
| | ----- | ----- |
| EFFECTS OF CHANGES IN EXCHANGE RATE ON CASH | 3,625 | (1,867) |
| | ----- | ----- |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (1,967) | (64,170) |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 29,520 | 123,860 |
| | ----- | ----- |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | \$ 27,553 | \$ 59,690 |
| | ===== | ===== |

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

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
 (UNAUDITED)

| | THREE MONTHS ENDED JUNE 30, | | SIX MONTHS ENDED JUNE 30, | |
|---|--------------------------------|-------------|------------------------------|-------------|
| | 1999 | 1998 | 1999 | 1998 |
| | (\$ in thousands) | | | |
| Net income (loss)..... | \$ 8,147 | \$(248,073) | \$ (3,803) | \$(504,573) |
| Other comprehensive income (loss) - foreign currency translation adjustments... | 2,809 | (2,172) | 3,625 | (1,867) |
| Comprehensive income (loss)..... | \$ 10,956 | \$(250,245) | \$ (178) | \$(506,440) |

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

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. ACCOUNTING PRINCIPLES

The accompanying unaudited consolidated financial statements of Chesapeake Energy Corporation and subsidiaries (the "Company") have been prepared in accordance with the instructions to Form 10-Q as prescribed by the Securities and Exchange Commission. All material adjustments (consisting solely of normal recurring adjustments) which, in the opinion of management, are necessary for a fair presentation of the results for the interim periods have been reflected. The results for the three and six months ended June 30, 1999 are not necessarily indicative of the results to be expected for the full fiscal year.

This Form 10-Q relates to the three and six months ended June 30, 1999 (the "Current Quarter" and "Current Period", respectively) and June 30, 1998 (the "Prior Quarter" and "Prior Period", respectively).

2. LEGAL PROCEEDINGS

Chesapeake Securities Litigation

The Company and certain of its officers and directors are defendants in a consolidated class action suit alleging violations of the Securities Exchange Act of 1934. The plaintiffs, in suits first filed in August 1997, assert that the defendants made material misrepresentations and failed to disclose material facts about the success of the Company's exploration efforts in the Louisiana Trend. As a result, the complaint alleges the price of the Company's common stock was artificially inflated from January 25, 1996 until June 27, 1997, when the Company issued a press release announcing disappointing drilling results in the Louisiana Trend and a full-cost ceiling writedown to be reflected in its June 30, 1997 financial statements. The plaintiffs further allege that certain of the named individual defendants sold common stock during the class period when they knew or should have known adverse nonpublic information. The plaintiffs seek a determination that the suit is a proper class action and damages in an unspecified amount, together with interest and costs of litigation, including attorneys' fees. The Company and the individual defendants believe that these claims are without merit, and intend to defend against them vigorously. No estimate of loss or range of estimate of loss, if any, can be made at this time.

Bayard Securities Litigation

A purported class action alleging violations of the Securities Act of 1933 and the Oklahoma Securities Act was filed in February 1998 against the Company and others on behalf of investors who purchased common stock of Bayard Drilling Technologies, Inc. ("Bayard") in, or traceable to, its initial public offering in November 1997. Total proceeds of the offering were \$254 million, of which the Company received net proceeds of \$90 million as a selling shareholder. Plaintiffs allege that the Company, a major customer of Bayard's drilling services and the owner of 30.1% of Bayard's common stock outstanding prior to the offering, was a controlling person of Bayard. Plaintiffs assert that the Bayard prospectus contained material omissions and misstatements relating to (i) the Company's financial "problems" and their impact on Bayard's operating results, (ii) increased costs associated with Bayard's growth strategy, (iii) undisclosed pending related-party transactions between Bayard and third parties other than the Company, (iv) Bayard's planned use of offering proceeds and (v) Bayard's capital expenditures and liquidity. The alleged defective disclosures are claimed to have resulted in a decline in Bayard's share price following the public offering. Plaintiffs seek a determination that the suit is a proper class action and damages in an unspecified amount or rescission, together with interest and costs of litigation, including attorneys' fees. The Company believes that the claims are without merit and intends to defend against them vigorously. No estimate of loss or range of estimate of loss, if any, can be made at this time.

Patent Litigation

In October 1996, Union Pacific Resources Company ("UPRC") sued the Company alleging infringement of a patent for a drillbit steering method. Other claims asserted by UPRC have been dismissed. UPRC's infringement claims against the Company are based on services provided to the Company by a third party vendor controlled by former UPRC employees. UPRC is seeking damages of an unspecified amount, including actual and enhanced damages, interest, costs and attorneys' fees. In June 1999, the issues of the validity of the patent and the Company's alleged

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

infringement were tried to the Court. No ruling has been issued yet. If necessary, a trial on damages will be scheduled after the ruling. No estimate of loss or range of estimate of loss, if any, can be made at this time; however, in reports filed in the proceeding, experts for UPRC claim that damages could be as much as \$18 million while Company experts state that the amount should not exceed \$25,000, in each case based on a reasonable royalty.

West Panhandle Litigation

The Company, Natural Gas Pipeline Company of America and MidCon Gas Services, Inc. are defendants in 13 lawsuits filed in 1997 and 1998 by royalty owners seeking the cancellation of oil and gas leases in the West Panhandle Field in Texas. In April 1998, the Company acquired MC Panhandle, Inc., the owner of the leases since January 1, 1997. Plaintiffs claim the leases terminated upon the cessation of production for various periods between 1926 and 1997 and/or for failure to produce in paying quantities. Plaintiffs also seek to recover conversion damages in an amount equal to 7/8 of gross production for the period beginning two years prior to the filing of each suit through the time of trial, plus attorneys' fees and interest, as well as exemplary damages. Plaintiffs assert that defendants knew the leases had terminated and therefore are bad faith trespassers and not entitled (in the event of an adverse judgment) to recover the value of improvements or operating costs. In the alternative, plaintiffs seek damages for the breach of implied covenants of the leases, i.e., for failure to protect against drainage, to maximize production, and to reasonably develop and market. Defendants assert that any cessation of production was excused by their timely commencement of operations to restore production and assert affirmative defenses of limitations, waiver, estoppel, laches and title by adverse possession under 3, 5, 10 and 25-year statutes of adverse possession.

Four of the cases were tried to juries in May, June and July 1999, resulting in three verdicts in favor of and one against the defendants. The juries which found for defendants determined that the plaintiffs' termination claims were barred by laches, adverse possession and (in two cases) revivor. The adverse verdict found that the defendants were bad-faith trespassers and produced gas from the leases as a result of fraud. The jury assessed \$1.2 million in exemplary damages against each of the defendants and awarded plaintiffs attorneys' fees in the amount of \$158,000. The amount of any actual damages will be based on prior production. The parties stipulated that the value of gas produced by defendants was \$1.0 million since January 1, 1996 and \$1.5 million since January 1, 1994. The court will determine which amount of actual damages, if either, should be awarded based on the statute of limitations and other considerations. The Company has filed a motion for judgment notwithstanding verdict and, if not granted, intends to appeal the decision. The other nine cases have not been set for trial.

The Company has previously established an accrued liability that management believes will be sufficient to cover the estimated costs of litigation for each of the lease cancellation cases. Because of the inconsistent verdicts reached by the juries in the four cases tried to date and because the amount of damages sought is not specified in all of the other cases, the outcome of the remaining trials cannot be predicted and the amount of damages that might ultimately be awarded could differ from the estimates. Management believes, however, that the leases are valid, there is no basis for exemplary damages and that any findings of fraud or bad faith will be overturned on appeal. The defendants intend to continue to vigorously defend its position.

The Company is currently involved in various other routine disputes incidental to its business operations. While it is not possible to determine the ultimate disposition of these matters, management, after consultation with legal counsel, is of the opinion that the final resolution of all such currently pending or threatened litigation is not likely to have a material adverse effect on the consolidated financial position or results of operations of the Company.

3. IMPAIRMENT OF OIL AND GAS PROPERTIES AND OTHER ASSETS

The Company incurred an impairment of oil and gas properties charge of \$216.0 million in the Prior Quarter. This writedown was caused primarily by the effects of accounting for the Prior Quarter acquisitions using the purchase accounting method, as well as a significant decline in oil prices from March 31, 1998 to June 30, 1998. The Company also recorded a \$10.0 million impairment in the Prior Quarter related to certain of its gas processing and transportation assets located in Louisiana.

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

4. EARNINGS PER SHARE

Statement of Financial Accounting Standards No. 128, Earnings Per Share ("SFAS 128") requires presentation of "basic" and "diluted" earnings per share, as defined, on the face of the statement of operations for all entities with complex capital structures. SFAS 128 requires a reconciliation of the numerators and denominators of the basic and diluted EPS computations. For the Prior Quarter, the Current Period and the Prior Period, there was no difference between actual weighted average shares outstanding, which are used in computing basic EPS, and diluted weighted average shares outstanding, which are used in computing diluted EPS. Options to purchase 13.2 million and 8.3 million shares of common stock at a weighted average exercise price of \$1.74 and \$4.13 were outstanding at June 30, 1999 and 1998, respectively, but were not included in the computation of diluted EPS in the Prior Quarter, Current Period or Prior Period because the effect of these outstanding options would be antidilutive. A reconciliation for the Current Quarter is as follows (in 000's, except per share amounts):

| | Income (Numerator) | Shares (Denominator) | Per Share Amount |
|---|-----------------------|-------------------------|---------------------|
| | ----- | ----- | ----- |
| FOR THE QUARTER ENDED JUNE 30, 1999: | | | |
| BASIC EPS | | | |
| Income available to common stockholders.... | \$ 4,121 | 97,049 | \$ 0.04 |
| | | | ===== |
| EFFECT OF DILUTIVE SECURITIES | | | |
| Employee stock options..... | -- | 4,401 | |
| | ----- | ----- | |
| DILUTED EPS | | | |
| Income available to common stockholders and assumed conversions..... | \$ 4,121 | 101,450 | \$ 0.04 |
| | ===== | ===== | ===== |

5. SUBSEQUENT EVENT

The Company has a \$50 million revolving bank credit facility with a committed borrowing base of \$50 million. Subsequent to June 30, 1999, the Company entered into an amendment to the facility to extend the maturity date from August 1999 to February 2001. The amendment also increased the interest rate and certain fees and provided for other minor modifications. As of June 30, 1999, the Company had borrowed \$39 million under this facility, which was included in long-term debt. Borrowings under this facility are secured by certain producing oil and gas properties. The interest rate at June 30, 1999 was 7.75% per annum.

6. SENIOR NOTES

10.5% Notes

The Company had outstanding at March 31, 1998, \$90 million in aggregate principal amount of 10.5% Senior Notes which were to mature June 1, 2001. The 10.5% Notes were senior, unsecured obligations of the Company and were fully and unconditionally guaranteed, jointly and severally, by Guarantor Subsidiaries (as defined below). All outstanding 10.5% Notes were acquired by the Company effective April 30, 1998.

9.625% Notes

The Company has outstanding \$500 million in aggregate principal amount of 9.625% Senior Notes which mature May 1, 2005, and bear interest at the rate of 9.625%, payable semiannually on each May 1 and November 1. The 9.625% Notes are senior, unsecured obligations of the Company and are fully and unconditionally guaranteed, jointly and severally, by the Guarantor Subsidiaries.

9.125% Notes

The Company has outstanding \$120 million in aggregate principal amount of 9.125% Senior Notes which mature April 15, 2006, and bear interest at an annual rate of 9.125%, payable semiannually on each April 15 and October 15. The 9.125% Notes are senior, unsecured obligations of the Company and are fully and unconditionally guaranteed, jointly and severally, by the Guarantor Subsidiaries.

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

7.875% Notes

The Company has outstanding \$150 million in aggregate principal amount of 7.875% Senior Notes which mature March 15, 2004, and bear interest at the rate of 7.875%, payable semiannually on each March 15 and September 15. The 7.875% Notes are senior, unsecured obligations of the Company and are fully and unconditionally guaranteed, jointly and severally, by the Guarantor Subsidiaries.

8.5% Notes

The Company has outstanding \$150 million in aggregate principal amount of 8.5% Senior Notes which mature March 15, 2012, and bear interest at the rate of 8.5%, payable semiannually on each March 15 and September 15. The 8.5% Notes are senior, unsecured obligations of the Company and are fully and unconditionally guaranteed, jointly and severally, by the Guarantor Subsidiaries.

The Company is a holding company and owns no operating assets and has no significant operations independent of its subsidiaries. The Company's obligations under its Senior Notes have been fully and unconditionally guaranteed, on a joint and several basis, by each of the Company's "Restricted Subsidiaries" (as defined in the respective indentures governing the Senior Notes) (collectively, the "Guarantor Subsidiaries"). Each of the Guarantor Subsidiaries is a direct or indirect wholly-owned subsidiary of the Company.

The Senior Note indentures contain certain covenants, including covenants limiting the Company and the Guarantor Subsidiaries with respect to asset sales, restricted payments, the incurrence of additional indebtedness and the issuance of preferred stock, liens, sale and leaseback transactions, lines of business, dividend and other payment restrictions affecting Guarantor Subsidiaries, mergers or consolidations, and transactions with affiliates. The Company is obligated to repurchase the 9.625% and 9.125% Senior Notes in the event of a change of control or certain asset sales.

These Senior Note indentures also limit the Company's ability to make restricted payments (as defined in the indentures), including the payment of preferred stock dividends, unless certain tests are met. As of December 31, 1998, March 31, 1999 and June 30, 1999, the Company was unable to meet the requirements to incur additional unsecured indebtedness, and consequently was unable to pay the quarterly cash dividend of \$4.0 million on its 7% cumulative convertible preferred stock on February 1, 1999, May 1, 1999 or August 1, 1999. As of June 30, 1999 the cumulative earned but unpaid dividends on the preferred stock was \$11.2 million. Subsequent payments will be subject to the same restrictions and are dependent upon variables, most particularly oil and gas prices, that are beyond the Company's ability to predict. This restriction does not affect the Company's ability to borrow under or expand its secured commercial bank facility. If the Company fails to pay dividends for six quarterly periods, the holders of preferred stock would be entitled to elect two additional members to the Board.

Set forth below are condensed consolidating financial statements of the Guarantor Subsidiaries, the Company's subsidiary which is not a guarantor of the Senior Notes (the "Non-Guarantor Subsidiary") and the Company. As of and for the three and six months ended June 30, 1999 and 1998, Chesapeake Energy Marketing, Inc. was the only Non-Guarantor Subsidiary. For both periods, all other subsidiaries of the Company were Guarantor Subsidiaries. Separate financial statements of each Guarantor Subsidiary have not been provided because management has determined that they are not material to investors.

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

CONDENSED CONSOLIDATING BALANCE SHEET

AS OF JUNE 30, 1999
(\$ IN THOUSANDS)

| | ASSETS | | | | |
|--|---------------------------|-----------------------------|---------------------|-----------------------|-------------------|
| | GUARANTOR SUBSIDIARIES | NON-GUARANTOR SUBSIDIARY | COMPANY (PARENT) | ELIMINATIONS | CONSOLIDATED |
| CURRENT ASSETS: | | | | | |
| Cash and cash equivalents..... | \$ (9,126) | \$ 17,591 | \$ 20,530 | \$ -- | \$ 28,995 |
| Accounts receivable, net..... | 40,910 | 26,442 | 473 | (13,183) | 54,642 |
| Inventory..... | 4,566 | 311 | -- | -- | 4,877 |
| Other..... | 2,071 | 16 | 359 | -- | 2,446 |
| Total Current Assets..... | 38,421 | 44,360 | 21,362 | (13,183) | 90,960 |
| PROPERTY AND EQUIPMENT: | | | | | |
| Oil and gas properties..... | 2,218,839 | -- | -- | -- | 2,218,839 |
| Unevaluated leasehold..... | 45,190 | -- | -- | -- | 45,190 |
| Other property and equipment..... | 45,916 | 14,801 | 17,760 | -- | 78,477 |
| Less: accumulated depreciation, depletion and amortization..... | (1,651,974) | (8,183) | (1,620) | -- | (1,661,777) |
| Total Property and Equipment..... | 657,971 | 6,618 | 16,140 | -- | 680,729 |
| INVESTMENTS IN SUBSIDIARIES AND INTERCOMPANY ADVANCES..... | 808,285 | -- | 493,738 | (1,302,023) | -- |
| OTHER ASSETS..... | 10,612 | 566 | 18,096 | (53) | 29,221 |
| TOTAL ASSETS..... | \$ 1,515,289 | \$ 51,544 | \$ 549,336 | \$ (1,315,259) | \$ 800,910 |
| LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT) | | | | | |
| CURRENT LIABILITIES: | | | | | |
| Notes payable and current maturities of long-term debt..... | \$ -- | \$ -- | \$ -- | \$ -- | \$ -- |
| Accounts payable and other..... | 53,804 | 17,180 | 17,503 | (13,159) | 75,328 |
| Total Current Liabilities..... | 53,804 | 17,180 | 17,503 | (13,159) | 75,328 |
| LONG-TERM DEBT..... | 39,000 | -- | 919,118 | -- | 958,118 |
| REVENUES PAYABLE..... | 11,137 | -- | -- | -- | 11,137 |
| DEFERRED INCOME TAXES..... | 4,880 | -- | -- | -- | 4,880 |
| INTERCOMPANY PAYABLES..... | 1,372,792 | 1,038 | (1,373,806) | (24) | -- |
| STOCKHOLDERS' EQUITY (DEFICIT): | | | | | |
| Preferred Stock..... | -- | -- | 230,000 | -- | 230,000 |
| Common Stock..... | 27 | 1 | 1,044 | (17) | 1,055 |
| Other..... | 33,649 | 33,325 | 755,477 | (1,302,059) | (479,608) |
| Total Stockholders' Equity (Deficit)..... | 33,676 | 33,326 | 986,521 | (1,302,076) | (248,553) |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)..... | \$ 1,515,289 | \$ 51,544 | \$ 549,336 | \$ (1,315,259) | \$ 800,910 |

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

CONDENSED CONSOLIDATING BALANCE SHEET

AS OF DECEMBER 31, 1998
(\$ IN THOUSANDS)

| | ASSETS | | | | |
|--|---------------------------|-----------------------------|---------------------|--------------|--------------|
| | GUARANTOR SUBSIDIARIES | NON-GUARANTOR SUBSIDIARY | COMPANY (PARENT) | ELIMINATIONS | CONSOLIDATED |
| CURRENT ASSETS: | | | | | |
| Cash and cash equivalents..... | \$ (11,565) | \$ 7,000 | \$ 39,839 | \$ -- | \$ 35,274 |
| Accounts receivable..... | 54,384 | 29,641 | 270 | (7,996) | 76,299 |
| Inventory..... | 4,919 | 406 | -- | -- | 5,325 |
| Other..... | 721 | 15 | 365 | -- | 1,101 |
| Total Current Assets..... | 48,459 | 37,062 | 40,474 | (7,996) | 117,999 |
| PROPERTY AND EQUIPMENT: | | | | | |
| Oil and gas properties..... | 2,142,943 | -- | -- | -- | 2,142,943 |
| Unevaluated leasehold..... | 52,687 | -- | -- | -- | 52,687 |
| Other property and equipment..... | 47,628 | 15,109 | 16,981 | -- | 79,718 |
| Less: accumulated depreciation, depletion and amortization..... | (1,601,931) | (8,036) | (1,390) | -- | (1,611,357) |
| Total Property & Equipment..... | 641,327 | 7,073 | 15,591 | -- | 663,991 |
| INVESTMENTS IN SUBSIDIARIES AND INTERCOMPANY ADVANCES..... | 473,578 | -- | 481,150 | (954,728) | -- |
| OTHER ASSETS..... | 10,610 | 560 | 19,455 | -- | 30,625 |
| TOTAL ASSETS..... | \$ 1,173,974 | \$ 44,695 | \$ 556,670 | \$ (962,724) | \$ 812,615 |
| LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT) | | | | | |
| CURRENT LIABILITIES: | | | | | |
| Notes payable and current maturities of long-term debt..... | \$ 25,000 | \$ -- | \$ -- | \$ -- | \$ 25,000 |
| Accounts payable and other..... | 80,786 | 15,992 | 17,529 | (8,023) | 106,284 |
| Total Current Liabilities..... | 105,786 | 15,992 | 17,529 | (8,023) | 131,284 |
| LONG-TERM DEBT..... | -- | -- | 919,076 | -- | 919,076 |
| REVENUES PAYABLE..... | 10,823 | -- | -- | -- | 10,823 |
| INTERCOMPANY PAYABLES..... | 1,338,948 | 11,376 | (1,350,351) | 27 | -- |
| STOCKHOLDERS' EQUITY (DEFICIT): | | | | | |
| Common Stock..... | 26 | 1 | 1,042 | (17) | 1,052 |
| Other..... | (281,609) | 17,326 | 969,374 | (954,711) | (249,620) |
| Total Stockholders' Equity (Deficit)..... | (281,583) | 17,327 | 970,416 | (954,728) | (248,568) |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)..... | \$ 1,173,974 | \$ 44,695 | \$ 556,670 | \$ (962,724) | \$ 812,615 |

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS
(\$ IN THOUSANDS)

| | GUARANTOR SUBSIDIARIES | NON-GUARANTOR SUBSIDIARY | COMPANY (PARENT) | ELIMINATIONS | CONSOLIDATED |
|--|---------------------------|-----------------------------|---------------------|--------------|--------------|
| FOR THE THREE MONTHS ENDED JUNE 30, 1999 | | | | | |
| REVENUES: | | | | | |
| Oil and gas sales..... | \$ 68,869 | \$ -- | \$ -- | \$ (597) | \$ 68,272 |
| Oil and gas marketing sales..... | -- | 37,823 | -- | (25,203) | 12,620 |
| Total Revenues..... | 68,869 | 37,823 | -- | (25,800) | 80,892 |
| OPERATING COSTS: | | | | | |
| Production expenses and taxes..... | 13,981 | -- | -- | -- | 13,981 |
| Oil and gas marketing expenses..... | -- | 37,473 | -- | (25,800) | 11,673 |
| Oil and gas depreciation, depletion and amortization..... | 24,233 | -- | -- | -- | 24,233 |
| Other depreciation and amortization.... | 1,138 | 20 | 814 | -- | 1,972 |
| General and administrative..... | 2,942 | 324 | 2 | -- | 3,268 |
| Total Operating Costs..... | 42,294 | 37,817 | 816 | (25,800) | 55,127 |
| INCOME (LOSS) FROM OPERATIONS..... | 26,575 | 6 | (816) | -- | 25,765 |
| OTHER INCOME (LOSS) | | | | | |
| Interest and other income..... | 440 | 2,408 | 29,188 | (29,069) | 2,967 |
| Interest expense..... | (29,009) | -- | (20,319) | 29,069 | (20,259) |
| | (28,569) | 2,408 | 8,869 | -- | (17,292) |
| INCOME (LOSS) BEFORE INCOME TAXES..... | (1,994) | 2,414 | 8,053 | -- | 8,473 |
| INCOME TAX EXPENSE (BENEFIT)..... | 326 | -- | -- | -- | 326 |
| NET INCOME (LOSS) BEFORE EXTRAORDINARY ITEM..... | (2,320) | 2,414 | 8,053 | -- | 8,147 |
| EXTRAORDINARY ITEM: | | | | | |
| Loss on early extinguishment of debt, net of applicable income tax..... | -- | -- | -- | -- | -- |
| NET INCOME (LOSS)..... | \$ (2,320) | \$ 2,414 | \$ 8,053 | \$ -- | \$ 8,147 |
| FOR THE THREE MONTHS ENDED JUNE 30, 1998 | | | | | |
| REVENUES: | | | | | |
| Oil and gas sales..... | \$ 74,592 | \$ -- | \$ -- | \$ 1,047 | \$ 75,639 |
| Oil and gas marketing sales..... | 11,350 | 49,561 | -- | (27,240) | 33,671 |
| Total Revenues..... | 85,942 | 49,561 | -- | (26,193) | 109,310 |
| OPERATING COSTS: | | | | | |
| Production expenses and taxes..... | 17,294 | -- | -- | -- | 17,294 |
| Oil and gas marketing expenses..... | 11,081 | 48,817 | -- | (26,193) | 33,705 |
| Impairment of oil and gas properties.... | 216,000 | -- | -- | -- | 216,000 |
| Impairment of other assets..... | 10,000 | -- | -- | -- | 10,000 |
| Oil and gas depreciation, depletion and amortization..... | 43,900 | -- | -- | -- | 43,900 |
| Other depreciation and amortization.... | 1,198 | 34 | 690 | -- | 1,922 |
| General and administrative..... | 4,800 | 359 | (25) | -- | 5,134 |
| Total Operating Costs..... | 304,273 | 49,210 | 665 | (26,193) | 327,955 |
| INCOME (LOSS) FROM OPERATIONS..... | (218,331) | 351 | (665) | -- | (218,645) |
| OTHER INCOME (LOSS) | | | | | |
| Interest and other income..... | 542 | 129 | 23,948 | (22,048) | 2,571 |
| Interest expense..... | (21,876) | -- | (18,837) | 22,048 | (18,665) |
| | (21,334) | 129 | 5,111 | -- | (16,094) |
| INCOME (LOSS) BEFORE INCOME TAXES..... | (239,665) | 480 | 4,446 | -- | (234,739) |
| INCOME TAX EXPENSE (BENEFIT)..... | -- | -- | -- | -- | -- |
| NET INCOME (LOSS) BEFORE EXTRAORDINARY ITEM..... | (239,665) | 480 | 4,446 | -- | (234,739) |
| EXTRAORDINARY ITEM: | | | | | |
| Loss on early extinguishment of debt, net of applicable income tax..... | (2,164) | -- | (11,170) | -- | (13,334) |
| NET INCOME (LOSS)..... | \$ (241,829) | \$ 480 | \$ (6,724) | \$ -- | \$ (248,073) |

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS
(\$ IN THOUSANDS)

| | GUARANTOR SUBSIDIARIES | NON-GUARANTOR SUBSIDIARY | COMPANY (PARENT) | ELIMINATIONS | CONSOLIDATED |
|---|---------------------------|-----------------------------|---------------------|--------------|--------------|
| | ----- | ----- | ----- | ----- | ----- |
| FOR THE SIX MONTHS ENDED JUNE 30, 1999 | | | | | |
| REVENUES: | | | | | |
| Oil and gas sales | \$ 120,078 | \$ -- | \$ -- | \$ -- | \$ 120,078 |
| Oil and gas marketing sales | -- | 73,258 | -- | (46,767) | 26,491 |
| | ----- | ----- | ----- | ----- | ----- |
| Total Revenues | 120,078 | 73,258 | -- | (46,767) | 146,569 |
| | ----- | ----- | ----- | ----- | ----- |
| OPERATING COSTS: | | | | | |
| Production expenses and taxes | 29,963 | -- | -- | -- | 29,963 |
| Oil and gas marketing expenses | -- | 71,725 | -- | (46,767) | 24,958 |
| Oil and gas depreciation, depletion and amortization | 47,386 | -- | -- | -- | 47,386 |
| Other depreciation and amortization.. | 2,476 | 40 | 1,622 | -- | 4,138 |
| General and administrative | 6,464 | 781 | 47 | -- | 7,292 |
| | ----- | ----- | ----- | ----- | ----- |
| Total Operating Costs | 86,289 | 72,546 | 1,669 | (46,767) | 113,737 |
| | ----- | ----- | ----- | ----- | ----- |
| INCOME (LOSS) FROM OPERATIONS | 33,789 | 712 | (1,669) | -- | 32,832 |
| | ----- | ----- | ----- | ----- | ----- |
| OTHER INCOME (LOSS) | | | | | |
| Interest and other income | 707 | 2,845 | 58,328 | (58,040) | 3,840 |
| Interest expense | (57,415) | -- | (40,774) | 58,040 | (40,149) |
| | ----- | ----- | ----- | ----- | ----- |
| | (56,708) | 2,845 | 17,554 | -- | (36,309) |
| | ----- | ----- | ----- | ----- | ----- |
| INCOME (LOSS) BEFORE INCOME TAXES | (22,919) | 3,557 | 15,885 | -- | (3,477) |
| INCOME TAX EXPENSE (BENEFIT) | 326 | -- | -- | -- | 326 |
| | ----- | ----- | ----- | ----- | ----- |
| NET INCOME (LOSS) BEFORE EXTRAORDINARY ITEM | (23,245) | 3,557 | 15,885 | -- | (3,803) |
| EXTRAORDINARY ITEM: | | | | | |
| Loss on early extinguishment of debt, net of applicable income tax | -- | -- | -- | -- | -- |
| | ----- | ----- | ----- | ----- | ----- |
| NET INCOME (LOSS) | \$ (23,245) | \$ 3,557 | \$ 15,885 | \$ -- | \$ (3,803) |
| | ===== | ===== | ===== | ===== | ===== |
| FOR THE SIX MONTHS ENDED JUNE 30, 1998 | | | | | |
| REVENUES: | | | | | |
| Oil and gas sales | \$ 124,207 | \$ -- | \$ -- | \$ 1,673 | \$ 125,880 |
| Oil and gas marketing sales | 21,071 | 87,565 | -- | (48,441) | 60,195 |
| | ----- | ----- | ----- | ----- | ----- |
| Total Revenues | 145,278 | 87,565 | -- | (46,768) | 186,075 |
| | ----- | ----- | ----- | ----- | ----- |
| OPERATING COSTS: | | | | | |
| Production expenses and taxes | 26,732 | -- | -- | -- | 26,732 |
| Oil and gas marketing expenses | 20,617 | 86,117 | -- | (46,768) | 59,966 |
| Impairment of oil and gas properties | 466,000 | -- | -- | -- | 466,000 |
| Impairment of other assets | 10,000 | -- | -- | -- | 10,000 |
| Oil and gas depreciation, depletion and amortization | 75,242 | -- | -- | -- | 75,242 |
| Other depreciation and amortization.. | 2,061 | 54 | 1,187 | -- | 3,302 |
| General and administrative | 8,874 | 633 | 7 | -- | 9,514 |
| | ----- | ----- | ----- | ----- | ----- |
| Total Operating Costs | 609,526 | 86,804 | 1,194 | (46,768) | 650,756 |
| | ----- | ----- | ----- | ----- | ----- |
| INCOME (LOSS) FROM OPERATIONS | (464,248) | 761 | (1,194) | -- | (464,681) |
| | ----- | ----- | ----- | ----- | ----- |
| OTHER INCOME (LOSS) | | | | | |
| Interest and other income | 566 | 219 | 43,983 | (41,973) | 2,795 |
| Interest expense | (41,099) | -- | (30,227) | 41,973 | (29,353) |
| | ----- | ----- | ----- | ----- | ----- |
| | (40,533) | 219 | 13,756 | -- | (26,558) |
| | ----- | ----- | ----- | ----- | ----- |
| INCOME (LOSS) BEFORE INCOME TAXES | (504,781) | 980 | 12,562 | -- | (491,239) |
| INCOME TAX EXPENSE (BENEFIT) | -- | -- | -- | -- | -- |
| | ----- | ----- | ----- | ----- | ----- |
| NET INCOME (LOSS) BEFORE EXTRAORDINARY ITEM | (504,781) | 980 | 12,562 | -- | (491,239) |
| EXTRAORDINARY ITEM: | | | | | |
| Loss on early extinguishment of debt, net of applicable income tax | (2,164) | -- | (11,170) | -- | (13,334) |
| | ----- | ----- | ----- | ----- | ----- |
| NET INCOME (LOSS) | \$ (506,945) | \$ 980 | \$ 1,392 | \$ -- | \$ (504,573) |
| | ===== | ===== | ===== | ===== | ===== |

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS
(\$ IN THOUSANDS)

| | GUARANTOR SUBSIDIARIES | NON-GUARANTOR SUBSIDIARY | COMPANY (PARENT) | ELIMINATIONS | CONSOLIDATED |
|---|---------------------------|-----------------------------|---------------------|--------------|--------------|
| | ----- | ----- | ----- | ----- | ----- |
| FOR THE SIX MONTHS ENDED JUNE 30, 1999 | | | | | |
| CASH FLOWS FROM OPERATING ACTIVITIES:..... | \$ 22,128 | \$ 8,119 | \$ 17,319 | \$ -- | \$ 47,566 |
| | ----- | ----- | ----- | ----- | ----- |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | | | |
| Oil and gas properties | (85,787) | -- | -- | -- | (85,787) |
| Proceeds from sale of oil and gas properties | 17,387 | -- | -- | -- | 17,387 |
| Proceeds from sale of other assets | 1,306 | -- | -- | -- | 1,306 |
| Other additions | 427 | 308 | (986) | -- | (251) |
| | ----- | ----- | ----- | ----- | ----- |
| | (66,667) | 308 | (986) | -- | (67,345) |
| | ----- | ----- | ----- | ----- | ----- |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | | | |
| Proceeds from borrowings | 14,000 | -- | -- | -- | 14,000 |
| Cash paid for purchase of treasury stock | -- | (53) | -- | -- | (53) |
| Cash received from exercise of stock options | -- | -- | 240 | -- | 240 |
| Intercompany advances, net | 33,665 | 2,217 | (35,882) | -- | -- |
| | ----- | ----- | ----- | ----- | ----- |
| | 47,665 | 2,164 | (35,642) | -- | 14,187 |
| | ----- | ----- | ----- | ----- | ----- |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH | 3,625 | -- | -- | -- | 3,625 |
| | ----- | ----- | ----- | ----- | ----- |
| Net increase (decrease) in cash | 6,751 | 10,591 | (19,309) | -- | (1,967) |
| Cash, beginning of period | (17,319) | 7,000 | 39,839 | -- | 29,520 |
| | ----- | ----- | ----- | ----- | ----- |
| Cash, end of period | \$ (10,568) | \$ 17,591 | \$ 20,530 | \$ -- | \$ 27,553 |
| | ===== | ===== | ===== | ===== | ===== |
| FOR THE SIX MONTHS ENDED JUNE 30, 1998 | | | | | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | \$ (609) | \$ (476) | \$ 20,805 | \$ -- | \$ 19,720 |
| | ----- | ----- | ----- | ----- | ----- |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | | | |
| Oil and gas properties | (472,879) | -- | -- | -- | (472,879) |
| Proceeds from sale of assets | 804 | -- | 3,600 | -- | 4,404 |
| Repayment of long-term loans | 2,000 | -- | -- | -- | 2,000 |
| Other additions | (3,448) | (258) | (1,477) | -- | (5,183) |
| | ----- | ----- | ----- | ----- | ----- |
| | (473,523) | (258) | 2,123 | -- | (471,658) |
| | ----- | ----- | ----- | ----- | ----- |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | | | |
| Proceeds from borrowings | -- | -- | 658,750 | -- | 658,750 |
| Payments on borrowings | -- | -- | (474,166) | -- | (474,166) |
| Cash received from issuance of preferred stock | -- | -- | 222,781 | -- | 222,781 |
| Cash paid for purchase of treasury stock | -- | -- | (17,831) | -- | (17,831) |
| Cash received from exercise of stock options | -- | -- | 101 | -- | 101 |
| Intercompany advances, net | 465,229 | (2,545) | (462,684) | -- | -- |
| | ----- | ----- | ----- | ----- | ----- |
| | 465,229 | (2,545) | (73,049) | -- | 389,635 |
| | ----- | ----- | ----- | ----- | ----- |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH | (1,867) | -- | -- | -- | (1,867) |
| | ----- | ----- | ----- | ----- | ----- |
| Net increase (decrease) in cash | (10,770) | (3,279) | (50,121) | -- | (64,170) |
| Cash, beginning of period | (284) | 13,694 | 110,450 | -- | 123,860 |
| | ----- | ----- | ----- | ----- | ----- |
| Cash, end of period | \$ (11,054) | \$ 10,415 | \$ 60,329 | \$ -- | \$ 59,690 |
| | ===== | ===== | ===== | ===== | ===== |

PART I. FINANCIAL INFORMATION

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

Three Months Ended June 30, 1999 vs. June 30, 1998

General. For the three months ended June 30, 1999 (the "Current Quarter"), the Company had net income of \$8.1 million, or \$0.04 per common share after deducting preferred dividends of \$4.0 million. This compares to a net loss of \$248.1 million, or a loss of \$2.41 per common share after deducting preferred dividends of \$4.0 million, in the three months ended June 30, 1998 (the "Prior Quarter"). The loss in the Prior Quarter resulted from a \$216.0 million asset writedown recorded under the full-cost method of accounting, a \$10.0 million impairment related to certain of the Company's gas processing and transportation assets located in Louisiana, a \$13.3 million extraordinary loss on the early extinguishment of debt, and an \$8.7 million loss from recurring operations. The asset writedown was caused by acquisitions completed by the Company in April 1998 for consideration in excess of the present value (10% discount) of the future net revenues of the proved reserves acquired as of June 30, 1998, as well as the evaluation of certain leasehold, seismic and other exploration-related costs that were previously unevaluated, and by decreases in oil prices from March 31, 1998 to June 30, 1998. See " - Impairment of Oil and Gas Properties".

Oil and Gas Sales. During the Current Quarter, oil and gas sales decreased to \$68.3 million from \$75.6 million, a decrease of \$7.3 million, or 10%. This decrease resulted from lower oil and gas production volumes, which decreased from 37.2 billion cubic feet equivalent of natural gas ("bcfe") in the Prior Quarter to 33.6 bcfe in the Current Quarter, a decrease of 3.6 bcfe, or 10%. The decrease in production volumes were primarily the result of the asset divestitures completed during the last quarter of 1998 and first half of 1999. For the Current Quarter, the Company produced 1.1 million barrels of oil ("mbo") and 27.0 billion cubic feet of natural gas ("bcf"), compared to 1.8 mbo and 26.3 bcf in the Prior Quarter. Average oil prices realized were \$16.01 per barrel of oil in the Current Quarter compared to \$12.85 per barrel in the Prior Quarter, an increase of 25%. Average gas prices realized were \$1.88 per thousand cubic feet ("mcf") in the Current Quarter compared to \$1.99 per mcf in the Prior Quarter, a decrease of 6%.

For the Current Quarter, the Company realized an average price of \$2.03 per thousand cubic feet equivalent of natural gas ("mcf"), compared to \$2.03 per mcf in the Prior Quarter. The Company's hedging activities resulted in increased oil and gas revenues of \$2.9 million, or \$0.09 per mcf, in the Current Quarter, compared to increases in oil and gas revenues of \$2.2 million in the Prior Quarter.

The following table shows the Company's production by region for the Current Quarter and the Prior Quarter:

| OPERATING AREAS | FOR THE THREE MONTHS ENDED JUNE 30, | | | |
|--------------------|-------------------------------------|---------|--------|---------|
| | 1999 | | 1998 | |
| | MMCFE | PERCENT | MMCFE | PERCENT |
| Mid-Continent..... | 18,960 | 57% | 19,514 | 53% |
| Gulf Coast..... | 10,811 | 32 | 14,265 | 38 |
| Canada..... | 3,134 | 9 | 2,414 | 6 |
| Other areas..... | 661 | 2 | 1,038 | 3 |
| Total..... | 33,566 | 100% | 37,231 | 100% |

Natural gas production represented approximately 80% of the Company's total production volume on a gas equivalent basis in the Current Quarter, compared to 71% in the Prior Quarter. The Company anticipates natural gas will represent approximately 80% of anticipated 1999 production. As of June 30, 1999 natural gas represented approximately 87% of the Company's proved reserves.

Oil and Gas Marketing Sales. The Company realized \$12.6 million in oil and gas marketing sales to third parties in the Current Quarter, with corresponding oil and gas marketing expenses of \$11.7 million. This compares to sales of

\$33.7 million and expenses of \$33.7 million in the Prior Quarter. The decrease in marketing sales and cost of sales was due primarily to lower third party sales in the Current Quarter as compared to the Prior Quarter. The increase in gross margin between periods was due primarily to the improved operating results from certain gas gathering, transportation and marketing assets.

Production Expenses and Taxes. Production expenses decreased to \$11.2 million in the Current Quarter, a \$3.5 million decrease from \$14.7 million incurred in the Prior Quarter. The decrease was due primarily to the Company's divestiture of higher cost oil and gas properties and the closing of various field offices. On a production unit basis, production expenses were \$0.33 and \$0.39 per mcfe in the Current and Prior Quarters, respectively. The Company anticipates production expenses will average \$0.35 to \$0.40 per mcfe for 1999.

Production taxes, which consist primarily of wellhead severance taxes, were \$2.8 million and \$2.6 million in the Current and Prior Quarters, respectively. On a per unit basis, production taxes were \$0.08 per mcfe in the Current Quarter compared to \$0.07 per mcfe in the Prior Quarter.

Impairment of Oil and Gas Properties. The Company utilizes the full-cost method to account for its investment in oil and gas properties. Under this method, all costs of acquisition, exploration and development of oil and gas reserves (including such costs as leasehold acquisition costs, geological and geophysical expenditures, certain capitalized internal costs, dry hole costs and tangible and intangible development costs) are capitalized as incurred. These oil and gas property costs, including the estimated future capital expenditures to develop proved undeveloped reserves, are depleted and charged to operations using the unit-of-production method based on the ratio of current production to proved oil and gas reserves as estimated by the Company's independent engineering consultants and in-house engineers. Costs directly associated with the acquisition and evaluation of unproved properties are excluded from the amortization computation until it is determined whether or not proved reserves can be assigned to the property or whether impairment has occurred. The excess of capitalized costs of oil and gas properties, net of accumulated depreciation, depletion and amortization and related deferred income taxes, over the discounted future net revenues (at 10%) of proved oil and gas properties is charged to operations.

The Company incurred an impairment of oil and gas properties charge of \$216 million in the Prior Quarter, compared to no impairment charge in the Current Quarter. The writedown in the Prior Quarter was caused by a combination of several factors, including the acquisitions completed by the Company in April 1998. The most significant factor was the completion of the acquisition of DLB Oil & Gas, Inc. ("DLB"), which was accounted for using the purchase method. The purchase price, which was established in February 1998 when the terms of the acquisition were amended (based upon a Chesapeake common stock price of \$6 per share), was allocated primarily to DLB's evaluated oil and gas properties. Based upon reserve estimates as of June 30, 1998, the portion of the purchase price which was allocated to evaluated oil and gas properties exceeded the associated discounted future net revenues from DLB's estimated proved reserves by approximately \$70 million. In total, approximately \$116 million of the writedown was related to acquisitions completed during the Prior Quarter. The evaluation of certain leasehold, seismic and other exploration-related costs that were previously unevaluated, together with decreases in oil prices at June 30, 1998, were the remaining contributing factors which led to the writedown in the Prior Quarter.

Impairment of Other Assets. In the Prior Quarter, the Company incurred an impairment charge of \$10 million related to certain of the Company's gas processing and transportation assets located in Louisiana. No such charge was recorded in the Current Quarter.

Oil and Gas Depreciation, Depletion and Amortization. Depreciation, depletion and amortization of oil and gas properties ("DD&A") for the Current Quarter was \$24.2 million, compared to \$43.9 million in the Prior Quarter. This decrease was caused by a decrease in the DD&A rate per mcfe from \$1.18 to \$0.72 in the Prior and Current Quarters, respectively. The decrease in the DD&A rate per mcfe is due primarily to the impairment of oil and gas properties recorded during 1998.

Depreciation and Amortization of Other Assets. Depreciation and amortization of other assets ("D&A") increased to \$2.0 million in the Current Quarter compared to \$1.9 million in the Prior Quarter. The Company anticipates D&A expense throughout the remainder of 1999 to remain at approximately the same level.

General and Administrative. General and administrative expenses ("G&A"), which are net of capitalized internal payroll and non-payroll expenses, were \$3.3 million in the Current Quarter compared to \$5.1 million in the Prior Quarter. This decrease was primarily caused by various measures designed to lower corporate overhead, including staff reductions and office closings which occurred subsequent to June 30, 1998. The Company capitalized \$0.8 million of internal costs in the Current Quarter directly related to the Company's oil and gas exploration and development efforts, compared to \$1.1 million in the Prior Quarter. The Company anticipates that G&A costs for the remainder of 1999 will remain at generally the same level as in the Current Quarter.

Interest and Other Income. Interest and other income for the Current Quarter was \$3.0 million compared to \$2.6 million in the Prior Quarter.

Interest. Interest expense increased to \$20.3 million in the Current Quarter from \$18.7 million in the Prior Quarter. This increase was a result of lower capitalized interest in the Current Quarter, higher levels of indebtedness and a full quarter of interest on the 9.625% Senior Notes which were issued on April 22, 1998. The Company capitalized \$1.0 million of interest during the Current Quarter compared to \$1.6 million capitalized in the Prior Quarter. The Company anticipates that interest expense will remain at generally the same level as in the Current Quarter.

Provision for Income Taxes. The Company recorded \$0.3 million of income tax expense for the Current Quarter, compared to none in the Prior Quarter. The income tax expense in the Current Quarter is entirely related to the Company's operations in Canada. At June 30, 1999, the Company had a net operating loss carryforward of approximately \$650 million for regular U.S. federal income taxes which will expire in future years beginning in 2007. Management believes that it cannot be demonstrated at this time that it is more likely than not that its domestic deferred income tax assets, comprised primarily of the net operating loss carryforward generated in the United States, will be realizable in future years, and therefore a valuation allowance of \$455 million has been recorded.

Six Months Ended June 30, 1999 vs. June 30, 1998

General. For the six months ended June 30, 1999 (the "Current Period"), the Company realized a net loss of \$3.8 million, or a net loss of \$0.12 per common share after deducting preferred dividends of \$8.1 million. This compares to a net loss of \$504.6 million, or a net loss of \$5.50 per common share after deducting preferred dividends of \$4.0 million, in the six months ended June 30, 1998 (the "Prior Period"). The loss in the Prior Period was primarily caused by a \$466.0 million asset writedown recorded under the full-cost method of accounting, a \$10.0 million impairment related to certain of the Company's gas processing and transportation assets located in Louisiana, a \$13.3 million extraordinary loss on the early extinguishment of debt, and a \$15.2 million loss from recurring operations. The asset writedown was partially caused by the acquisitions completed during the Prior Period for consideration in excess of the present value (10% discount) of the future net revenues of the proved reserves acquired as of June 30, 1998. See "- Impairment of Oil and Gas Properties".

Oil and Gas Sales. During the Current Period, oil and gas sales decreased to \$120.1 million from \$125.9 million, a decrease of \$5.8 million, or 5%. This decrease resulted from lower oil and gas prices between periods, partially offset by higher oil and gas production volumes, which increased from 60.2 bcfe in the Prior Period to 66.9 bcfe in the Current Period, an increase of 6.7 bcfe, or 11%. For the Current Period, the Company produced 2.4 mmbo and 52.7 bcf, compared to 3.0 mmbo and 42.2 bcf in the Prior Period. Average oil prices realized were \$13.27 per barrel in the Current Period compared to \$13.63 per barrel in the Prior Period, a decrease of 3%. Average gas prices realized were \$1.68 per mcf in the Current Period compared to \$2.01 per mcf in the Prior Period, a decrease of 16%.

For the Current Period, the Company realized an average price of \$1.80 per mcfe, compared to \$2.09 per mcfe in the Prior Period. The Company's hedging activities resulted in increased oil and gas revenues of \$3.9 million, or \$0.06 per mcfe, in the Current Period, compared to increases in oil and gas revenues of \$4.0 million in the Prior Period.

The following table shows the Company's production by region for the Current Period and the Prior Period:

| OPERATING AREAS | FOR THE SIX MONTHS ENDED JUNE 30, | | | |
|--------------------|-----------------------------------|---------|--------|---------|
| | 1999 | | 1998 | |
| | MMCFE | PERCENT | MMCFE | PERCENT |
| Mid-Continent..... | 35,969 | 54% | 27,896 | 47% |
| Gulf Coast..... | 21,525 | 32 | 27,135 | 45 |
| Canada..... | 5,564 | 8 | 3,144 | 5 |
| Other areas..... | 3,820 | 6 | 2,019 | 3 |
| Total..... | 66,878 | 100% | 60,194 | 100% |

Natural gas production represented approximately 79% of the Company's total production volume on an equivalent basis in the Current Period, compared to 70% in the Prior Period.

Oil and Gas Marketing Sales. The Company realized \$26.5 million in oil and gas marketing sales to third parties in the Current Period, with corresponding oil and gas marketing expenses of \$25.0 million. This compares to sales of \$60.2 million and expenses of \$60.0 million in the Prior Period.

Production Expenses and Taxes. Production expenses increased to \$25.2 million in the Current Period, a \$2.6 million increase from \$22.6 million incurred in the Prior Period. On a production unit basis, production expenses were \$0.38 and \$0.37 per mcf in the Current and Prior Periods, respectively.

Production taxes, which consist primarily of wellhead severance taxes, were \$4.8 million and \$4.2 million in the Current and Prior Periods, respectively. This increase was primarily the result of increased natural gas production. On a per unit basis, production taxes were \$0.07 per mcf in the Current Period compared to \$0.07 per mcf in the Prior Period.

Impairment of Oil and Gas Properties. The Company utilizes the full-cost method to account for its investment in oil and gas properties. Under this method, all costs of acquisition, exploration and development of oil and gas reserves (including such costs as leasehold acquisition costs, geological and geophysical expenditures, certain capitalized internal costs, dry hole costs and tangible and intangible development costs) are capitalized as incurred. These oil and gas property costs, including the estimated future capital expenditures to develop proved undeveloped reserves, are depleted and charged to operations using the unit-of-production method based on the ratio of current production to proved oil and gas reserves as estimated by the Company's independent engineering consultants and in-house engineers. Costs directly associated with the acquisition and evaluation of unproved properties are excluded from the amortization computation until it is determined whether or not proved reserves can be assigned to the property or whether impairment has occurred. The excess of capitalized costs of oil and gas properties, net of accumulated depreciation, depletion and amortization and related deferred income taxes, over the discounted future net revenues of proved oil and gas properties is charged to operations.

The Company incurred an impairment of oil and gas properties charge of \$466.0 million in the Prior Period, compared to no impairment charge in the Current Period. The writedown in the Prior Period was caused by a combination of several factors, including the acquisitions completed by the Company during the Prior Period, which were accounted for using the purchase method. The most significant factors were the acquisitions of Hugoton Energy Corporation ("Hugoton") and DLB. Higher drilling and completion costs, the evaluation of certain leasehold, seismic and other exploration-related costs that were previously unevaluated, together with decreases in oil and gas prices from December 31, 1997 to June 30, 1998 were the remaining contributing factors which led to the writedown in the Prior Period.

Impairment of Other Assets. In the Prior Period, the Company incurred an impairment charge of \$10.0 million related to certain of the Company's gas processing and transportation assets located in Louisiana. No such charge was recorded in the Current Period.

Oil and Gas Depreciation, Depletion and Amortization. DD&A for the Current Period was \$47.4 million, compared to \$75.2 million in the Prior Period. This decrease was caused by a decrease in the DD&A rate per mcf from \$1.25

to \$0.71 in the Prior and Current Periods, respectively. The decrease in the DD&A rate per mcfe is due primarily to the impairment of oil and gas properties recorded during 1998.

Depreciation and Amortization of Other Assets. D&A increased to \$4.1 million in the Current Period compared to \$3.3 million in the Prior Period. This increase in D&A was caused by a full six months of amortization of debt issuance costs related to the issuance of Senior Notes in April 1998.

General and Administrative. G&A, which is net of capitalized internal payroll and non-payroll expenses, was \$7.3 million in the Current Period compared to \$9.5 million in the Prior Period. This decrease was primarily caused by various measures designed to lower corporate overhead, including staff reductions and office closings which occurred subsequent to June 30, 1998. The Company capitalized \$2.0 million of internal costs in the Current Period directly related to the Company's oil and gas exploration and development efforts, compared to \$3.2 million in the Prior Period.

Interest and Other Income. Interest and other income for the Current Period was \$3.8 million compared to \$2.8 million in the Prior Period. This increase is due primarily to a \$1.5 million gain on the sale of certain marketing assets located in the Mid-Continent in the Current Period.

Interest. Interest expense increased to \$40.1 million in the Current Period from \$29.4 million in the Prior Period. This increase was a result of the issuance of the 9.625% Senior Notes in April 1998 as well as lower capitalized interest in the Current Period. The Company capitalized \$2.2 million of interest during the Current Period compared to \$3.8 million capitalized in the Prior Period.

Provision for Income Taxes. The Company recorded income tax expense of \$0.3 million for the Current Period, compared to none in the Prior Period. The income tax expense in the Current Period is entirely related to the Company's operations in Canada. Management believes that it cannot be demonstrated that it is more likely than not that its domestic deferred income tax assets will be realizable in future years, and therefore a valuation allowance of \$455.0 million has been recorded. Consequently, there was no income tax expense or benefit related to the Company's domestic operations during the Current and Prior Periods.

RISK MANAGEMENT ACTIVITIES

See Item 3 - "Quantitative and Qualitative Disclosures About Market Risks".

LIQUIDITY AND CAPITAL RESOURCES

As of June 30, 1999, the Company had working capital of approximately \$16 million. The Company has a \$50 million revolving bank credit facility with a committed borrowing base of \$50 million. Subsequent to June 30, 1999, the Company entered into an amendment to the facility to extend the maturity date from August 1999 to February 2001. The amendment also increased the interest rate and certain fees, and provided for other modifications. As of June 30, 1999, the Company had borrowed \$39 million under this facility, which was included in long-term debt. Borrowings under the facility are secured by certain producing oil and gas properties. The interest rate at June 30, 1999 was 7.75% per annum.

Two of the Company's Senior Note indentures contain financial covenants which restrict the ability of the Company and its restricted subsidiaries to incur additional indebtedness and to make restricted payments, such as paying cash dividends and repurchasing Company stock. These restrictions do not affect the Company's ability to borrow under or expand its secured commercial bank facility. The Company estimates that it could have incurred up to \$111 million of secured commercial bank indebtedness as of June 30, 1999 under the most restrictive of its indenture debt incurrence tests.

As of December 31, 1998, March 31, 1999, and June 30, 1999 the Company was unable to meet the restricted payment test under these indentures, including the requirement that the Company be able to incur additional unsecured indebtedness. As a result, the Company was not able to pay cash dividends on its 7% cumulative convertible preferred stock on February 1, 1999, May 1, 1999, or August 1, 1999. As of June 30, 1999, the

cumulative earned but unpaid dividends on the preferred stock was \$11.2 million. Subsequent dividend payments will be subject to the same restrictions and are dependent upon variables that are beyond the Company's ability to predict. If the Company fails to pay dividends for six quarterly periods, the holders of preferred stock would be entitled to elect two additional members to the board.

None of the senior note indenture covenants apply to Chesapeake Energy Marketing, Inc. ("CEMI"), an unrestricted subsidiary of the Company. The Company's Board of Directors has authorized CEMI to purchase up to \$10 million of the Company's senior notes and preferred stock in open market transactions or otherwise. In April 1999, CEMI purchased 3,600 shares of preferred stock for an aggregate purchase price of \$53,000, or \$14.63 per share, in an open market transaction. On April 22, 1999, CEMI commenced an offer to purchase up to 666,667 shares of preferred stock at \$15.00 per share (\$10 million in the aggregate, plus fees and expenses). The offer expired May 20, 1999 and no shares of preferred stock were acquired pursuant to the offer to purchase.

Debt ratings for the senior notes are B3 by Moody's Investors Service and B by Standard & Poor's Corporation as of August 12, 1999, and both rating agencies have had the Company on review with negative implications since December 1998. There are no scheduled principal payments required on any of the Company's senior notes until March 2004, when \$150.0 million is due.

The Company believes it has adequate resources, including cash on hand, budgeted cash flow from operations and proceeds from miscellaneous asset sales, to fund its exploration and development capital expenditure budget for 1999, which is currently estimated to be approximately \$120 million. The Company anticipates proceeds from miscellaneous asset sales will be approximately \$50 million during 1999. However, lower oil and gas prices or unfavorable drilling results could cause the Company to alter its drilling program, or the amount of anticipated property acquisitions and/or asset sales.

The Company's cash provided by operating activities before changes in current assets and liabilities decreased 25% to \$48.1 million during the Current Period compared to \$63.8 million during the Prior Period. The decrease was due primarily to reduced operating income as a result of a decrease in gas prices between periods.

Cash used in investing activities decreased to \$67.4 million during the Current Period from \$471.7 million in the Prior Period. The Company completed several acquisitions requiring cash in the Prior Period which totaled \$345.0 million, compared to \$6.4 million in the Current Period, and significantly decreased its drilling activity and leasehold acquisitions in the Current Period compared to the Prior Period. During the Current Period, the Company expended approximately \$68.3 million to initiate drilling on 80 gross (48.9 net) wells and invested approximately \$11.1 million in leasehold acquisitions. This compares to \$112.0 million to initiate drilling on 91 gross (82.0 net) wells and \$8.4 million to purchase leasehold in the Prior Period.

Cash provided by financing activities was \$14.2 million in the Current Period, compared to \$389.6 million in the Prior Period. During the Current Period, the Company expanded its borrowings under its commercial bank facility by \$14.0 million. During the Prior Period, the Company retired \$465.0 million in debt consisting of \$85.0 million in debt assumed at the completion of the DLB acquisition, \$120.0 million in debt assumed at the completion of the Hugoton acquisition, \$90.0 million in senior notes, and \$170.0 million in borrowings made under its commercial bank credit facilities. Also during the Prior Period, the Company issued \$500.0 million in senior notes and \$230.0 million in preferred stock.

YEAR 2000

Project. The Company has placed a high priority on proactively resolving computer or embedded chip problems related to the "Year 2000" problem which may have adverse material effects on its continuing operations or cash flow. These problems would be caused by the inability of a component (software, hardware or equipment with embedded microprocessors) to correctly process date data in and between the 20th and 21st centuries and therefore fail to properly perform its intended functions, and/or to exchange correct date data with other components. This problem would most typically be caused by erroneous date calculations, which results from using two digits to signify a year (century implied), handling leap years incorrectly or the use of "special" values that can be confused with legitimate calendar dates. The scope of the Year 2000 project includes conducting an inventory of the

Company's software, hardware and "embedded systems" equipment, assessing potential for failure and the associated risk, prioritizing the need for remedial actions, identifying an appropriate action, then implementing and testing. In addition, the Company will take a similar approach to mitigating risks associated with the Year 2000 readiness of material business partners (vendors, suppliers, customers, etc.). The project will also identify contingency plans to cope with unexpected events resulting from Year 2000 issues.

Beginning in mid-1997, the Company began an assessment of its core financial and operational software systems. Three critical systems were identified with date sensitivities: oil and gas financial accounting, production accounting, and land/lease administration. A Year 2000 compliant release of the oil and gas financial accounting package used by the Company is available and has been scheduled for implementation during the third quarter of 1999. The Year 2000 ready version of the production accounting system was successfully implemented during June 1999. The timing of remaining upgrades has been scheduled to be concurrent with the respective vendors' support requirements and to take advantage of additional features or performance enhancements. A project has been underway since early 1997 to implement a completely revamped version of the land/lease administration package in use at the Company to provide significantly increased functionality and reliability. The terms of this development arrangement stipulated Year 2000 compliance. Preliminary versions of the system have been installed and are being tested. As part of the testing, Year 2000 compliance will be assured. Final conversion of all users to the new release is scheduled to be complete in late October 1999.

All hardware has been verified Year 2000 ready with the exception of a few items that support various legacy functions. These functions are scheduled to be retired before year-end and the associated hardware will also be retired.

Other activities either already underway or scheduled, include assessment of material business partners, and inventory of embedded systems in field locations. The following table summarizes the current overall status of the project with anticipated completion dates:

| COMPONENT | PHASE | | |
|-----------------------------------|-------------|-------------------------------|-----------------------------|
| | INVENTORY | ASSESSMENT/ PRIORITIZATION | REMEDIATION/ CONTINGENCY |
| Software | Completed | Completed | November 1999 |
| Hardware | Completed | Completed | Completed |
| Business partners | Completed | August 1999 | August 1999 |
| Embedded systems (non-IT systems) | August 1999 | August 1999 | September 1999 |

The following schedule changes were made in the Current Quarter:

- o Changes in the Software Remediation schedule were due to delays in the delivery of vendor products. Contingency plans to guard against further delays have been put in place.
- o Business Partner assessment was deferred pending availability of critical personnel. Personnel have now been assigned and priority adjusted to recover the original schedule.

In addition to the above, during the third quarter of 1999 the Company will develop an overall contingency plan to assure continued operations which will include precautionary measures. Specific elements of this plan have been identified and developed.

Cost. To date, the Company has incurred minimal consulting costs for Year 2000 project planning and scope definition. Expenses to date have totaled \$65,000, composed of \$39,000 software and \$26,000 consulting. For currently identified software systems requiring a Year 2000 upgrade, the vendor is providing that upgrade under the terms of existing maintenance agreements, and thus no additional license or upgrade fees are required. In all cases these upgrades had been previously scheduled to maintain desired vendor support. No upgrade project schedule has been accelerated to achieve Year 2000 compliance, nor has any project been deferred because of Year 2000 concerns or efforts. An accurate cost cannot be determined prior to conclusion of the Assessment/Prioritization phase, but it is expected total project expenditures, including the use of outside consultants, should not exceed \$1 million. This does not include any costs which may be assessed by joint venture partners on properties not operated by the Company.

Risks/Contingency. The failure to remediate critical systems (software, hardware or embedded systems), or the failure of a material business partner to resolve critical Year 2000 issues could have serious adverse impact on the ability of the Company to continue operations and meet obligations. At the current time, it is believed that any interruption in operation will be minor and short-lived and will pose no safety or environmental risks. However, until all assessment phases have been completed it is impossible to accurately identify the risks, quantify potential impacts or establish a contingency plan. The Company has not yet clearly identified the most reasonably likely worst case scenario if the Company and material business partners do not achieve Year 2000 compliance on a timely basis. The Company currently intends to complete its contingency planning by November 30, 1999 with testing and training to take place early in the fourth quarter.

RECENTLY ISSUED ACCOUNTING STANDARDS

On June 15, 1998, the Financial Accounting Standards Board issued FAS No. 133, Accounting for Derivative Instruments and Hedging Activities ("FAS 133"). FAS 133 establishes a new model for accounting for derivatives and hedging activities and supersedes and amends a number of existing standards. FAS 133 (as amended by FAS 137) is effective for all fiscal quarters of fiscal years beginning after June 15, 2000.

FAS 133 standardizes the accounting for derivative instruments by requiring that all derivatives be recognized as assets and liabilities and measured at fair value. The accounting for changes in the fair value of derivatives (gains and losses) depends on whether the derivative is designated and qualifies as a hedge, and the type of hedging relationship that exists. Changes in the fair value of derivatives that are not designated as hedges or that do not meet the hedge accounting criteria in FAS 133 are required to be reported in earnings. In addition, all hedging relationships must be designated, reassessed and documented pursuant to the provisions of FAS 133. The Company has not yet determined the impact that adoption of FAS 133 will have on the financial statements.

FORWARD LOOKING STATEMENTS

This Form 10-Q 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. All statements other than statements of historical facts included in this Form 10-Q, including, without limitation, statements regarding oil and gas reserve estimates, planned capital expenditures, expected oil and gas production, the Company's financial position, business strategy and other plans and objectives for future operations, expected future expenses, realization of deferred tax assets, and Year 2000 compliance efforts, are forward-looking statements. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct. Factors that could cause actual results to differ materially from those expected by the Company, including, without limitation, factors discussed under Risk Factors in the Company's Form 10-K for the year ended December 31, 1998, are substantial indebtedness, impairment of asset value, need to replace reserves, substantial capital requirements, ability to supplement capital resources with asset sales, fluctuations in the prices of oil and gas, uncertainties inherent in estimating quantities of oil and gas reserves, projecting future rates of production and the timing of development expenditures, competition, operating risks, risks associated with foreign operations, restrictions imposed by lenders, liquidity and capital requirements, the effects of governmental and environmental regulation, pending patent, securities and lease cancellation litigation, adverse changes in the market for the Company's oil and gas production and the Company's ability to successfully address Year 2000 issues. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the

date hereof. The Company undertakes no obligation to release publicly the result of any revisions to these forward-looking statements that may be made to reflect events or circumstances after the date hereof, including, without limitation, changes in the Company's business strategy or planned capital expenditures, or to reflect the occurrence of unanticipated events.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

COMMODITY PRICE RISK

Periodically the Company utilizes hedging strategies to hedge the price of a portion of its future oil and gas production. These strategies include (i) swap arrangements that establish an index-related price above which the Company pays the counterparty and below which the Company is paid by the counterparty, (ii) the purchase of index-related puts that provide for a "floor" price below which the counterparty pays the Company the amount by which the price of the commodity is below the contracted floor, (iii) the sale of index-related calls that provide for a "ceiling" price above which the Company pays the counterparty the amount by which the price of the commodity is above the contracted ceiling, and (iv) basis protection swaps, which are arrangements that guarantee the price differential of oil or gas from a specified delivery point or points. Results from hedging transactions are reflected in oil and gas sales to the extent related to the Company's oil and gas production. The Company only enters into hedging transactions related to the Company's oil and gas production volumes or physical purchase or sale commitments of its oil and gas marketing subsidiary. Gains or losses on crude oil and natural gas hedging transactions are recognized as price adjustments in the months of related production.

Prior to June 30, 1999, the Company entered into and closed transactions designed to hedge a portion of the Company's domestic oil and gas production. The net unrecognized gains resulting from these transactions, \$0.6 million, will be recognized as price adjustments in the months of related production. These hedging gains and losses are set forth below (\$ in 000's):

| MONTH | HEDGING GAINS (LOSSES) | | |
|--------------------|------------------------|----------|--------|
| | GAS | OIL | TOTAL |
| July 1999..... | 210 | (73) | 137 |
| August 1999..... | 180 | (73) | 107 |
| September 1999.... | 144 | (70) | 74 |
| October 1999..... | 421 | (72) | 349 |
| November 1999..... | 102 | (69) | 33 |
| December 1999..... | -- | (71) | (71) |
| | ----- | ----- | ----- |
| | \$ 1,057 | \$ (428) | \$ 629 |
| | ===== | ===== | ===== |

Subsequent to June 30, 1999, the Company entered into the following natural gas swap arrangements designed to hedge a portion of the Company's domestic gas production.

| MONTHS | MONTHLY VOLUME (MMBTU) | NYMEX-INDEX STRIKE PRICE (PER MMBTU) |
|---------------------|------------------------|--------------------------------------|
| April 2000..... | 600,000 | \$ 2.41 |
| May 2000..... | 620,000 | \$ 2.41 |
| June 2000..... | 600,000 | \$ 2.41 |
| July 2000..... | 620,000 | \$ 2.41 |
| August 2000..... | 620,000 | \$ 2.41 |
| September 2000..... | 600,000 | \$ 2.41 |
| October 2000..... | 620,000 | \$ 2.41 |

Subsequent to June 30, 1999, the Company entered into the following crude oil collar transactions related to its domestic oil production:

| MONTHS | VOLUME (BBLs) | NYMEX-DEFINED HIGH STRIKE PRICE | NYMEX-DEFINED LOW STRIKE PRICE |
|---------------------|------------------|------------------------------------|-----------------------------------|
| July 1999..... | 155,000 | \$ 19.710 | \$ 17.50 |
| August 1999..... | 310,000 | \$ 20.255 | \$ 17.75 |
| September 1999..... | 300,000 | \$ 20.255 | \$ 17.75 |
| October 1999..... | 310,000 | \$ 20.255 | \$ 17.75 |
| November 1999..... | 300,000 | \$ 20.255 | \$ 17.75 |
| December 1999..... | 310,000 | \$ 20.255 | \$ 17.75 |
| January 2000..... | 310,000 | \$ 20.255 | \$ 17.75 |
| February 2000..... | 290,000 | \$ 20.255 | \$ 17.75 |
| March 2000..... | 310,000 | \$ 20.255 | \$ 17.75 |
| April 2000..... | 300,000 | \$ 20.255 | \$ 17.75 |
| May 2000..... | 310,000 | \$ 20.255 | \$ 17.75 |
| June 2000..... | 300,000 | \$ 20.255 | \$ 17.75 |
| July 2000..... | 155,000 | \$ 20.800 | \$ 18.00 |

As of June 30, 1999, the Company had the following natural gas swap arrangement designed to hedge a portion of the Company's Canadian gas production for periods after June 1999:

| MONTHS | VOLUME (MMBTU) | INDEX STRIKE PRICE (PER MMBTU) (IN US \$) |
|----------------|-------------------|---|
| July 1999..... | 589,000 | \$1.60 |

If the Canadian gas swap arrangement listed above had been settled on June 30, 1999, the Company would have incurred a loss of \$0.2 million. Prior to June 30, 1999 the Company also entered into additional transactions designed to hedge a portion of the Company's Canadian gas production during August through September 1999. Such transactions were closed in May 1999. The net loss resulting from these transactions of \$0.6 million (in US \$) will be recognized as price adjustments in the months of related production.

In addition to commodity hedging transactions related to the Company's oil and gas production, CEMI periodically enters into various hedging transactions designed to hedge against physical purchase commitments made by CEMI. Gains or losses on these transactions are recorded as adjustments to Oil and Gas Marketing Sales in the consolidated statements of operations and are not considered by management to be material.

INTEREST RATE RISK

The Company also utilizes hedging strategies to manage fixed-interest rate exposure. Through the use of a swap arrangement, the Company believes it can benefit from stable or falling interest rates and reduce its current interest expense. During the Current Quarter, the Company's interest rate swap resulted in a \$0.6 million reduction of interest expense.

The table below presents principal cash flows and related weighted average interest rates by expected maturity dates. As of June 30, 1999, the carrying amounts of short-term borrowings are representative of fair values because of the short-term maturity of these instruments. The fair value of the long-term debt has been estimated based on quoted market prices.

| | JUNE 30, 1999 | | | | | | | TOTAL | FAIR VALUE |
|---|------------------|-------|-------|-------|-------|------------|--------|--------|------------|
| | YEAR OF MATURITY | | | | | | | | |
| | 1999 | 2000 | 2001 | 2002 | 2003 | THEREAFTER | | | |
| (\$ IN MILLIONS) | | | | | | | | | |
| LIABILITIES: | | | | | | | | | |
| Long-term debt - variable rate | \$ -- | \$ -- | \$ 39 | \$ -- | \$ -- | \$ -- | \$ 39 | \$ 39 | |
| Average interest rate..... | -- | -- | 7.75% | -- | -- | -- | -- | -- | |
| Long-term debt, including current portion - fixed rate..... | \$ -- | \$ -- | \$ -- | \$ -- | \$ -- | \$ 920 | \$ 920 | \$ 816 | |
| Average interest rate..... | -- | -- | -- | -- | -- | 9.1% | -- | -- | |

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company is subject to ordinary routine litigation incidental to its business. In addition, the Company and certain of its officers and directors are defendants in pending actions which are described in Item 3 of the Company's annual report on Form 10-K for the year ended December 31, 1998. Subsequent developments are as follows:

Union Pacific Resources Company v. Chesapeake Energy Corporation, et al., U.S. District Court for the Northern District of Texas, Fort Worth Division, was tried to the Court in June 1999. The issues were limited to the validity of a UPRC patent and the Company's alleged infringement of the patent. No ruling has been issued yet. If necessary, a trial on damages will be scheduled after the ruling. UPRC originally filed the case against the Company in October 1996. UPRC's claims are based on services provided to the Company by a third party vendor controlled by former UPRC employees. UPRC is seeking damages of an unspecified amount, including actual, enhanced, consequential and punitive damages, interest, costs and attorneys' fees.

West Panhandle Field Cessation Cases. A subsidiary of the Company, Chesapeake Panhandle Limited Partnership ("CP") (f/k/a MC Panhandle, Inc.), Natural Gas Pipeline Company of America ("NGPL") and MidCon Gas Services, Inc. are defendants in thirteen lawsuits filed in 1997 and 1998 by royalty owners seeking the cancellation of oil and gas leases in the West Panhandle Field in Texas. The Company acquired MC Panhandle, Inc. on April 30, 1998. MC Panhandle, Inc. has owned the leases since January 1, 1997. Plaintiffs claim the leases terminated upon the cessation of production for various periods between 1926 and 1997 and/or for failure to produce in paying quantities. Plaintiffs also seek to recover conversion damages in an amount equal to 7/8 of gross production for the period beginning two years prior to the filing of each suit through the time of trial, plus attorneys' fees and interest, as well as exemplary damages. Plaintiffs assert that NGPL, which was a prior lessee, knew that the leases had terminated and that, therefore, defendants are bad faith trespassers and not entitled (in the event of an adverse judgment) to recover the value of improvements or operating costs. In the alternative, plaintiffs seek damages for the breach of implied covenants of the leases, i.e., for failure to protect against drainage, to maximize production, and to reasonably develop and market.

Defendants assert that any cessation of production was excused by their timely commencement of operations to restore production and assert affirmative defenses of limitations, waiver, estoppel, laches and title by adverse possession under 3, 5, 10 and 25-year statutes of adverse possession.

Following are the cases pending in the District Court of Moore County, Texas, 69th Judicial District:

- o Lois Law, et al. v. NGPL, et al., No. 97-70, filed December 22, 1997, jury trial in June 1999, verdict for defendants
- o A.C. Smith, et al. v. NGPL, et al., No. 98-47, first filed January 26, 1998 and refiled May 29, 1998, notice given that summary judgment terminating leases will be entered
- o Joseph H. Pool, et al. v. NGPL, et al.,
 - No. 98-30, first filed December 17, 1997 and refiled May 11, 1998, jury trial in June 1999, verdict for defendants
 - No. 98-36, first filed February 2, 1998 and refiled May 20, 1998, jury trial in July 1999, verdict for plaintiffs
 - No. 98-35, first filed February 2, 1998 and refiled May 20, 1998
 - No. 98-49, first filed March 10, 1998 refiled May 29, 1998
 - No. 98-50, first filed March 18, 1998 and refiled May 29, 1998
 - No. 98-51, first filed December 2, 1997 and refiled May 29, 1998
 - No. 98-48, first filed February 2, 1998 and refiled May 29, 1998
 - No. 98-70, first filed March 23, 1998 and refiled October 22, 1998

The Pool cases listed above were first filed in the U.S. District Court, Northern District of Texas, Amarillo Division. Other related cases pending are the following:

- o Phillip Thompson, et al. v. NGPL, et al, U.S. District Court, Northern District of Texas, Amarillo Division, Nos. CV-012 and CV-106, filed January 8, 1998 and March 18, 1998, respectively (actions consolidated), jury trial in May 1999, verdict for defendants

- o Craig Fuller, et al. v. NGPL, et al., District Court of Carson County, Texas, 100th Judicial District, No. 8456, filed June 23, 1997, cross motions for summary judgment pending
- o Ralph W. Coon, et al. v. MC Panhandle, Inc., et al., U.S. District Court, Eastern District of Texas, Lufkin Division, No. 2:98-CV-63, filed March 27, 1998

Four of the cases listed above were tried in May, June and July 1999. Three resulted in verdicts in favor of CP and the other defendants (Thompson, Law and Pool No. 98-30), and one, Pool No. 98-36, resulted in a verdict against them. The juries which found for defendants determined that the plaintiff's termination claims were barred by laches, adverse possession and (in two cases) revivor. The jury in Pool No. 98-36 found that the defendants were bad-faith trespassers and produced gas from the leases as a result of fraud. The jury assessed \$1.2 million in exemplary damages against CP and each of the other two defendants and awarded plaintiffs attorneys' fees in the amount of \$158,000. The parties stipulated that the value of gas produced by defendants was \$1 million since January 1, 1996 and \$1.5 million since January 1, 1994. The court will determine which amount of actual damages, if either, should be awarded based on the statute of limitations and other considerations. CP has filed motions for judgment in Thompson, Law and Pool No. 98-30 and a motion for judgment notwithstanding verdict in Pool No. 98-36. The Company intends to appeal the decision if the latter motion is not granted. The other nine cases have not been set for trial.

The Company has previously established an accrued liability that management believes will be sufficient to cover the estimated costs of litigation for each of these cases. Because of the inconsistent verdicts reached by the juries in the four cases tried to date and because the amount of damages sought is not specified in all of the other cases, the outcome of the remaining trials and the amount of damages that might ultimately be awarded could differ from management's estimates. Management believes, however, that the leases are valid, there is no basis for exemplary damages and that any findings of fraud or bad faith will be overturned on appeal. CP and the other defendants intend to vigorously defend against the plaintiff's claims.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

- - Not applicable

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

- - Not applicable

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Company's annual meeting of shareholders was held on June 23, 1999. In the election of directors, Aubrey K. McClendon received 78,688,202 votes for election, and 1,455,980 shares were withheld from voting. Shannon T. Self received 78,693,249 votes for election, and 1,450,933 shares were withheld from voting. The other directors whose terms continued after the meeting are Breene M. Kerr, Walter C. Wilson, Edgar F. Heizer, Jr. and Frederick B. Whittemore.

ITEM 5. OTHER INFORMATION

- - Not applicable

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

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

Exhibit No.

| | |
|--------|---|
| 10.1.5 | Registrant's 1999 Stock Option Plan |
| 10.2.1 | First Amendment to the Amended and Restated Employment Agreement dated as of December 31, 1998 between Aubrey K. McClendon and Chesapeake Energy Corporation. |
| 10.2.2 | First Amendment to the Amended and Restated Employment Agreement dated as of December 31, 1998 between Tom L. Ward and Chesapeake Energy Corporation. |
| 12 | Computation of Ratios |
| 27 | Financial Data Schedule |

(b) Reports on Form 8-K

During the quarter ended June 30, 1999, the Company filed the following current reports on Form 8-K:

On April 1, 1999, the Company filed a current report on Form 8-K reporting under Item 5 that the Board of Directors approved the repurchase of up to \$10 million of the Company's senior notes and/or its convertible preferred stock.

On May 5, 1999, the Company filed a current report on Form 8-K reporting under Item 5 that the Company issued a press release announcing the first quarter 1999 results.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CHESAPEAKE ENERGY CORPORATION
(Registrant)

August 16, 1999

Date

/s/ Aubrey K. McClendon

Aubrey K. McClendon
Chairman and
Chief Executive Officer

August 16, 1999

Date

/s/ Marcus C. Rowland

Marcus C. Rowland
Executive Vice President and
Chief Financial Officer

EXHIBIT INDEX

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CHESAPEAKE ENERGY CORPORATION

1999 STOCK OPTION PLAN

CHESAPEAKE ENERGY CORPORATION
1999 STOCK OPTION PLAN

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ARTICLE I

PURPOSE

SECTION 1.1 Purpose. This Stock Option Plan is established by Chesapeake Energy Corporation (the "Company") to create incentives which are designed to motivate Eligible Employees to put forth maximum effort toward the success and growth of the Company and to enable the Company to attract and retain experienced individuals who by their position, ability and diligence are able to make important contributions to the Company's success. Toward these objectives, the Plan provides for the granting of Options to Eligible Employees on the terms and subject to the conditions set forth in the Plan.

SECTION 1.2 Establishment. The Plan is effective as of March 5, 1999 and for a period of 10 years from such date. The Plan will terminate on March 4, 2009; however, it will continue in effect until all matters relating to the exercise of Options and administration of the Plan have been settled.

SECTION 1.3 Shares Subject to the Plan. Subject to Articles IV, VII and IX of this Plan, shares of stock covered by Options shall consist of Three Million (3,000,000) shares of Common Stock.

SECTION 1.4 Shareholder Approval. Nonqualified Stock Options under the Plan may be granted to Participants prior to Shareholder Approval of the Plan, but no Incentive Stock Options may be granted prior to Shareholder Approval. In the event Shareholder Approval is not obtained within the twelve-month period following the date the Plan is adopted by the Board, no Incentive Stock Options may be granted under the Plan.

ARTICLE II

DEFINITIONS

SECTION 2.1 "Board" means the Board of Directors of the Company.

SECTION 2.2 "Code" means the Internal Revenue Code of 1986, as amended. Reference in the Plan to any Section of the Code shall be deemed to include any amendments or successor provisions to such Section and any regulations under such Section.

SECTION 2.3 "Committee" has the meaning set forth in Section 3.1.

SECTION 2.4 "Common Stock" means the common stock, par value \$.01 per share, of the Company and, after substitution, such other stock as shall be substituted therefor as provided in Article VII or Article IX of the Plan.

SECTION 2.5 "Date of Grant" means the date on which the granting of an Option is authorized by the Committee or such later date as may be specified by the Committee in such authorization.

SECTION 2.6 "Disability" has the meaning set forth in Section 22(e)(3) of the Code.

SECTION 2.7 "Eligible Employee" means any employee of the Company, a Subsidiary or a partnership or limited liability company which the Company controls.

SECTION 2.8 "Exchange Act" means the Securities Exchange Act of 1934, as amended.

SECTION 2.9 "Executive Officer Participants" means Participants who are subject to the provisions of Section 16 of the Exchange Act.

SECTION 2.10 "Fair Market Value" means (A) during such time as the Common Stock is listed on the New York Stock Exchange or other national securities exchanges or the Nasdaq National Market (each, an "exchange"), the closing price of the Common Stock on the New York Stock Exchange or, if no sale of the Common

Stock shall have been made on the New York Stock Exchange, such other principal exchange on the day for which such value is to be determined, or if no sale of the Common Stock shall have been made on any such exchange that day, on the next preceding day on which there was a sale of such Common Stock or (B) during any such time as the Common Stock is not listed upon an exchange, the mean between dealer "bid" and "ask" prices of the Common Stock in the over-the-counter market on the day for which such value is to be determined, as reported by the National Association of Securities Dealers, Inc.

SECTION 2.11 "Incentive Stock Option" means an Option within the meaning of Section 422 of the Code.

SECTION 2.12 "Non-Executive Officer Participants" means Participants who are not subject to the provisions of Section 16 of the Exchange Act.

SECTION 2.13 "Nonqualified Stock Option" means an Option which is not an Incentive Stock Option.

SECTION 2.14 "Option" means an Option granted under Article VI of the Plan and includes both Nonqualified Stock Options and Incentive Stock Options to purchase shares of Common Stock.

SECTION 2.15 "Option Agreement" means any written instrument that establishes the terms, conditions, restrictions, and/or limitations applicable to an Option in addition to those established by this Plan and by the Committee's exercise of its administrative powers.

SECTION 2.16 "Participant" means an Eligible Employee to whom an Option has been granted by the Committee under the Plan.

SECTION 2.17 "Plan" means the Chesapeake Energy Corporation 1999 Stock Option Plan.

SECTION 2.18 "Regular Stock Option Committee" means a committee designated by the Board which shall consist of not less than two members of the Board.

SECTION 2.19 "Shareholder Approval" means approval by the holders of a majority of the outstanding shares of Common Stock, present, or represented, and entitled to vote at a meeting called for such purposes.

SECTION 2.20 "Special Stock Option Committee" means a committee designated by the Board which shall consist of not less than two members of the Board who meet the definition of "non-employee directors" pursuant to Rule 16b-3, or any successor rule, promulgated under Section 16 of the Exchange Act.

SECTION 2.21 "Subsidiary" shall have the same meaning set forth in Section 424 of the Code.

ARTICLE III

ADMINISTRATION

SECTION 3.1 Administration of the Plan; the Committee. For purposes of administration, the Plan shall be deemed to consist of two separate stock option plans, a "Non-Executive Officer Participant Plan" which is limited to Non-Executive Officer Participants, and an "Executive Officer Participant Plan" which is limited to Executive Officer Participants. Except for administration and the category of Participants eligible to receive Options, the terms of the Non-Executive Officer Participant Plan and the Executive Officer Participant Plan are identical.

The Non-Executive Officer Participant Plan shall be administered by the Regular Stock Option Committee, and the Executive Officer Participant Plan shall be administered by either the Special Stock Option Committee or the Board. Accordingly, with respect to decisions relating to Non-Executive Officer Participants, including the grant of

Options, the term "Committee" shall mean only the Regular Stock Option Committee; and, with respect to all decisions relating to Executive Officer Participants, including the grant of Options, the term "Committee" shall mean either the Special Stock Option Committee or the Board.

Unless otherwise provided in the by-laws of the Company or resolutions adopted from time to time by the Board establishing the Committee, the Board may from time to time remove members from, or add members to, the Committee. Vacancies on the Committee, however caused, shall be filled by the Board. The Committee shall hold meetings at such times and places as it may determine. A majority of the Committee shall constitute a quorum, and the acts of a majority of the members present at any meeting at which a quorum is present or acts reduced to or approved by the Committee in writing by a majority of the members of the Committee shall be the valid acts of the Committee.

Subject to the provisions of the Plan, the Committee shall have exclusive power to:

(a) Select the Eligible Employees to participate in the Plan.

(b) Determine the time or times when Options will be granted.

(c) Determine the form of an Option, whether an Incentive Stock Option or a Nonqualified Stock Option, the number of shares of Common Stock subject to the Option, all the terms, conditions (including performance requirements), restrictions and/or limitations, if any, of an Option, including the time and conditions of exercise or vesting, and the terms of any Option Agreement, which may include the waiver or amendment of prior terms and conditions or acceleration of the vesting or exercise of an Option under certain circumstances determined by the Committee.

(d) Determine whether Options will be granted singly or in combination.

(e) Take any and all other action it deems necessary or advisable for the proper operation or administration of the Plan.

SECTION 3.2 Committee to Make Rules and Interpret Plan. The Committee in its sole discretion shall have the authority, subject to the provisions of the Plan, to establish, adopt, or revise such rules and regulations and to make all such determinations relating to the Plan as it may deem necessary or advisable for the administration of the Plan. The Committee's interpretation of the Plan or any Options granted pursuant hereto and all decisions and determinations by the Committee with respect to the Plan shall be final, binding, and conclusive on all parties.

ARTICLE IV

GRANT OF OPTIONS

The Committee may, from time to time, grant Options to one or more Participants, provided, however, that:

(a) Subject to Article VII, the aggregate number of shares of Common Stock made subject to the grant of Options to any Participant in any fiscal year of the Company may not exceed 500,000.

(b) Any shares of Common Stock related to Options which terminate by expiration, forfeiture, cancellation or otherwise without the issuance of shares of Common Stock shall be available again for grant under the Plan.

(c) Common Stock delivered by the Company upon exercise of an Option under the Plan may be authorized and unissued Common Stock or Common Stock held in the treasury of the Company or may be purchased on the open market or by private purchase.

(d) The Committee shall, in its sole discretion, determine the manner in which fractional shares arising under this Plan shall be treated.

(e) Upon the exercise of any Option, the Company shall issue and deliver to the Participant who exercised the Option a certificate representing the number of shares of Common Stock purchased thereby.

ARTICLE V

ELIGIBILITY

Subject to the provisions of the Plan, the Committee shall, from time to time, select from the Eligible Employees those to whom Options shall be granted and shall determine the type or types of Options to be granted and shall establish in the related Option Agreements the terms, conditions, restrictions and/or limitations, if any, applicable to the Options in addition to those set forth in the Plan and the administrative rules and regulations issued by the Committee.

ARTICLE VI

STOCK OPTIONS

SECTION 6.1 Grant of Options. The Committee may, from time to time, subject to the provisions of the Plan and such other terms and conditions as it may determine, grant Options to Eligible Employees. These Options may be Incentive Stock Options or Nonqualified Stock Options, or a combination of both. Each grant of an Option shall be evidenced by an Option Agreement executed by the Company and the Participant, and shall contain such terms and conditions and be in such form as the Committee may from time to time approve, subject to the requirements of Section 6.2.

SECTION 6.2 Conditions of Options. Each Option so granted shall be subject to the following conditions:

(a) Exercise Price. As limited by Section 6.2(e) below, each Option shall state the exercise price which shall be set by the Committee on the Date of Grant. Except as provided below, no Option shall be granted at an exercise price which is less than the Fair Market Value of the Common Stock on the Date of Grant. Notwithstanding the foregoing, Nonqualified Stock Options, not exceeding ten percent (10%) of the Options which can be issued under this Plan, may be granted at an exercise price which is not less than eighty-five percent (85%) of the Fair Market Value of the Common Stock on the Date of Grant.

(b) Form of Payment. The exercise price of an Option may be paid (i) in cash or by check, bank draft or money order payable to the order of the Company; (ii) by delivering shares of Common Stock having a Fair Market Value on the date of payment equal to the amount of the exercise price, provided that the Participant certifies that such shares of Common Stock have been issued to the Participant for a period of at least six months; or (iii) a combination of the foregoing. In addition to the foregoing, any Option granted under the Plan may be exercised by a broker-dealer acting on behalf of a Participant if (A) the broker-dealer has received from the Participant or the Company a notice evidencing the exercise of such Option and instructions signed by the Participant requesting the Company to deliver the shares of Common Stock subject to such Option to the broker-dealer on behalf of the Participant and specifying the account into which such shares should be deposited, (B) adequate provision has been made with respect to the payment of any withholding taxes due upon such exercise or, in the case of an Incentive Stock Option, upon the premature disposition of such shares and (C) the broker-dealer and the Participant have otherwise complied with Section

220.3(e)(4) of Regulation T, 12 CFR, Part 220 and any successor rules and regulations applicable to such exercise.

(c) Exercise of Options. Options granted under the Plan shall be exercisable, in whole or in such installments and at such times, and shall expire at such time, as shall be provided by the Committee in the Option Agreement. Exercise of an Option shall be by written notice stating the election to exercise in the form and manner determined by the Committee. Every share of Common Stock acquired through the exercise of an Option shall be deemed to be fully paid at the time of exercise and payment of the exercise price.

(d) Other Terms and Conditions. Among other conditions that may be imposed by the Committee, if deemed appropriate, are those relating to (i) the period or periods and the conditions of exercisability of any Option; (ii) the minimum periods during which Participants must be employed by the Company or its Subsidiaries, or must hold Options before they may be exercised; (iii) the minimum periods during which shares acquired upon exercise must be held before sale or transfer shall be permitted; (iv) conditions under which such Options or shares may be subject to forfeiture; (v) the frequency of exercise or the minimum or maximum number of shares that may be acquired at any one time and (vi) the achievement by the Company of specified performance criteria.

(e) Special Restrictions Relating to Incentive Stock Options. In addition to being subject to all applicable terms, conditions, restrictions and/or limitations established by the Committee, Options issued in the form of Incentive Stock Options shall comply with the requirements of Section 422 of the Code (or any successor Section thereto), including, without limitation, the requirement that the exercise price of an Incentive Stock Option not be less than 100% of the Fair Market Value of the Common Stock on the Date of Grant, the requirement that each Incentive Stock Option, unless sooner exercised, terminated or cancelled, expire no later than 10 years from its Date of Grant, the requirement that Incentive Stock Options be granted only to Eligible Employees, and the requirement that the aggregate Fair Market Value (determined on the Date of Grant) of the Common Stock with respect to which Incentive Stock Options are exercisable for the first time by a Participant during any calendar year (under this Plan or any other plan of the Company or any Subsidiary) not exceed \$100,000. Incentive Stock Options which are in excess of the applicable \$100,000 limitation will be automatically recharacterized as Nonqualified Stock Options as provided under Section 6.3 of this Plan. No Incentive Stock Options shall be granted to any Eligible Employee if, immediately before the grant of an Incentive Stock Option, such Eligible Employee owns more than 10% of the total combined voting power of all classes of stock of the Company or its Subsidiaries (as determined in accordance with the stock attribution rules contained in Sections 422 and 424(d) of the Code). Provided, the preceding sentence shall not apply if, at the time the Incentive Stock Option is granted, the exercise price is at least 110% of the Fair Market Value of the Common Stock subject to the Incentive Stock Option, and such Incentive Stock Option by its terms is exercisable no more than five years from the date such Incentive Stock Option is granted.

(f) Application of Funds. The proceeds received by the Company from the sale of Common Stock pursuant to Options will be used for general corporate purposes.

(g) Shareholder Rights. No Participant shall have any rights as a shareholder with respect to any share of Common Stock subject to an Option prior to the purchase of such share of Common Stock by exercise of the Option.

SECTION 6.3 Options Not Qualifying as Incentive Stock Options. With respect to all or any portion of any Option granted under this Plan not qualifying as an "incentive stock option" under Section 422 of the Code, such Option shall be considered a Nonqualified Stock Option granted under this Plan for all purposes. Further, this Plan and any Incentive Stock Options granted hereunder shall be deemed to have incorporated by reference all the provisions

and requirements of Section 422 of the Code (and the Treasury Regulations issued thereunder) necessary to ensure that all Incentive Stock Options granted hereunder shall be "incentive stock options" described in Section 422 of the Code. Further, in the event that the \$100,000 limitation contained in Section 6.2(e) herein is exceeded in any Incentive Stock Option granted under this Plan, the portion of the Incentive Stock Option in excess of such limitation shall be treated as a Nonqualified Stock Option under this Plan subject to the terms and provisions of the applicable Option Agreement, except to the extent modified to reflect recharacterization of the Incentive Stock Option as a Nonqualified Stock Option.

ARTICLE VII

STOCK ADJUSTMENTS

Subject to the provisions of Article IX of this Plan, in the event that the shares of Common Stock, as presently constituted shall be changed into or exchanged for a different number or kind or shares of stock or other securities of the Company or of another corporation (whether by reason of merger, consolidation, recapitalization, reclassification, stock split, combination of shares or otherwise), or if the number of such shares of Common Stock shall be increased through the payment of a stock dividend, or a dividend on the shares of Common Stock or rights or warrants to purchase securities of the Company shall be made, then there shall be substituted for or added to each share available under and subject to the Plan as provided in Section 1.3 hereof, and each share then subject or thereafter subject or which may become subject to Options under the Plan, the number and kind of shares of stock or other securities into which each outstanding share of Common Stock shall be so changed or for which each such share shall be exchanged or to which each such share shall be entitled, as the case may be, on a fair and equivalent basis in accordance with the applicable provisions of Section 424 of the Code; provided, however, in no such event will such adjustment result in a modification of any Option as defined in Section 424(h) of the Code. In the event there shall be any other change in the number or kind of the outstanding shares of Common Stock, or any stock or other securities into which the Common Stock shall have been changed or for which it shall have been exchanged, then if the Committee shall, in its sole discretion, determine that such change equitably requires an adjustment in the shares available under and subject to the Plan, or in any Option theretofore granted or which may be granted under the Plan, such adjustments shall be made in accordance with such determination, except that no adjustment of the number of shares of Common Stock available under the Plan or to which any Option relates that would otherwise be required shall be made unless and until such adjustment either by itself or with other adjustments not previously made would require an increase or decrease of at least 1% of the number of shares of Common Stock available under the Plan or to which any Option relates immediately prior to the making of such adjustment (the "Minimum Adjustment"). Any adjustment representing a change of less than such minimum amount shall be carried forward and made as soon as such adjustment together with other adjustments required by this Article VII and not previously made would result in a Minimum Adjustment. Notwithstanding the foregoing, any adjustment required by this Article VII which otherwise would not result in a Minimum Adjustment shall be made with respect to shares of Common Stock relating to any Option immediately prior to exercise of such Option.

No fractional shares of Common Stock or units of other securities shall be issued pursuant to any such adjustment, and any fractions resulting from any such adjustment shall be eliminated in each case by rounding downward to the nearest whole share.

ARTICLE VIII

GENERAL

SECTION 8.1 Amendment or Termination of Plan. The Board may suspend or terminate the Plan at any time. In addition, the Board may, from time to time, amend the Plan in any manner, but may not adopt any amendment without Shareholder Approval if (i) the amendment relates to Incentive Stock Options and Section 422 of the Code requires Shareholder Approval of such amendment, or (ii) in the opinion of counsel to the Company, Shareholder Approval is required by any Federal or state law or regulations or rules promulgated thereunder.

SECTION 8.2 Acceleration of Otherwise Unexercisable Stock Options on Death, Disability or Other Special Circumstances. The Committee, in its sole discretion, may permit (i) a Participant who terminates employment due to a Disability, (ii) the personal representative of a deceased Participant, or (iii) any other Participant who terminates employment upon the occurrence of special circumstances (as determined by the Committee) to purchase all or any part of the shares subject to any unvested Option on the date of the Participant's termination of employment due to a Disability, death or special circumstances, or as the Committee otherwise so determines. With respect to Options which have already vested at the date of such termination or the vesting of which is accelerated by the Committee in accordance with the foregoing provision, the Participant or the personal representative of a deceased Participant shall have the right to exercise such vested Options which are Incentive Stock Options within three months of such date of termination of employment or one year in the case of a Participant suffering a Disability or three years in the case of a deceased Participant. The Participant or the personal representative of a deceased Participant shall have the right to exercise such vested Options which are Nonqualified Stock Options within such period(s) as the Committee shall determine.

SECTION 8.3 Nonassignability. No Option shall be subject in any manner to alienation, anticipation, sale, transfer, assignment, pledge, or encumbrance, except for transfer by will or the laws of descent and distribution. Any attempt to transfer, assign, pledge, hypothecate or otherwise dispose of, or to subject to execution, attachment or similar process, any Option contrary to the provisions hereof, shall be void and ineffective, shall give no right to any purported transferee, and may, at the sole discretion of the Committee, result in forfeiture of the Option involved in such attempt.

SECTION 8.4 Withholding Taxes. A Participant must pay the amount of taxes required by law upon the exercise of an Option in cash.

SECTION 8.5 Amendments to Options. The Committee may at any time unilaterally amend the terms of any Option Agreement, whether or not the Option granted thereunder is presently exercisable or vested, to the extent it deems appropriate; provided, however, that any such amendment which is adverse to the Participant shall require the Participant's consent.

SECTION 8.6 Regulatory Approval and Listings. The Company shall use its best efforts to file with the Securities and Exchange Commission as soon as practicable following the date this Plan is adopted by the Board, and keep continuously effective and usable, a Registration Statement on Form S-8 with respect to shares of Common Stock subject to Options hereunder. Notwithstanding anything contained in this Plan to the contrary, the Company shall have no obligation to issue or deliver certificates representing shares of Common Stock evidencing Options prior to:

- (a) the obtaining of any approval from, or satisfaction of any waiting period or other condition imposed by, any governmental agency which the Committee shall, in its sole discretion, determine to be necessary or advisable;
- (b) the admission of such shares to listing on any exchange on which the Common Stock may be listed; and
- (c) the completion of any registration or other qualification of such shares under any state or Federal law or ruling of any governmental body which the Committee shall, in its sole discretion, determine to be necessary or advisable.

SECTION 8.7 Right to Continued Employment. Participation in the Plan shall not give any Participant any right to remain in the employ of the Company or any Subsidiary or any partnership or limited liability company controlled by the Company. Further, the adoption of this Plan shall not be deemed to give any Eligible Employee or any other individual any right to be selected as a Participant or to be granted an Option.

SECTION 8.8 Reliance on Reports. Each member of the Committee and each member of the Board shall be fully justified in relying or acting in good faith upon any report made by the independent public accountants of the Company and its Subsidiaries and upon any other information furnished in connection with the Plan by any person or persons other than the Committee or Board member. In no event shall any person who is or shall have been a member of the Committee or of the Board be liable for any determination made or other action taken or any omission to act in reliance upon any such report or information or for any action taken, including the furnishing of information, or failure to act, if in good faith.

SECTION 8.9 Construction. The titles and headings of the sections in the Plan are for the convenience of reference only, and in the event of any conflict, the text of the Plan, rather than such titles or headings, shall control.

SECTION 8.10 Governing Law. The Plan shall be governed by and construed in accordance with the laws of the State of Oklahoma except as superseded by applicable Federal law.

ARTICLE IX

ACCELERATION OF OPTIONS UPON CORPORATE EVENT

SECTION 9.1 Procedures for Acceleration and Exercise. If the Company shall, pursuant to action by the Board, at any time propose to dissolve or liquidate or merge into, consolidate with, or sell or otherwise transfer all or substantially all of its assets to another corporation and provision is not made pursuant to the terms of such transaction for the assumption by the surviving, resulting or acquiring corporation of outstanding Options under the Plan, or for the substitution of new options therefor, the Committee shall cause written notice of the proposed transaction to be given to each Participant no less than forty days prior to the anticipated effective date of the proposed transaction, and the Participant's Option shall become 100% vested. Prior to a date specified in such notice, which shall be not more than ten days prior to the anticipated effective date of the proposed transaction, each Participant shall have the right to exercise his or her Option to purchase any or all of the Common Stock then subject to such Option. Each Participant, by so notifying the Company in writing, may, in exercising his or her Option, condition such exercise upon, and provide that such exercise shall become effective immediately prior to the consummation of the transaction, in which event such Participant need not make payment for the Common Stock to be purchased upon exercise of such Option until five days after receipt of written notice by the Company to such Participant that the transaction has been consummated. If the transaction is consummated, each Option, to the extent not previously exercised prior to the date specified in the foregoing notice, shall terminate on the effective date such transaction is consummated. If the transaction is abandoned, (i) any Common Stock not purchased upon exercise of such Option shall continue to be available for purchase in accordance with the other provisions of the Plan and (ii) to the extent that any Option not exercised prior to such abandonment shall have vested solely by operation of this Section 9.1, such vesting shall be deemed voided as of the time such acceleration otherwise occurred pursuant to Section 9.1, and the vesting schedule set forth in the Participant's Option Agreement shall be reinstated as of the date of such abandonment.

SECTION 9.2 Certain Additional Payments by the Company. The Committee may, in its sole discretion, provide in any Option Agreement for certain payments by the Company in the event that acceleration of vesting of any Option under the Plan is subject to the excise tax imposed by Section 4999 of the Code or any interest or penalties with respect to such excise tax (such excise tax, interest and penalties, collectively, the "Excise Tax"). An Option Agreement may provide that the Participant shall be entitled to receive a payment (a "Gross-Up Payment") in an amount such that after payment by the Participant of all taxes (including any interest or penalties imposed with respect to such taxes), including any Excise Tax, imposed upon the Gross-Up Payment, the Participant retains an amount of the Gross-Up Payment equal to the Excise Tax imposed upon such acceleration of vesting of any Option.

FIRST AMENDMENT TO
AMENDED AND RESTATED EMPLOYMENT AGREEMENT

THIS AGREEMENT is made effective December 31, 1998, between CHESAPEAKE ENERGY CORPORATION, an Oklahoma corporation (the "Company"), and AUBREY K. McCLENDON, an individual (the "Executive").

W I T N E S S E T H :

WHEREAS, the Company and the Executive entered into that certain Amended and Restated Employment Agreement (the "Prior Agreement") dated effective July 1, 1998, which the parties desire to amend as provided herein.

NOW, THEREFORE, in consideration of the mutual promises herein contained, the Company and the Executive agree as follows:

1. Amendment to Paragraph 3.1. Paragraph 3.1 of the Prior Agreement is hereby deleted in its entirety (including subparagraphs 3.1.1 and 3.1.2) and the following paragraphs are substituted therefor:

3.1 Company's Activities. The Executive or the Executive's designated affiliate will be permitted to acquire a working interest in all of the wells spudded by the Company or the Company's subsidiary corporations, partnerships or entities (the "Program Wells") on the terms and conditions set forth herein in any Calendar Quarter (as hereafter defined) during the term of this Agreement. The Program Wells include any well spudded during such Calendar Quarter in which the Company or the Company's subsidiary corporations, partnerships or entities participate as a nonoperator.

3.1.1 Amount of Participation. On or before the date which is thirty (30) days before the first (1st) day of each Calendar Quarter, the Executive will provide notice to the compensation committee of the Company's board of directors of the Executive's intent to participate in the Program Wells during the succeeding Calendar Quarter and the approximate percentage working interest which the Executive proposes to participate with during such Calendar Quarter (the "Approved Percentage"). The Executive's Approved Percentage working interest participation (determined without consideration of any carried interest) in the Program Wells for any Calendar Quarter will not exceed two and one-half percent (2.5%) on an eight-eighths (8/8ths) basis. On designation of the Approved Percentage for a Calendar Quarter, the Executive will be deemed to have elected to participate in each Program Well spudded during such Calendar

Quarter with a working interest equal to the following applicable percentage determined on a well-by-well basis (the "Minimum Participation"): (a) the Approved Percentage for each Operations Well and each Program Well which does not fall within clause (b) of this paragraph 3.1.1; or (b) zero percent (0%) if the combined participation in the Program Well by the Executive, Mr. Tom L. Ward and Mr. Marcus C. Rowland with such individuals' Approved Percentage under their respective employment agreements causes the Company's working interest (determined without consideration of any carried interest) on the spud date for such Program Well to be less than twelve and one-half percent (12.5%) on an eight-eighths (8/8ths) basis. If clause (b) of this paragraph 3.1.1 prohibits the Executive's participation in a Program Well, then Messrs. Ward and Rowland will not be entitled to participate in such Program Well under their employment agreements. An "Operations Well" means a Program Well which falls within the provisions of clause (b) of this paragraph 3.1.1, but for which the Executive's participation is deemed necessary for the Company to retain operations as determined by the disinterested members of the compensation committee of the Company's board of directors. If the Executive elects not to participate for a Calendar Quarter or fails to provide notice of the Executive's intent to participate and the Executive's proposed participation prior to the specified date as provided herein, the amount of the Approved Percentage for the Calendar Quarter will be deemed to be zero (0).

- 3.1.2 Conditions of Participation. Except as provided herein, the participation by the Executive in each Program Well will be on no better terms than the terms agreed to by unaffiliated third party participants in connection with the acquisition of an interest in such Program Well from the Company or its subsidiary corporations, partnerships or entities. Once elected the Approved Percentage cannot be changed during any Calendar Quarter without the prior approval of the disinterested members of the compensation committee of the Company's board of directors. Any participation by the Executive under this paragraph 3.1 is also conditioned upon the Executive's participation in each Program Well spudded during such Calendar Quarter in an amount equal to the Minimum Participation. The Executive hereby agrees to execute and deliver any documents reasonably requested by the Company and hereby irrevocably appoints the Company as the Executive's agent and attorney-in-fact to execute and deliver such documents if the Executive fails or refuses to execute such documents. The Executive further agrees to pay: (a) all joint interest billings within one hundred fifty (150) days after receipt for all joint interest billings received before June 30,

2000; and (b) within ninety (90) days after receipt for all other joint interest billings. For purposes of this Agreement, the term "Calendar Quarter" means the three (3) month period commencing on the first (1st) day of January, April, July and October.

3.1.3 Revenue Advance. After the date of this Agreement, the Executive will receive an advance (the "Revenue Advance") from the Company in an amount equal to the revenue disbursed by the Company to the Executive during the prior six (6) months for all Program Wells and any other wells for which the Company disburses revenue to the Executive divided by six (6). The Revenue Advance represents oil and gas revenue received by the Company with respect to the Executive's interest in various oil and gas wells for which the Company markets production but not yet disbursed to the Executive or other participants in such wells. As a result, if the Executive sells or the Company otherwise ceases to market oil and gas for a material portion of the Executive's oil and gas interests the six (6) month revenue amount used in computing the Revenue Advance will be adjusted to reflect such change in circumstances. As of the date of this Agreement, the amount the Company has actually advanced (the "Current Advance") to the Executive is Nine Hundred Eighty-Four Thousand Dollars (\$984,000.00), which amount exceeds the Revenue Advance as a result of a decline in the Executive's production and prices received for such production. Subsequent to January 1, 1999, the Company will charge and the Executive will pay quarterly interest at the per annum rate of 9 1/8% on the amount by which the Current Advance exceeds the oil and gas revenue received by the Company with respect to the Executive's interest but not yet disbursed. Prior to December 31, 2000, the Company will not increase the Current Advance or make additional advances to the Executive unless the amount of the Current Advance is less than the Revenue Advance. After December 31, 2000, the Executive agrees to promptly pay any amount by which the Current Advance and any amounts advanced to the Executive in connection with revenue from the Executive's oil and gas wells exceed, in the aggregate, the Revenue Advance.

2. Supersession. Except as expressly amended by this First Amendment to Amended and Restated Employment Agreement, the Prior Agreement continues in full force and effect and the terms and conditions thereof as amended hereby will govern the relationship between the Company and the Executive.

IN WITNESS WHEREOF, the undersigned have executed this Agreement effective the date first above written.

CHESAPEAKE ENERGY CORPORATION, an
Oklahoma corporation

By /s/ TOM L. WARD

Tom L. Ward, President

(the "Company")

/s/ AUBREY K. McCLENDON

AUBREY K. McCLENDON, individually

(the "Executive")

FIRST AMENDMENT TO
AMENDED AND RESTATED EMPLOYMENT AGREEMENT

THIS AGREEMENT is made effective December 31, 1998, between CHESAPEAKE ENERGY CORPORATION, an Oklahoma corporation (the "Company"), and TOM L. WARD, an individual (the "Executive").

W I T N E S S E T H :

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NOW, THEREFORE, in consideration of the mutual promises herein contained, the Company and the Executive agree as follows:

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3.1.1 Amount of Participation. On or before the date which is thirty (30) days before the first (1st) day of each Calendar Quarter, the Executive will provide notice to the compensation committee of the Company's board of directors of the Executive's intent to participate in the Program Wells during the succeeding Calendar Quarter and the approximate percentage working interest which the Executive proposes to participate with during such Calendar Quarter (the "Approved Percentage"). The Executive's Approved Percentage working interest participation (determined without consideration of any carried interest) in the Program Wells for any Calendar Quarter will not exceed two and one-half percent (2.5%) on an eight-eighths (8/8ths) basis. On designation of the Approved Percentage for a Calendar Quarter, the Executive will be deemed to have elected to participate in each Program Well spudded during such Calendar Quarter with a working interest equal to the following applicable

percentage determined on a well-by-well basis (the "Minimum Participation"): (a) the Approved Percentage for each Operations Well and each Program Well which does not fall within clause (b) of this paragraph 3.1.1; or (b) zero percent (0%) if the combined participation in the Program Well by the Executive, Mr. Aubrey K. McClendon and Mr. Marcus C. Rowland with such individuals' Approved Percentage under their respective employment agreements causes the Company's working interest (determined without consideration of any carried interest) on the spud date for such Program Well to be less than twelve and one-half percent (12.5%) on an eight-eighths (8/8ths) basis. If clause (b) of this paragraph 3.1.1 prohibits the Executive's participation in a Program Well, then Messrs. McClendon and Rowland will not be entitled to participate in such Program Well under their employment agreements. An "Operations Well" means a Program Well which falls within the provisions of clause (b) of this paragraph 3.1.1, but for which the Executive's participation is deemed necessary for the Company to retain operations as determined by the disinterested members of the compensation committee of the Company's board of directors. If the Executive elects not to participate for a Calendar Quarter or fails to provide notice of the Executive's intent to participate and the Executive's proposed participation prior to the specified date as provided herein, the amount of the Approved Percentage for the Calendar Quarter will be deemed to be zero (0).

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interest billings. For purposes of this Agreement, the term "Calendar Quarter" means the three (3) month period commencing on the first (1st) day of January, April, July and October.

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2. Supersession. Except as expressly amended by this First Amendment to Amended and Restated Employment Agreement, the Prior Agreement continues in full force and effect and the terms and conditions thereof as amended hereby will govern the relationship between the Company and the Executive.

IN WITNESS WHEREOF, the undersigned have executed this Agreement effective the date first above written.

CHESAPEAKE ENERGY CORPORATION, an
Oklahoma corporation

By /s/ AUBREY K. McCLENDON

Aubrey K. McClendon, Chief Executive Officer

(the "Company")

/s/ TOM L. WARD

TOM L. WARD, individually
(the "Executive")

EXHIBIT 12

| | 3 Months Ended June 30, 1999 ----- | 3 Months Ended June 30, 1998 ----- | 6 Months Ended June 30, 1999 ----- | 6 Months Ended June 30, 1998 ----- |
|---|--|--|--|--|
| | | | | |
| | | (in 000's, except ratios) | | |
| RATIO OF EARNINGS TO FIXED CHARGES | | | | |
| Income before income taxes and extraordinary item | 8,473 | (234,739) | (3,477) | (491,239) |
| Interest | 20,259 | 18,665 | 40,149 | 29,353 |
| Preferred Stock Dividends | 4,025 | 4,025 | 8,051 | 4,025 |
| Bond discount amortization (a) | -- | -- | -- | -- |
| Loan cost amortization | 832 | 606 | 1,601 | 1,002 |
| | ----- | ----- | ----- | ----- |
| Earnings | 33,589 | (211,443) | 46,324 | (456,859) |
| Interest expense | 20,259 | 18,665 | 40,149 | 29,353 |
| Capitalized interest | 967 | 1,569 | 2,017 | 3,821 |
| Preferred Stock Dividends | 4,025 | 4,025 | 8,051 | 4,025 |
| Bond discount amortization (a) | -- | -- | -- | -- |
| Loan cost amortization | 832 | 606 | 1,601 | 1,002 |
| | ----- | ----- | ----- | ----- |
| Fixed Charges | 26,083 | 24,865 | 51,818 | 38,201 |
| Ratio | 1.29 | (8.50) | 0.89 | (11.96) |
| (A) Bond discount excluded since its included in interest expense | | | | |
| Insufficient coverage | -- | 236,308 | 5,494 | 495,060 |

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM BALANCE SHEET AS OF JUNE 30, 1999, AND STATEMENT OF INCOME FOR THE SIX MONTHS ENDED JUNE 30, 1999.

1,000

| | | |
|---------|-------------|-----------|
| 6-MOS | DEC-31-1999 | |
| | JAN-01-1999 | |
| | JUN-30-1999 | |
| | | 28,995 |
| | | 0 |
| | | 58,241 |
| | | 3,244 |
| | | 4,877 |
| | | 90,960 |
| | | 2,342,506 |
| | | 1,661,777 |
| | | 800,910 |
| 75,328 | | 958,118 |
| | | 0 |
| | | 230,000 |
| | | 1,055 |
| | | (479,608) |
| 800,910 | | 146,569 |
| | | 150,409 |
| | | 113,737 |
| | | 153,886 |
| | | 0 |
| | | 6 |
| | | 40,149 |
| | | (3,477) |
| | | 326 |
| (3,803) | | 0 |
| | | 0 |
| | | 0 |
| | | (3,803) |
| | | (.12) |
| | | (.12) |