**RELATED PARTY TRANSACTIONS AND CHESAPEAKE ENERGY**

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Related party transactions by business enterprises require disclosures in the financial reports. But, when do transactions by their CEOs require disclosures? Consider the fascinating case of Aubrey McClendon, CEO of Chesapeake Energy.

The facts are laid out in “[The Energy Billionaire’s Shrouded Loans](http://www.reuters.com/article/2012/04/18/us-chesapeake-mcclendon-loans-idUSBRE83H0GA20120418),” a special report written by Anna Driver and Brian Grow. In a nutshell, Chesapeake Energy allows its CEO to receive a 2.5 percent personal share of every well drilled by the firm. This is termed the Founders Well Participation Plan.

Aubrey McClendon has borrowed approximately $1.1 billion dollars to finance these transactions. Section 2.2 of the mortgage note says the following:

Compliance by Operator. As to any Mortgaged Property that is not a working interest, Mortgagor agrees to take all commercially reasonable action and to exercise all rights and remedies as are reasonably available to Mortgagor to cause the owner or owners of the working interest in or related to such Mortgaged Property to comply with Mortgagor’s covenants and agreements contained herein with respect to such Mortgaged Property; and as to any part of the Mortgaged Properties that is a working interest but is operated by a Person other than Mortgagor, Mortgagor agrees to take all commercially reasonable action and to exercise all rights and remedies as are reasonably available to Mortgagor (including all rights under any operating agreement) to cause such Person to comply with Mortgagor’s covenants and agreements contained herein with respect to such Mortgaged Property.

Given this paragraph, does SFAS 57 “[Related Party Disclosures](http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820909171&blobheader=application%2Fpdf)” require Chesapeake Energy to disclose this financing? We would argue yes. The mortgage note says that McClendon should “take all reasonable action and to exercise all rights and remedies” on behalf of investors in the special purpose entity funding these loans. Because it is possible for the interests of the investors and creditors of Chesapeake Energy to diverge from the interests of investors in this SPE, we think this triggers the requirement to disclose the related party transaction.

The only real issue pivots on who is a related party. Normally, we think of related party transactions as transactions by the entity with others instead of transactions by a manager with others. But, in its definition of a related party, the FASB includes “other parties with which the enterprise may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests.” As this influence is quite possible, given the terms of the mortgage note, we think Chesapeake Energy should have disclosed the substance of these transactions in its filings with the SEC.

As of this writing, Chesapeake Energy’s stock price is down 10 percent. Seems like the market agrees with this analysis.

*This essay reflects the opinion of the authors and not necessarily the opinions of The Pennsylvania State University, The American College, or Villanova University.*