

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2007 or
- - - - -
☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission File No. 1-7259



Southwest Airlines Co.

(Exact name of registrant as specified in its charter)

TEXAS

(State or other jurisdiction of
incorporation or organization)

P.O. Box 36611, Dallas, Texas
(Address of principal executive offices)

74-1563240

(IRS Employer
Identification No.)

75235-1611

(Zip Code)

Registrant's telephone number, including area code: **(214) 792-4000**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Number of shares of Common Stock outstanding as of the close of business on October 17, 2007:
734,037,983

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SOUTHWEST AIRLINES CO.
FORM 10-Q
Part I - FINANCIAL INFORMATION

Item 1. Financial Statements

Southwest Airlines Co.
Condensed Consolidated Balance Sheet
(in millions)
(unaudited)

	<u>September 30, 2007</u>	<u>December 31, 2006</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,050	\$ 1,390
Short-term investments	507	369
Accounts and other receivables	326	241
Inventories of parts and supplies, at cost	204	181
Fuel derivative contracts	697	369
Prepaid expenses and other current assets	86	51
Total current assets	<u>2,870</u>	<u>2,601</u>
Property and equipment, at cost:		
Flight equipment	12,698	11,769
Ground property and equipment	1,458	1,356
Deposits on flight equipment purchase contracts	655	734
	<u>14,811</u>	<u>13,859</u>
Less allowance for depreciation and amortization	4,144	3,765
	<u>10,667</u>	<u>10,094</u>
Other assets	987	765
	<u>\$ 14,524</u>	<u>\$ 13,460</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 735	\$ 643
Accrued liabilities	1,972	1,323
Air traffic liability	1,095	799
Current maturities of long-term debt	24	122
Total current liabilities	<u>3,826</u>	<u>2,887</u>
Long-term debt less current maturities	1,555	1,567
Deferred income taxes	2,404	2,104
Deferred gains from sale and leaseback of aircraft	110	120
Other deferred liabilities	360	333
Stockholders' equity:		
Common stock	808	808
Capital in excess of par value	1,171	1,142
Retained earnings	4,685	4,307
Accumulated other comprehensive income	723	582
Treasury stock, at cost	(1,118)	(390)
Total stockholders' equity	<u>6,269</u>	<u>6,449</u>
	<u>\$ 14,524</u>	<u>\$ 13,460</u>

See accompanying notes.

Southwest Airlines Co.
Condensed Consolidated Statement of Income
(in millions, except per share amounts)
(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
OPERATING REVENUES:				
Passenger	\$ 2,482	\$ 2,258	\$ 7,069	\$ 6,558
Freight	32	30	95	103
Other	74	54	205	149
Total operating revenues	2,588	2,342	7,369	6,810
OPERATING EXPENSES:				
Salaries, wages, and benefits	832	771	2,413	2,273
Fuel and oil	660	563	1,831	1,581
Maintenance materials and repairs	160	117	450	341
Aircraft rentals	38	39	116	119
Landing fees and other rentals	145	128	422	374
Depreciation and amortization	140	131	411	381
Other operating expenses	362	332	1,062	981
Total operating expenses	2,337	2,081	6,705	6,050
OPERATING INCOME	251	261	664	760
OTHER EXPENSES (INCOME):				
Interest expense	28	32	86	100
Capitalized interest	(13)	(12)	(39)	(38)
Interest income	(9)	(23)	(36)	(62)
Other (gains) losses, net	(32)	186	(221)	71
Total other expenses (income)	(26)	183	(210)	71
INCOME BEFORE INCOME TAXES	277	78	874	689
PROVISION FOR INCOME TAXES	115	30	341	247
NET INCOME	\$ 162	\$ 48	\$ 533	\$ 442
NET INCOME PER SHARE, BASIC				
	\$.22	\$.06	\$.70	\$.56
NET INCOME PER SHARE, DILUTED				
	\$.22	\$.06	\$.69	\$.53
WEIGHTED AVERAGE SHARES OUTSTANDING:				
Basic	739	789	765	796
Diluted	752	821	777	827

See accompanying notes.

Southwest Airlines Co.
Condensed Consolidated Statement of Cash Flows
(in millions)
(unaudited)

	Three months ended September 30, 2007	2006	Nine months ended September 30, 2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net income	\$ 162	\$ 48	\$ 533	\$ 442
Adjustments to reconcile net income to cash provided by operating activities:				
Depreciation and amortization	140	131	411	381
Deferred income taxes	105	24	272	238
Amortization of deferred gains on sale and leaseback of aircraft	(4)	(4)	(11)	(12)
Share-based compensation expense	4	20	30	66
Excess tax benefits from share-based compensation arrangements	(2)	(25)	(30)	(55)
Changes in certain assets and liabilities:				
Accounts and other receivables	(5)	3	(85)	(29)
Other current assets	(69)	121	(218)	47
Accounts payable and accrued liabilities	(144)	(744)	686	(173)
Air traffic liability	(27)	10	296	319
Other, net	(6)	97	(133)	39
Net cash provided by (used in) operating activities	154	(319)	1,751	1,263
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchases of property and equipment, net	(319)	(381)	(981)	(1,046)
Purchases of short-term investments	(1,535)	(1,277)	(3,607)	(3,348)
Proceeds from sales of short-term investments	1,538	1,319	3,469	3,245
Proceeds from ATA Airlines, Inc. debtor in possession loan	-	-	-	20
Other, net	-	-	-	1
Net cash used in investing activities	(316)	(339)	(1,119)	(1,128)
CASH FLOWS FROM FINANCING ACTIVITIES:				
Proceeds from Employee stock plans	36	90	128	226
Payments of long-term debt and capital lease obligations	(101)	(1)	(116)	(137)
Payments of cash dividends	(3)	(4)	(14)	(14)
Repurchase of common stock	(327)	(98)	(1,001)	(600)
Excess tax benefits from share-based compensation arrangements	2	25	30	55
Other, net	-	1	1	2
Net cash provided by (used in) financing activities	(393)	13	(972)	(468)
NET CHANGE IN CASH AND CASH EQUIVALENTS				
	(555)	(645)	(340)	(333)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD				
	1,605	2,592	1,390	2,280
CASH AND CASH EQUIVALENTS AT END OF PERIOD				
	\$ 1,050	\$ 1,947	\$ 1,050	\$ 1,947
CASH PAYMENTS FOR:				
Interest, net of amount capitalized	\$ 21	\$ 20	\$ 50	\$ 58
Income taxes	\$ 68	\$ 7	\$ 72	\$ 10

See accompanying notes.

Southwest Airlines Co.
Notes to Condensed Consolidated Financial Statements
(unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of Southwest Airlines Co. (Company or Southwest) have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. The unaudited condensed consolidated financial statements for the interim periods ended September 30, 2007 and 2006, include all adjustments which are, in the opinion of management, necessary for a fair presentation of the results for the interim periods. This includes all normal and recurring adjustments, but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. Financial results for the Company, and airlines in general, are seasonal in nature. Historically, the Company's second and third fiscal quarters have been more profitable than its first and fourth fiscal quarters. However, as a result of the extensive nature of the Company's fuel hedging program, the volatility of commodities used by the Company for hedging jet fuel, and the unique accounting requirements of SFAS 133, as amended, the Company has experienced significant volatility in its results in all fiscal periods. See Note 5 for further information. Operating results for the three and nine months ended September 30, 2007, are not necessarily indicative of the results that may be expected for the year ended December 31, 2007. For further information, refer to the consolidated financial statements and footnotes thereto included in the Southwest Airlines Co. Annual Report on Form 10-K for the year ended December 31, 2006.

Certain prior period amounts have been reclassified to conform to the current presentation. In the unaudited Condensed Consolidated Statement of Cash Flows for the three and nine months ended September 30, 2006, "Purchases of short-term investments" and "Proceeds from sales of short-term investments" are shown as gross amounts instead of being netted into a single line item within investing activities.

2. SHARE-BASED COMPENSATION

The Company accounts for share-based compensation in accordance with SFAS No. 123R, "Share-Based Payment," which was adopted January 1, 2006, utilizing the modified retrospective transition method.

Stock Option Plans

The Company has stock option plans covering Employees subject to collective bargaining agreements (collective bargaining plans) and stock plans covering Employees not subject to collective bargaining agreements (other Employee plans). None of the collective bargaining plans were required to be approved by Shareholders. Options granted to Employees under collective bargaining plans are non-qualified, granted at or above the fair market value of the Company's Common Stock on the date of grant, and generally have terms ranging from six to twelve years. Neither Executive Officers nor members of the Company's Board of Directors are eligible to participate in any of these collective bargaining plans. Options granted to Employees through other Employee plans are both qualified as incentive stock options under the Internal Revenue Code of 1986 and non-qualified stock options, granted at or above the fair market value of the Company's Common Stock on the date of grant, and have ten-year terms. All of the options included in the Company's definition of other Employee plans have been approved by Shareholders, except the plan covering non-management, non-contract Employees, which had options outstanding to purchase 5.2 million shares of the Company's Common Stock as of September 30, 2007. Although the Company does not have a formal policy per se, upon option exercise, the Company will typically issue Treasury stock, to the extent such shares are available.

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Vesting terms for both collective bargaining plans and other Employee plans differ based on the grant made, and have ranged in length from immediate vesting to vesting over ten years, and have also included vesting periods in accordance with the period covered by collective bargaining agreement. For grants in any of the Company's plans that are subject to graded vesting over a service period, we recognize expense on a straight-line basis over the requisite service period for the entire award. None of the Company's past grants have included performance-based or market-based vesting conditions, as defined.

The fair value of each option grant is estimated on the date of grant using a modified Black-Scholes option pricing model. The Black-Scholes option valuation model was developed for use in estimating the fair value of short-term traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of somewhat subjective assumptions including expected stock price volatility. During the three months ended September 30, 2007 and 2006, there were .1 million and .2 million stock options granted under the Company's plans related to collective bargaining agreements, respectively. The fair value of options granted under these plans during the three months ended September 30, 2007, ranged from \$1.57 to \$4.11, with a weighted-average fair value of \$3.31. The fair value of options granted under these plans during the three months ended September 30, 2006, ranged from \$2.48 to \$5.74, with a weighted-average fair value of \$4.22. During the three months ended September 30, 2007, there were .3 million stock options granted from the 2007 Equity Incentive Plan. The fair value of options granted under this plan during the three months ended September 30, 2007, was \$6.26. Stock options granted from other Employee plans during the three months ended September 30, 2006, were immaterial.

The unaudited Condensed Consolidated Statement of Income for the three months ended September 30, 2007 and 2006 reflects share-based compensation cost of \$4 million and \$20 million, respectively. The total tax benefit recognized from share-based compensation arrangements for the three months ended September 30, 2007 and 2006, was \$2 million and \$6 million, respectively. The Company currently estimates that share-based compensation expense will be approximately \$37 million for the full year 2007, before income taxes and profitsharing.

As of September 30, 2007, there was \$43 million of total unrecognized compensation cost related to share-based compensation arrangements, which is expected to be recognized over a weighted-average period of 2.2 years. The total recognition period for the remaining unrecognized compensation cost is approximately eight years; however, the majority of this cost will be recognized over the next two years, in accordance with vesting provisions.

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Employee Stock Purchase Plan

Under the amended 1991 Employee Stock Purchase Plan (ESPP), which has been approved by Shareholders, the Company is authorized to issue up to a remaining balance of 6.8 million shares of Common Stock to Employees of the Company. These shares may be issued at a price equal to 90 percent of the market value at the end of each monthly purchase period. Common Stock purchases are paid for through periodic payroll deductions. For the three months ended September 30, 2007 and 2006, participants under the ESPP purchased .3 million shares and .3 million shares at average prices of \$13.74 and \$15.55, respectively. The weighted-average fair value of each purchase right under the ESPP granted for the three months ended September 30, 2007 and 2006, which is equal to the ten percent discount from the market value of the Common Stock at the end of each monthly purchase period, was \$1.53 and \$1.73, respectively.

3. DIVIDENDS

During the three month periods ended March 31, June 30, and September 30, 2007, dividends of \$.0045 per share were declared on the 787 million shares, 764 million shares, and 738 million shares of Common Stock then outstanding, respectively. During the three month periods ended March 31, June 30, and September 30, 2006, dividends of \$.0045 per share were declared on the 803 million shares, 798 million shares, and 791 million shares of Common Stock then outstanding, respectively.

4. NET INCOME PER SHARE

The following table sets forth the computation of basic and diluted net income per share (in millions except per share amounts):

	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
NUMERATOR:				
Net income available to common stockholders	\$ 162	\$ 48	\$ 533	\$ 442
DENOMINATOR:				
Weighted-average shares outstanding, basic	739	789	765	796
Dilutive effect of Employee stock options	13	32	12	31
Adjusted weighted-average shares outstanding, diluted	752	821	777	827
NET INCOME PER SHARE:				
Basic	\$.22	\$.06	\$.70	\$.56
Diluted	\$.22	\$.06	\$.69	\$.53

5. FINANCIAL DERIVATIVE INSTRUMENTS

Fuel Contracts

Airline operators are inherently dependent upon energy to operate and, therefore, are significantly impacted by changes in jet fuel prices. Jet fuel and oil consumed for the three months ended September 30, 2007 and 2006 represented approximately 28.2 percent and 27.1 percent of Southwest's operating expenses, respectively. In both years, jet fuel costs were the second largest expense incurred by the Company, following only salaries, wages, and benefits. The Company utilizes financial derivative instruments to decrease its exposure to jet fuel price increases in its attempt to acquire jet fuel at the lowest possible cost. Because jet fuel is not traded on an organized futures exchange, liquidity for hedging is limited; however, the Company has found commodities for hedging of jet fuel costs, primarily crude oil, and refined products such as heating oil. The Company does not purchase or hold any derivative financial instruments for trading purposes.

The Company has utilized financial derivative instruments for both short-term and long-term time frames. In addition to the significant protective fuel derivative positions the Company had in place during the first nine months of 2007, the Company also has significant future positions. The Company currently has a mixture of purchased call options, collar structures, and fixed price swap agreements in place to provide protection for approximately 90 percent of its remaining 2007 total anticipated jet fuel requirements at average crude oil equivalent prices of approximately \$51 per barrel, and has also added refinery margin contracts on most of those positions. Based on current growth plans, the Company is also approximately 70 percent protected for 2008 at approximately \$51 per barrel, approximately 55 percent protected for 2009 at approximately \$51 per barrel, over 25 percent protected for 2010 at approximately \$63 per barrel, and has modest positions in 2011 and 2012.

Upon proper qualification, the Company accounts for its fuel derivative instruments as cash flow hedges, as defined in Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended (SFAS 133). Under SFAS 133, all derivatives are reflected at fair value in the Company's unaudited Condensed Consolidated Balance Sheet, and all derivatives designated as hedges that meet certain requirements are granted special hedge accounting treatment. Generally, utilizing the special hedge accounting, all periodic changes in fair value of the derivatives designated as hedges that are considered to be effective, as defined, are recorded in "Accumulated other comprehensive income" until the underlying jet fuel is consumed. See Note 6 for further information on Accumulated other comprehensive income. The Company is exposed to the risk that periodic changes will not be perfectly effective, as defined, or that the derivatives will no longer qualify for special hedge accounting. Ineffectiveness, as defined, results when the change in the fair value of the derivative instrument exceeds the change in the value of the Company's expected future cash outlay to purchase and consume jet fuel. To the extent that the periodic changes in the fair value of the derivatives exceed the change in the value of the Company's expected future cash outlay to purchase and consume jet fuel, that ineffectiveness is recorded immediately to "Other (gains) and losses, net" in the income statement. Likewise, if a hedge ceases to qualify for hedge accounting, any change in the fair value of derivative instruments since the last period is recorded to "Other (gains) and losses, net" in the income statement in the period of the change.

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The Company has utilized historical data, which is updated every quarterly reporting period to ascertain whether SFAS 133 hedge accounting is allowed for every commodity the Company uses in its hedging program. However, ineffectiveness is inherent in hedging jet fuel with derivative positions based in other crude oil related commodities, especially given the magnitude of the current fair market value of the Company's fuel derivatives and the recent volatility in the prices of refined products. In addition, since there is not a reliable forward market for jet fuel, the Company must estimate the future prices of jet fuel in order to measure the effectiveness of the hedging instruments in offsetting changes to the prices, as required by SFAS 133. Due to these reasons, the Company is unable to predict the amount of ineffectiveness each period, including the loss of hedge accounting, which could be determined on a derivative by derivative basis or in the aggregate for an entire commodity. This may result, and has resulted, in increased volatility in the Company's results. The significant increase in the amount of hedge ineffectiveness and unrealized gains and losses on derivative contracts settling in future periods recorded in recent years has been due to a number of factors. These factors included: the significant fluctuation in energy prices, the number of derivative positions the Company holds, significant weather events that have affected refinery capacity and the production of refined products, and the volatility of the different types of products the Company uses for protection. The number of instances in which the Company has discontinued hedge accounting for specific hedges has increased recently, primarily due to these reasons. In these cases, the Company has determined that the hedges will not regain effectiveness in the time period remaining until settlement and therefore must discontinue special hedge accounting, as defined by SFAS 133. In addition, the Company can no longer show that any unleaded gasoline-based derivative will be highly effective in offsetting future cash flows associated with the purchase of jet fuel, so the Company cannot utilize special hedge accounting for any unleaded gasoline-based derivatives. When the Company cannot utilize special hedge accounting, any changes in fair value of the derivative instruments are marked to market through earnings in the period of change. However, any amounts that have been recorded in "Accumulated other comprehensive income" at the time special hedge accounting is discontinued, are required to remain in "Accumulated other comprehensive income" until the time that the original forecasted transaction affects earnings (i.e., the consumption of jet fuel occurs). All cash flows associated with the purchase of derivative instruments (such as call options and collar structures) are classified as operating cash flows.

Even though derivatives may not meet the strict requirements to qualify for SFAS 133 special hedge accounting, the Company may continue to hold the instruments because it believes they continue to represent good "economic hedges" in its goal to minimize jet fuel costs. As previously mentioned, there is not a reliable forward derivatives market for jet fuel, so the Company is subject to the inherent ineffectiveness of using other commodities in hedging, which the Company believes is a better alternative than not hedging at all. As the fair value of the Company's hedge positions increases in amount, there is a higher degree of probability that there will be continued variability recorded in the income statement and that the amount of hedge ineffectiveness and unrealized gains or losses for changes in value of the derivatives recorded in future periods will be material. This is primarily due to the fact that small differences in the correlation of crude oil related products are leveraged over large dollar volumes.

Net gains and/or losses on derivatives that are effective, as defined in SFAS 133, are reflected as a component of Fuel and oil expense in the unaudited Condensed Consolidated Statement of Income. Ineffectiveness, as defined, gains and losses from derivative instruments that do not qualify for hedge accounting, and all premium costs associated with purchased option and collar contracts, are reflected in "Other (gains) losses, net." The following table presents the location of gains and/or losses on derivative instruments for the three and nine months ended September 30, 2006 and 2007.

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(In millions)	Three months ended September 30,	
	2007	2006
Fuel hedge (gains) included in Fuel and oil expense	\$ (188)	\$ (201)
Mark-to-market impact from fuel contracts settling in future periods - included in Other (gains) losses, net	(44)	123
Ineffectiveness from fuel hedges settling in future periods - included in Other (gains) losses, net	(11)	18
Realized ineffectiveness and mark-to-market (gains) or losses - included in Other (gains) losses, net	7	32
Premium cost of fuel contracts included in Other (gains) losses, net	14	13

(In millions)	Nine months ended September 30,	
	2007	2006
Fuel hedge (gains) included in Fuel and oil expense	\$ (439)	\$ (515)
Mark-to-market impact from fuel contracts settling in future periods - included in Other (gains) losses, net	(216)	18
Ineffectiveness from fuel hedges settling in future periods - included in Other (gains) losses, net	(4)	22
Realized ineffectiveness and mark-to-market (gains) or losses - included in Other (gains) losses, net	(45)	(3)
Premium cost of fuel contracts included in Other (gains) losses, net	43	37

Also, the following table presents the fair values of the Company's remaining derivative instruments, receivable amounts from settled/expired derivative contracts, and the amounts of unrealized gains, net of tax, in Accumulated other comprehensive income related to fuel hedges.

(In millions)	September 30,	December 31,
	2007	2006
Fair value of current fuel contracts (Fuel derivative contracts)	\$ 697	\$ 369
Fair value of noncurrent fuel contracts (Other assets)	848	630
Due from third parties for settled fuel contracts (Accounts and other receivables)	71	42
Net unrealized gains from fuel hedges, net of tax (Accumulated other comprehensive income)	725	584

The fair value of derivative instruments, depending on the type of instrument, was determined by the use of present value methods or standard option valuation models with assumptions about commodity prices based on those observed in underlying markets. Included in the above \$725 million net unrealized gains from fuel hedges are approximately \$339 million in net unrealized gains that are expected to be realized in earnings during the twelve months following September 30, 2007.

Interest Rate Swaps

Prior to 2007, the Company had entered into interest rate swap agreements relating to its \$350 million 5.25% senior unsecured notes due 2014 and its \$385 million 6.5% senior unsecured notes due 2012. During first quarter 2007, the Company executed interest rate swap agreements relating to its \$300 million 5.125% senior unsecured notes due 2017 and its \$100 million 7.375% senior unsecured notes due 2027. Under each of these interest rate swap agreements, the Company pays the London InterBank Offered Rate (LIBOR) plus a margin every six months on the notional amount of the debt, and receives the fixed stated rate of the notes every six months until the date the notes become due.

The Company's interest rate swap agreements qualify as fair value hedges, as defined by SFAS 133. The fair value of the interest rate swap agreements, which are adjusted regularly, are recorded in the Company's balance sheet as an asset or liability, as necessary, with a corresponding adjustment to the carrying value of the long-term debt. The fair value of the interest rate swap agreements, excluding accrued interest, at September 30, 2007, was a liability of approximately \$26 million. This entire amount is recorded in Other deferred liabilities in the unaudited Condensed Consolidated Balance Sheet. In accordance with fair value hedging, the offsetting entry is an adjustment to decrease the carrying value of long-term debt.

During 2007, the Company also entered into swap agreements to hedge the variability in interest rates on the anticipated issuance of \$500 million in Pass Through Certificates. These Pass Through Certificates were subsequently issued on October 3, 2007. The swap agreements were accounted for as cash flow hedges, and were settled, resulting in a payment by the Company of \$20 million. The effective portion of the hedge is being amortized to interest expense concurrent with the amortization of the debt. The ineffectiveness of the hedge transaction was immaterial. See Note 10 for further information on the Pass Through Certificates.

6. COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) included changes in the fair value of certain financial derivative instruments, which qualify for hedge accounting, and unrealized gains and losses on certain investments. Comprehensive income totaled \$133 million for the three months ended September 30, 2007 and comprehensive (loss) totaled \$337 million for the three months ended September 30, 2006. For the nine months ended September 30, 2007 and 2006, comprehensive income totaled \$674 million and \$269 million, respectively. The differences between net income and comprehensive income (loss) for each of these periods were as follows:

(In millions)	Three months ended September 30,	
	2007	2006
Net income	\$ 162	\$ 48
Unrealized gain (loss) on derivative instruments, net of deferred taxes of (\$18) and (\$240)	(29)	(386)
Other, net of deferred taxes of \$0 and \$1	-	1
Total other comprehensive income (loss)	(29)	(385)
Comprehensive income (loss)	\$ 133	\$ (337)

(In millions)	Nine months ended September 30,	
	2007	2006
Net income	\$ 533	\$ 442
Unrealized gain (loss) on derivative instruments, net of deferred taxes of \$87 and (\$118)	141	(175)
Other, net of deferred taxes of \$0 and \$1	-	2
Total other comprehensive income (loss)	141	(173)
Comprehensive income	\$ 674	\$ 269

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A rollforward of the amounts included in Accumulated other comprehensive income, net of taxes, is shown below:

(In millions)	Fuel hedge derivatives	Other	Accumulated other comprehensive income (loss)
Balance at June 30, 2007	\$ 754	\$ (2)	\$ 752
Third quarter 2007 changes in value	78	-	78
Reclassification to earnings	(107)	-	(107)
Balance at September 30, 2007	<u>\$ 725</u>	<u>\$ (2)</u>	<u>\$ 723</u>

(In millions)	Fuel hedge derivatives	Other	Accumulated other comprehensive income (loss)
Balance at December 31, 2006	\$ 584	\$ (2)	\$ 582
2007 changes in value	383	-	383
Reclassification to earnings	(242)	-	(242)
Balance at September 30, 2007	<u>\$ 725</u>	<u>\$ (2)</u>	<u>\$ 723</u>

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7. OTHER ASSETS AND ACCRUED LIABILITIES

(In millions)	September 30, 2007	December 31, 2006
Noncurrent fuel hedge contracts, at fair value	\$ 848	\$ 630
Other	139	135
Other assets	<u>\$ 987</u>	<u>\$ 765</u>

(In millions)	September 30, 2007	December 31, 2006
Retirement Plans	\$ 106	\$ 165
Aircraft Rentals	118	128
Vacation Pay	164	151
Advances and deposits	1,159	546
Deferred income taxes	137	78
Other accrued benefits	148	101
Other	140	154
Accrued liabilities	<u>\$ 1,972</u>	<u>\$ 1,323</u>

8. POSTRETIREMENT BENEFITS

The following table sets forth the Company's periodic postretirement benefit cost for each of the interim periods identified:

(In millions)	Three months ended September 30, 2007	2006
Service cost	\$ 4	\$ 4
Interest cost	1	1
Amortization of prior service cost	1	-
Recognized actuarial loss	-	-
Net periodic postretirement benefit cost	<u>\$ 6</u>	<u>\$ 5</u>

(In millions)	Nine months ended September 30, 2007	2006
Service cost	\$ 11	\$ 11
Interest cost	4	4
Amortization of prior service cost	2	1
Recognized actuarial loss	-	-
Net periodic postretirement benefit cost	<u>\$ 17</u>	<u>\$ 16</u>

9. PROJECT EARLY DEPARTURE

Project Early Departure was a voluntary early retirement program offered in July to eligible Employees, in which the Company offered a cash bonus of \$25,000 plus medical/dental continuation coverage and travel privileges based on eligibility.

A total of 608 out of approximately 8,500 eligible Employees elected to participate in the program. The number of Employees from each group that accepted the package is as follows: 395 from Reservations, 165 from Ground Operations, 41 from Inflight and seven from Provisioning. The participants' last day of work falls between September 30, 2007 and April 30, 2008, based on the operational needs of particular work locations and departments. The Company did not have a target or expectation for the number of Employees expected to accept the package.

Project Early Departure resulted in a pre-tax, pre-profitsharing, one-time charge of approximately \$25 million during third quarter 2007, all of which is reflected in Salaries, wages and benefits in the accompanying unaudited Condensed Consolidated Statement of Income. Approximately \$18 million remained and was classified as an accrued liability in the accompanying unaudited Condensed Consolidated Balance Sheet as of September 30, 2007. The Company anticipates that future cost savings will be approximately \$20 million annually through 2012. The Company will continue to address future staffing needs, but currently anticipates that the majority of the positions will be filled with entry-level Employees at lower wage rates to meet operational demands. The purpose of this voluntary initiative and other initiatives is to help the Company curb cost pressures, such as higher wage rates and the increase in fuel prices.

10. LONG-TERM DEBT

On September 1, 2007, the Company redeemed its \$100 million senior unsecured 7 7/8% notes on their scheduled maturity date.

On October 3, 2007, the Company issued \$500 million Pass Through Certificates consisting of \$412 million 6.15% Series A certificates and \$88 million 6.65% Series B certificates. A separate trust was established for each class of certificates. The trusts used the proceeds from the sale of certificates to acquire equipment notes, which were issued by Southwest on a full recourse basis. Payments on the equipment notes held in each trust will be passed through to the holders of certificates of such trust. The equipment notes were issued for each of 16 Boeing 737-700 aircraft owned by Southwest and are secured by a mortgage on such aircraft. Interest on the equipment notes held for the certificates is payable semi-annually, beginning February 1, 2008. Also beginning February 1, 2008, principal payments on the equipment notes held for both series of certificates are due semi-annually until the balance of the certificates mature on August 1, 2022. The Company plans to use the proceeds from the issuance of the Pass Through Certificates for general corporate purposes.

11. CONTINGENCIES

The Company is subject to various legal proceedings and claims arising in the ordinary course of business, including, but not limited to, examinations by the Internal Revenue Service (IRS). The IRS regularly examines the Company's federal income tax returns and, in the course thereof, proposes adjustments to the Company's federal income tax liability reported on such returns. It is the Company's practice to vigorously contest those proposed adjustments it deems lacking of merit.

The Company's management does not expect that the outcome in any of its currently ongoing legal proceedings or the outcome of any proposed adjustments presented to date by the IRS, individually or collectively, will result in a material adverse effect on the Company's financial condition, results of operations or cash flow.

12. RECENT ACCOUNTING PRONOUNCEMENTS

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109” (FIN 48), which clarifies the accounting and disclosure for uncertainty in tax positions, as defined. FIN 48 seeks to reduce the diversity in practice associated with certain aspects of the recognition and measurement related to accounting for income taxes. The Company is subject to the provisions of FIN 48 as of January 1, 2007, and has analyzed filing positions in all of the federal and state jurisdictions where it is required to file income tax returns, as well as all open tax years in these jurisdictions. The Company has identified its federal tax return and its state tax returns in California and Texas as “major” tax jurisdictions, as defined. The only periods subject to examination for the Company’s federal tax return are the 2005 and 2006 tax years. The periods subject to examination for the Company’s state tax returns in California and Texas are years 2002 through 2006. The Company believes that its income tax filing positions and deductions will be sustained on audit and does not anticipate any adjustments that will result in a material adverse effect on the Company’s financial condition, results of operations, or cash flow. Therefore, no reserves for uncertain income tax positions have been recorded pursuant to FIN 48. In addition, the Company did not record a cumulative effect adjustment related to the adoption of FIN 48.

The Company’s policy for recording interest and penalties associated with audits is to record such items as a component of income before taxes. Penalties are recorded in “Other (gains) losses, net,” and interest paid or received is recorded in interest expense or interest income, respectively, in the statement of income. For the nine months ended September 30, 2007, the Company recorded approximately \$1 million in interest income related to the settlement of audits for certain prior periods.

In February 2007, the FASB issued Statement No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities” (Statement 159). Statement 159 allows entities the option to measure eligible financial instruments at fair value as of specified dates. Such election, which may be applied on an instrument by instrument basis, is typically irrevocable once elected. Statement 159 is effective for fiscal years beginning after November 15, 2007, and early application is allowed under certain circumstances. The Company has not yet determined the impact this interpretation will have on our financial position.

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

Comparative Consolidated Operating Statistics

Relevant Southwest comparative operating statistics for the three and nine months ended September 30, 2007 and 2006 are as follows:

	Three months ended September 30,		
	2007	2006	Change
Revenue passengers carried	23,553,366	21,558,982	9.3%
Enplaned passengers	27,242,613	24,880,646	9.5%
Revenue passenger miles (RPMs) (000s)	19,685,690	17,767,128	10.8%
Available seat miles (ASMs) (000s)	25,715,957	23,784,615	8.1%
Load factor	76.6%	74.7%	1.9pts.
Average length of passenger haul (miles)	836	824	1.5%
Average aircraft stage length (miles)	633	625	1.3%
Trips flown	297,782	279,032	6.7%
Average passenger fare	\$105.37	\$104.75	0.6%
Passenger revenue yield per RPM (cents)	12.61	12.71	(0.8)%
Operating revenue yield per ASM (cents)	10.06	9.85	2.1%
Operating expenses per ASM (cents)	9.09	8.75	3.9%
Operating expenses per ASM, excluding fuel (cents)	6.52	6.38	2.2%
Fuel costs per gallon, excluding fuel tax	\$1.69	\$1.56	8.3%
Fuel consumed, in gallons (millions)	388	359	8.1%
Full-time equivalent Employees at period-end	33,787	32,144	5.1%
Size of fleet at period-end	511	475	7.6%

	Nine months ended September 30,		
	2007	2006	Change
Revenue passengers carried	66,956,318	62,757,726	6.7%
Enplaned passengers	77,035,110	72,202,988	6.7%
Revenue passenger miles (RPMs) (000s)	54,813,530	50,891,473	7.7%
Available seat miles (ASMs) (000s)	74,377,009	68,748,057	8.2%
Load factor	73.7%	74.0%	(.3)pts.
Average length of passenger haul (miles)	819	811	1.0%
Average aircraft stage length (miles)	630	620	1.6%
Trips flown	865,329	812,428	6.5%
Average passenger fare	\$105.57	\$104.50	1.0%
Passenger revenue yield per RPM (cents)	12.90	12.89	0.1%
Operating revenue yield per ASM (cents)	9.91	9.91	0.0%
Operating expenses per ASM (cents)	9.01	8.80	2.4%
Operating expenses per ASM, excluding fuel (cents)	6.55	6.50	0.8%
Fuel costs per gallon, excluding fuel tax	\$1.64	\$1.53	7.2%
Fuel consumed, in gallons (millions)	1,114	1,032	7.9%
Full-time equivalent Employees at period-end	33,787	32,144	5.1%
Size of fleet at period-end	511	475	7.6%

Material Changes in Results of Operations

Summary

The Company's third quarter 2007 net income of \$162 million (\$.22 per share, diluted), represented the Company's 66th consecutive quarterly profit and compared favorably to the Company's third quarter 2006 profit of \$48 million (\$.06 per share, diluted). Both third quarter 2007 and third quarter 2006 had significant adjustments related to derivative contracts the Company utilizes in attempting to hedge against jet fuel price increases. In third quarter 2007, forward prices for the derivatives Southwest uses for hedging purposes increased, resulting in unrealized gains related to the higher fair values of these contracts, and in third quarter 2006, forward prices had decreased, resulting in the recording of significant unrealized losses related to the lower fair values of these contracts. Primarily as a result of the third quarter 2007 rise in prices for fuel derivatives that will settle in future periods or that were ineffective, as defined, or that did not qualify for special hedge accounting, the Company recorded \$48 million in net gains, which are included in "Other (gains) losses, net." In third quarter 2006, the Company recorded a total of \$173 million in losses associated with fuel derivatives that were ineffective, as defined, or did not qualify for special hedge accounting. See Note 5 to the unaudited condensed consolidated financial statements for further information on the Company's hedging activities.

Third quarter 2007 operating income decreased \$10 million, or 3.8 percent, compared to third quarter 2006, as an increase in operating expenses outpaced an increase in operating revenues. Due to the significant unrealized adjustments recorded to "Other (gains) losses, net," which is below the operating income line, the Company believes operating income provides a better indication of the Company's financial performance in both years than does net income. Although the Company's fuel hedging program has resulted in significant unrealized gains and losses being recorded to "Other (gains) losses, net" for several years, it also continues to provide excellent economic benefits to the Company. Even with a less favorable fuel hedge position in 2007 versus 2006, our hedging program resulted in the realization of approximately \$189 million in cash settlements for third quarter 2007 compared to \$200 million in cash settlements for third quarter 2006. The majority of the \$189 million in third quarter 2007 cash settlements were reflected as a reduction to Fuel and oil expense. Even including this third quarter 2007 hedge position, fuel cost per gallon increased 8.3 percent versus third quarter 2006.

The decrease in operating income was primarily due to the fact that operating expenses grew 12.3 percent, while operating revenues grew only 10.5 percent. The increase in operating expenses included a \$25 million charge associated with an early retirement program taken by over 600 Employees during third quarter 2007, higher fuel costs, and higher maintenance expenses. Excluding the \$25 million early retirement charge, net of profitsharing, third quarter 2007 operating income would have moderately exceeded the prior year. Although the Company achieved a higher passenger load factor in third quarter 2007 versus 2006, RPM yields (passenger revenues divided by revenue passenger miles) declined .8 percent as passengers paid less to fly on a per mile basis. This was primarily due to the fact that the higher load factors resulted from strong demand for low fares.

For the nine months ended September 30, 2007, net income increased 20.6 percent to \$533 million (\$.69 per share, diluted), compared to net income of \$442 million (\$.53 per share, diluted) for the same 2006 period. Results in both years were significantly impacted by gains associated with fuel derivatives that did not qualify for special hedge accounting, as well as ineffectiveness associated with hedges, as defined. For the nine months ended September 30, 2007, these gains and hedge ineffectiveness totaled \$265 million compared to losses of \$37 million for the first nine months of 2006. Operating income, which excludes these items, was \$664 million for the nine months ended September 30, 2007, a decrease of 12.6 percent compared to the prior year. Operating expenses grew 10.8 percent, led by a 32.0 percent increase in maintenance expense and a 15.8 percent increase in fuel expense, while operating revenues grew 8.2 percent compared to the first nine months of 2006.

The early retirement program that was offered by the Company and accepted by more than 600 Employees during third quarter 2007 is one of many efforts underway in an attempt to improve the Company's future profitability. Although the program resulted in a one-time \$25 million charge to salaries, wages and benefits in third quarter 2007, the Company expects savings in excess of \$20 million per year over the next several years, as those Employees will be replaced by workers with lower initial wage rates. See Note 9 to the unaudited condensed consolidated financial statements for further information on this program. The Company has also outlined several initiatives that are designed to improve future revenues and enhance Customer Service, some of which have been recently announced. For example, the Company's new Customer boarding method for flights is designed to significantly reduce the average time a Customer spends waiting in line at the gate, while retaining the Company's famous open seating policy once aboard the aircraft. The new boarding method is scheduled to be implemented systemwide November 8, 2007, and allows for future enhancements such as product customization and additional incentives for the business and leisure traveler. In October 2007, the Company also announced an updated gate design to enhance the airport experience for Customers, to be installed at all 64 airports served by the Company. This "gate makeover" is scheduled for completion during mid-year 2008. Other items the Company intends to roll out in the near future include: introduction of an enhanced fare structure and Rapid Rewards frequent flyer program in fourth quarter 2007; launch of a new advertising campaign; and the expansion of our GDS (Global Distribution System) and corporate travel account efforts through agreements with Travelport's Galileo and Worldspan. In connection with and in support of these initiatives, the Company also intends to implement significant technology enhancements.

Based on our current forecast, the Company expects fourth quarter 2007 capacity to grow approximately five to six percent versus fourth quarter 2006. The Company will receive nine new Boeing 737-700 aircraft deliveries in fourth quarter 2007. The Company also anticipates a six percent available seat mile growth for 2008, based upon the planned delivery of 29 Boeing 737-700 aircraft, less the retirement and/or sale of at least ten existing aircraft, bringing 2008 planned additions to no more than 19 net aircraft. The Company's unit revenue trends improved throughout third quarter 2007 and we currently expect those trends to continue into fourth quarter 2007. Current bookings for fourth quarter 2007 are solid and Passenger revenue per ASM is currently expected to be up approximately 3 percent versus fourth quarter 2006. In addition, based on these revenue trends, bookings, and planned revenue initiatives and barring a slowdown in the domestic economy, we expect fourth quarter 2007 operating unit revenues to exceed year ago levels.

Comparison of three months ended September 30, 2007, to three months ended September 30, 2006

Revenues

Consolidated operating revenues increased by \$246 million, or 10.5 percent, primarily due to a \$224 million, or 9.9 percent, increase in Passenger revenues. The increase in Passenger revenues was primarily attributable to the 8.1 percent increase in capacity, as the Company added 36 aircraft since the end of third quarter 2006 (and had no aircraft retirements). The increase in Passenger revenues compared to capacity was primarily due to a higher load factor, as average fares were comparable to the same prior year period. The Company's third quarter 2007 load factor increased 1.9 points versus third quarter 2006 and represented a Company record for the quarter at 76.6 percent. As a result of this higher load factor, Passenger revenues per available seat mile also increased 1.7 percent compared to third quarter 2006. However, RPM yields (Passenger revenues divided by revenue passenger miles) declined .8 percent due to a higher mix of discounted fares in third quarter 2007.

Consolidated freight revenues increased by \$2 million, or 6.7 percent, primarily as a result of higher rates charged. The Company expects a comparable increase in consolidated freight revenues for fourth quarter 2007 compared to fourth quarter 2006. Other revenues increased by \$20 million, or 37.0 percent, compared to third quarter 2006, primarily due to higher commissions earned from programs the Company sponsors with certain business partners, such as the Company sponsored co-branded Visa card. This included a new long term agreement signed with a business partner during second quarter 2007, which resulted in higher rates and certain incentives that the Company had not received in previous agreements for our co-branded Visa card. The Company expects a year-over-year increase in Other revenues for fourth quarter 2007, although at a lower rate than experienced in third quarter 2007.

Operating expenses

To a large extent, changes in operating expenses for airlines are driven by changes in capacity, or ASMs. The following presents Southwest's operating expenses per ASM for the three months ended September 30, 2007 and 2006, followed by explanations of changes on a per-ASM basis and/or on a dollar basis, when appropriate (in cents, except for percentages):

	Three months ended September 30, 2007	2006	Per ASM Change	Percent Change
Salaries, wages, and benefits	3.23	3.24	(.01)	(.3)
Fuel and oil	2.57	2.37	.20	8.4
Maintenance materials and repairs	.62	.49	.13	26.5
Aircraft rentals	.15	.16	(.01)	(6.3)
Landing fees and other rentals	.57	.54	.03	5.6
Depreciation	.54	.55	(.01)	(1.8)
Other operating expenses	1.41	1.40	.01	.7
Total	9.09	8.75	.34	3.9

Operating expenses per ASM were 9.09 cents, a 3.9 percent increase compared to 8.75 cents for third quarter 2006. Over 55 percent of the increase per ASM was due to higher fuel costs, as the Company's average cost per gallon of fuel increased 8.3 percent versus the prior year, net of hedging. Approximately 35 percent of the increase per ASM was due to higher maintenance materials and repairs expense, as a result of an increase in the cost and number of both engine and airframe repair events. The remainder of the increase was primarily due to the \$25 million charge related to the Company's early retirement program during third quarter 2007; however, this was mostly offset in Salaries, wages and benefits by lower share-based compensation and lower profitsharing expense. Excluding fuel, year-over-year CASM increased 2.2 percent to 6.52 cents, primarily due to the increase in maintenance costs. Based on current unit operating cost trends and various cost pressures, the Company expects fourth quarter 2007 unit costs, excluding fuel, to be higher than third quarter 2007's 6.52 cents per ASM, primarily due to higher expected advertising costs, higher airport costs, higher fuel taxes, and expense associated with the Company's aforementioned "gate makeover." The Company currently expects to spend a total of approximately \$30 million to \$40 million on its "gate makeover" project, the majority of which is expected to be capitalized; however, portions of the project are not expected to be eligible for capitalization and will be immediately expensed during the period they are incurred. For fourth quarter 2007, the Company expects this expense to be approximately \$5 million. The Company's decision to slow its growth in fourth quarter 2007 is negatively impacting unit cost trends. Our fourth quarter 2007 flight schedule, which had been set before the decision to reduce capacity growth, is not optimized and the Company is incurring costs related to excess capacity that cannot be eliminated until January 2008.

Salaries, wages, and benefits expense per ASM declined slightly compared to third quarter 2006, but on a dollar basis increased \$61 million. Both figures included the impact of the one-time \$25 million charge in third quarter 2007 associated with the early retirement program offered by the Company. Excluding this charge, on a per-ASM basis, the Company would have experienced a larger decrease in Salaries, wages and benefits, as a result of lower share-based compensation expense and lower profitsharing expense versus third quarter 2006. The Company's profitsharing contributions are based on income before taxes excluding primarily unrealized gains and losses from fuel derivative contracts. See Note 2 to the unaudited condensed consolidated financial statements for further information on share-based compensation. On a dollar basis, excluding the one-time \$25 million third quarter 2007 charge (net of related profitsharing savings of \$4 million), the remaining \$40 million increase in Salaries, wages and benefits was primarily due to higher wages from a 5.1 percent increase in headcount, partially offset by lower share-based compensation expense. The Company currently expects Salaries, wages, and benefits per ASM in fourth quarter 2007 to be lower than the 3.26 cents reported in fourth quarter 2006, primarily due to lower share-based compensation expense.

Fuel and oil expense increased \$97 million, and on a per ASM basis increased 8.4 percent, primarily due to a weaker hedge position held by the Company in third quarter 2007 versus third quarter 2006 as well as higher average prices, excluding hedging. In third quarter 2007, the Company held fuel derivative instruments that were at higher average crude oil-equivalent prices than in third quarter 2006. The Company's average fuel cost per gallon in third quarter 2007 was \$1.69, which is 8.3 percent higher than third quarter 2006, including the effects of hedging activities. Excluding hedging, the Company's average fuel cost per gallon in third quarter 2007 was \$2.18 versus \$2.12 in third quarter 2006. For third quarter 2007, the Company had protected over 90 percent of its anticipated fuel needs at a crude oil-equivalent price of approximately \$51 per barrel, resulting in gains recorded in Fuel and oil expense of \$188 million. Third quarter 2006 hedging gains recorded in Fuel and oil expense were \$201 million.

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For fourth quarter 2007, the Company has fuel derivatives in place for approximately 90 percent of its expected fuel consumption with a combination of derivative instruments that effectively cap prices at approximately \$51 per barrel of crude oil and has added refinery margins on the majority of those positions. Based on this protection and current market prices, we are currently estimating our fourth quarter 2007 jet fuel cost per gallon to be in the \$1.80 range. The majority of the Company's near term fuel derivatives are in the form of option contracts. At September 30, 2007, the estimated net fair value of the Company's fuel derivative contracts was \$1.5 billion. See Note 5 to the unaudited condensed consolidated financial statements for further discussion of the Company's hedging activities. The Company has also continued its efforts to conserve fuel, and in 2007 began installing Aviation Partners Boeing Blended Winglets on a significant number of its 737-300 aircraft (substantially all 737-700 aircraft are already equipped with winglets). Installations have begun on these 737-300 aircraft and are expected to be completed in late 2008 or early 2009.

Maintenance materials and repairs per ASM increased 26.5 percent, and on a dollar basis increased \$43 million compared to third quarter 2006. Approximately half of the increase per ASM was a result of higher engine expense related to the Company's 737-700 aircraft, as the number of scheduled overhaul events for these aircraft engines was significantly higher than the same prior year period. This is primarily due to the maturing of these aircraft, which make up the majority of the Company's fleet. The majority of the remainder of the increase per ASM was in airframe expense as the Company also completed significantly more planned airframe inspection and repair events than in the prior year. These airframe inspection events, which are required based on the number of flight hours each individual aircraft has flown, were higher in number as well as cost per event. This increase in airframe maintenance is due to the maturing of the Company's fleet as well as the ongoing transition to a new airframe maintenance program for 737-300 and 737-500 aircraft, which began in 2006. This transition is expected to have an impact on maintenance expense for the next two to three years; however, the Company does not expect these higher airframe costs to be a long-term trend. The Company currently expects Maintenance materials and repairs per ASM for fourth quarter 2007 to be comparable to third quarter 2007's .62 cents.

Aircraft rentals per ASM decreased 6.3 percent compared to third quarter 2006, and on a dollar basis, expense decreased \$1 million. The decrease per ASM was primarily due to the 8.1 percent increase in ASMs, combined with the slight reduction in expense on a dollar basis. The Company currently expects Aircraft rentals per ASM for fourth quarter 2007 to be at approximately the same level as fourth quarter 2006.

Landing fees and other rentals increased \$17 million on a dollar basis, and on a per ASM basis increased 5.6 percent compared to third quarter 2006. The majority of the increases on both a dollar basis and a per ASM basis were due to higher space rentals in airports. These higher rentals were a result of both space increases by the Company to accommodate new flight activity and higher rates charged by those airports for gate and terminal space. The Company currently expects Landing fees and other rentals per ASM in fourth quarter 2007 to be higher than the .57 cents per ASM in third quarter 2007, primarily due to the same reasons noted above for third quarter 2007, combined with credits received as a result of airports' audits of prior periods during third quarter 2007 that are not currently expected to be repeated during fourth quarter 2007.

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Depreciation expenses per ASM declined slightly compared to third quarter 2006 but increased by \$9 million on a dollar basis. The increase on a dollar basis was primarily due to the Company's addition of 36 Boeing 737-700's to its fleet over the past twelve months, of which 34 were purchased. For fourth quarter 2007, the Company expects Depreciation expenses per ASM to be comparable to fourth quarter 2006's .56 cents.

Other operating expenses per ASM increased slightly compared to third quarter 2006's performance of 1.40 cents. On a dollar basis, other operating expenses increased \$30 million. The largest single items contributing to this dollar increase were identical \$6 million increases in personnel expenses and credit card transaction fees associated with the increase in revenues. For fourth quarter 2007, the Company currently expects Other operating expenses per ASM to be in the 1.50 cent range.

Through the 2003 Emergency Wartime Supplemental Appropriations Act, the federal government has continued to provide renewable, supplemental, first-party war-risk insurance coverage to commercial carriers, at substantially lower premiums than prevailing commercial rates and for levels of coverage not available in the commercial market. The government-provided supplemental coverage from the Wartime Act is currently set to expire on December 31, 2007. Although another extension beyond this date is expected, if such coverage is not extended by the government, the Company could incur substantially higher insurance costs or unavailability of adequate coverage in future periods.

Other

Interest expense decreased \$4 million, or 12.5 percent, compared to third quarter 2006. An increase in market interest rates was more than offset by a lower debt balance outstanding. The majority of the Company's long-term debt is at floating rates. See Notes 5 and 10 to the unaudited condensed consolidated financial statements for more information.

Capitalized interest increased \$1 million compared to the prior year primarily due to a slight increase in progress payment balances for scheduled future aircraft deliveries.

Interest income decreased by \$14 million, or 60.9 percent, primarily due to a decrease in the average balance of invested cash and short-term investments.

Other (gains) losses, net, primarily includes amounts recorded in accordance with the Company's hedging activities and SFAS 133. The following table displays the components of Other (gains) losses, net, for the three months ended September 30, 2007 and 2006:

(In millions)	Three months ended September 30,	
	2007	2006
Mark-to-market impact from fuel contracts settling in future periods - included in Other (gains) losses, net	\$ (44)	\$ 123
Ineffectiveness from fuel hedges settling in future periods - included in Other (gains) losses, net	(11)	18
Realized ineffectiveness and mark-to-market (gains) or losses - included in Other (gains) losses, net	7	32
Premium cost of fuel contracts included in Other (gains) losses, net	14	13
Other	2	-
	<u>\$ (32)</u>	<u>\$ 186</u>

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For the expense related to amounts excluded from the Company's measurements of hedge effectiveness (i.e., the premium cost of option and collar derivative contracts that settled during third quarter 2007), the Company expects a similar expense relating to these items in fourth quarter 2007.

The Company's effective tax rate was 41.5 percent in third quarter 2007 compared to 38.9 percent in third quarter 2006. The higher rate in third quarter 2007 was primarily due to a state of Illinois tax law change during third quarter 2007 that resulted in a net \$11 million (\$.01 per share, diluted) increase to state deferred tax liabilities that is recorded in third quarter 2007 tax expense. As a result of this law change, the Company currently expects its full year 2007 effective rate to be approximately 39 percent.

Comparison of nine months ended September 30, 2007, to nine months ended September 30, 2006

Revenues

Consolidated operating revenues increased by \$559 million, or 8.2 percent, primarily due to a \$511 million, or 7.8 percent, increase in Passenger revenues. The increase in Passenger revenues was primarily attributable to the 8.2 percent increase in capacity, as the Company added 36 aircraft since September 30, 2006 (and had no aircraft retirements). The increase in capacity was partially offset, however, by a slightly lower load factor compared to the nine months ended September 30, 2006. The 2007 load factor was 73.7 percent, compared to 74.0 percent for the nine months ended September 30, 2006. Passenger yield per RPM was basically flat versus the nine months ended September 30, 2006, as modest fare increases taken were mostly offset by a higher mix of discounted tickets flown during the first nine months of 2007. Passenger revenue per ASM was also flat compared to the same prior year period.

Consolidated freight revenues decreased by \$8 million, or 7.8 percent, primarily as a result of the Company's decision to discontinue the carrying of mail for the U.S. Postal Service effective as of June 30, 2006. Therefore, the Company had a \$14 million shortfall in mail revenues versus the nine months ended September 30, 2006. This decrease was partially offset by higher freight and cargo revenues, primarily as a result of higher rates charged. Other revenues increased by \$56 million, or 37.6 percent, compared to 2006. The increase was primarily due to higher commissions and incentives earned from programs the Company sponsors with certain business partners, such as the Company sponsored co-branded Visa card.

Operating expenses

To a large extent, changes in operating expenses for airlines are driven by changes in capacity, or ASMs. The following presents Southwest's operating expenses per ASM for the nine months ended September 30, 2007 and 2006, followed by explanations of changes on a per-ASM basis and/or on a dollar basis, when appropriate (in cents, except for percentages):

	Nine months ended September 30, 2007	2006	Per ASM Change	Percent Change
Salaries, wages, and benefits	3.24	3.31	(.07)	(2.1)
Fuel and oil	2.46	2.30	.16	7.0
Maintenance materials and repairs	.60	.50	.10	20.0
Aircraft rentals	.16	.17	(.01)	(5.9)
Landing fees and other rentals	.57	.54	.03	5.6
Depreciation	.55	.55	-	-
Other operating expenses	1.43	1.43	-	-
Total	9.01	8.80	.21	2.4

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Operating expenses per ASM were 9.01 cents, a 2.4 percent increase compared to 8.80 cents for the nine months ended September 30, 2006. Higher fuel expense per ASM from a higher price per gallon of jet fuel, net of hedging, and higher maintenance expense per ASM were partially offset by a decline in salaries, wages and benefits per ASM. Excluding fuel, year-over-year CASM increased .8 percent.

Salaries, wages, and benefits expense per ASM decreased 2.1 percent compared to the nine months ended September 30, 2006, including the impact of the one-time \$25 million charge in third quarter 2007 associated with the early retirement program offered by the Company. Excluding the impact of this charge, the decrease was larger primarily due to lower profitsharing expense and lower share-based compensation expense, partially offset by an increase in wage rates. The Company's profitsharing contributions are based on income before taxes excluding primarily unrealized gains and losses from fuel derivative contracts. Excluding these items from both years resulted in a 21.8 percent decrease in profitsharing contributions for the first nine months of 2007. On a dollar basis, salaries, wages, and benefits expense increased \$140 million. Excluding the one-time charge of \$25 million in 2007, the remainder of the change included a \$159 million salary increase, primarily due to higher wages from a 5.1 percent increase in headcount, and a \$22 million benefits increase (excluding profitsharing and share-based compensation). These increases were partially offset by a \$30 million decrease in profitsharing expense, due to less income available for profitsharing, and a \$36 million decrease in share-based compensation expense, primarily due to a greater number of Employee stock options becoming vested in 2006 versus 2007. See Note 2 to the unaudited condensed consolidated financial statements for further information on share-based compensation.

Fuel and oil expense increased \$250 million, and on a per ASM basis increased 7.0 percent, primarily due to a weaker hedge position held by the Company in 2007 versus 2006. In the first nine months of 2007, the Company held fuel derivative instruments that were at higher average crude oil-equivalent prices than in 2006. The Company's average fuel cost per gallon for the nine months ended September 30, 2007, was \$1.64, which was 7.2 percent higher than the same 2006 period, including the effects of hedging activities. Excluding hedging gains in both years, the Company's average jet fuel cost per gallon for the nine months ended September 30, 2007, and for the nine months ended September 30, 2006, was \$2.03 for each period. For the first nine months of 2007, the Company had protected against over 90 percent of its anticipated fuel needs at a crude oil-equivalent price of approximately \$50 per barrel, resulting in gains recorded in Fuel and oil expense of \$439 million. During the first nine months of 2006, hedging gains recorded in Fuel and oil expense were \$515 million.

Maintenance materials and repairs per ASM increased 20.0 percent compared to the first nine months of 2006, and increased \$109 million on a dollar basis. The majority of the increase on both a dollar basis and per ASM, was a result of higher airframe expense as the Company completed significantly more planned airframe inspection and repair events than in the prior year. These airframe inspection events, which are required based on the number of flight hours each individual aircraft has flown, were higher in number as well as cost per event, and were partially due to the ongoing transition to a new airframe maintenance program for 737-300 and 737-500 aircraft which began in 2006.

Landing fees and other rentals increased \$48 million on a dollar basis, and increased 5.6 percent on a per ASM basis compared to the first nine months of 2006, primarily from an increase in other rentals per ASM. This increase per ASM was primarily due to higher rates at certain airports and an increase in airport space in locations in which the Company has increased the number of flights offered.

Other operating expenses increased \$81 million, but was flat per ASM compared to the nine months ended September 30, 2006. On a dollar basis, approximately 20 percent of the increase was due to higher credit card fees associated with the increase in revenues, and another 20 percent was related to higher personnel expenses associated with flight crews, such as hotel and meal costs.

Other

Interest expense decreased \$14 million, or 14.0 percent, compared to the first nine months of 2006. An increase in interest rates was more than offset by a lower debt balance outstanding. The majority of the Company's long-term debt is at floating rates. See Notes 5 and 10 to the unaudited condensed consolidated financial statements for more information.

Capitalized interest increased \$1 million, or 2.6 percent, compared to the prior year, primarily due to a slight increase in the balances that qualify for interest capitalization—primarily progress payments made for future aircraft deliveries.

Interest income decreased by \$26 million, or 41.9 percent, primarily due to a decrease in invested cash and short-term investments.

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Other (gains) losses, net, primarily includes amounts recorded in accordance with the Company's hedging activities and SFAS 133. The following table displays the components of Other (gains) losses, net for the nine months ended September 30, 2007 and 2006:

(In millions)	Nine months ended September 30,	
	2007	2006
Mark-to-market impact from fuel contracts settling in future periods - included in Other (gains) losses, net	\$ (216)	\$ 18
Ineffectiveness from fuel hedges settling in future periods - included in Other (gains) losses, net	(4)	22
Realized ineffectiveness and mark-to-market (gains) or losses - included in Other (gains) losses, net	(45)	(3)
Premium cost of fuel contracts included in Other (gains) losses, net	43	37
Other	1	(3)
	\$ (221)	\$ 71

The Company's effective tax rate was 39.0 percent in the first nine months of 2007 compared to 35.9 percent in the same 2006 period. The lower rate in 2006 was primarily due to a \$13 million net reduction related to a revision in the State of Texas franchise tax law enacted during 2006. The 2007 rate also included an \$11 million (\$.01 per share, diluted) net addition related to a revision in the Illinois income tax laws enacted in 2007.

Liquidity and Capital Resources

Net cash provided by operating activities was \$154 million for the three months ended September 30, 2007, compared to \$319 million used in operating activities in the same prior year period. For the nine months ended September 30, 2007, net cash provided by operating activities was \$1.8 billion, compared to \$1.3 billion provided by operating activities in the prior year. The operating cash flows through September 30 in both years were largely impacted by fluctuations in counterparty deposits associated with the Company's fuel hedging program. There was an increase in counterparty deposits of \$600 million for the nine months ended September 30, 2007, versus a decrease of \$270 million during the nine months ended September 30, 2006 (counterparty deposits are classified in Accrued liabilities in the unaudited Condensed Consolidated Balance Sheet). The fluctuations in these deposits in both years has been due to large changes in the fair value of the Company's fuel derivatives portfolio. The fair value of the Company's fuel derivatives increased from \$1.0 billion at December 31, 2006, to \$1.5 billion at September 30, 2007, but decreased from \$1.7 billion at December 31, 2005, to \$1.3 billion at September 30, 2006. See Item 3, and Notes 5 and 7 to the unaudited condensed consolidated financial statements. The 2007 increase in counterparty deposits was partially offset by smaller decreases in cash flows within several items, such as Other current assets, Other noncurrent assets and liabilities (classified as "Other" in the unaudited Condensed Consolidated Statement of Cash Flows), and Accounts receivable. Cash flows from operating activities for both years were also impacted by changes in Air traffic liability as well as net income. For the nine months ended September 30, 2007, there was a \$296 million increase in Air traffic liability, as a result of seasonal bookings for future travel, and the Company achieved net income of \$533 million. These amounts were comparable to the prior year \$319 million increase in Air traffic liability and net income of \$442 million. Net cash provided by operating activities is primarily used to finance capital expenditures.

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Net cash flows used in investing activities during the three months ended September 30, 2007, totaled \$316 million compared to \$339 million in 2006. For the nine months ended September 30, 2007, net cash flows used in investing activities was \$1.1 billion, the same as the comparable 2006 period. Investing activities in both years consisted primarily of payments for new 737-700 aircraft delivered to the Company and progress payments for future aircraft deliveries. In addition, investing activities for both periods were impacted by changes in the balance of the Company's short-term investments, namely auction rate securities. During the nine months ended September 30, 2007, the Company's short-term investments increased by a net \$138 million, versus a net increase of \$103 million during the same prior year period.

Net cash used in financing activities during the three months ended September 30, 2007, was \$393 million compared to \$13 million provided by financing activities for the same period in 2006. For the nine months ended September 30, 2007, net cash used in financing activities was \$972 million, compared to \$468 million for the same 2006 period. During the nine months ended September 30, 2007, the Company repurchased \$1.0 billion of its Common Stock, representing a total of 66.4 million shares, and repaid a total of \$116 million in long-term debt and capital lease obligations, including the Company's \$100 million senior unsecured 7 7/8% notes in September 2007. These outflows were partially offset by \$128 million received from Employees' exercise of stock options. For the nine months ended September 30, 2006, the Company repurchased \$600 million of its Common Stock and repaid \$137 million in debt and capital lease obligations, which were partially offset by \$226 million received from Employees' exercise of stock options.

Contractual Obligations and Contingent Liabilities and Commitments

Southwest has contractual obligations and commitments primarily for future purchases of aircraft, payment of debt, and lease arrangements. Through the first nine months of 2007, the Company purchased 28 new 737-700 aircraft from Boeing and leased an additional two previously owned 737-700 aircraft from a third party. In addition, the Company will receive nine more 737-700 aircraft from Boeing during fourth quarter 2007. The Company also currently expects its fleet to grow by no more than 19 net aircraft during 2008. Southwest's firm orders and options to purchase Boeing 737-700 aircraft are reflected in the following table:

	The Boeing Company			Other	Total
	Firm	Options	Purchase Rights	Previously Owned	
2007	37			2	39*
2008	29				29**
2009	18	10			28
2010	10	24			34
2011	10	22			32
2012	10	30			40
2013	19				19
2014	10				10
Through 2014	-	-	54		54
Total	143	86	54	2	285

* 2007 delivery dates: eight in first quarter, eleven in second quarter, eleven in third quarter and nine in fourth quarter.

** The Company currently plans to reduce its fleet in 2008 by at least 10 aircraft, bringing 2008 planned net additions to no more than 19 aircraft.

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The following table details information on the 511 aircraft in the Company's fleet as of September 30, 2007:

737 Type	Seats	Average Age (Yrs)	Number of Aircraft	Number Owned	Number Leased
-300	137	16.4	194	112	82
-500	122	16.4	25	16	9
-700	137	4.1	292	288	4
TOTALS		9.4	511	416	95

The Company has the option, which must be exercised two years prior to the contractual delivery date, to substitute -600s or -800s for the -700s. Based on the above delivery schedule, aggregate funding needed for firm aircraft commitments was approximately \$3.4 billion, subject to adjustments for inflation, due as follows: \$232 million remaining in 2007, \$735 million in 2008, \$467 million in 2009, \$341 million in 2010, \$444 million in 2011, \$458 million in 2012, \$487 million in 2013 and \$197 million thereafter.

The Company has various options available to meet its capital and operating commitments, including cash on hand and short term investments at September 30, 2007, of \$1.6 billion, internally generated funds, and the Company's fully available \$600 million revolving credit facility. As discussed in Note 10 to the unaudited condensed consolidated financial statements, on October 3, 2007, the Company issued \$500 million Pass Through Certificates consisting of \$412 million 6.15% Series A certificates and \$88 million 6.65% Series B certificates. The Company will also consider various borrowing or leasing options to maximize earnings and supplement cash requirements.

In May 2007, the Company's Board of Directors authorized the repurchase of up to \$500 million of the Company's Common Stock. This program was completed during third quarter 2007, resulting in the repurchase of 32.9 million shares. See Item 2 of Part II of this filing for further information on this repurchase program.

The Company currently has outstanding shelf registrations for the issuance of up to \$540 million in public debt securities and pass-through certificates, which it may utilize for aircraft financings or other purposes in the future.

Forward looking statements

Some statements in this Form 10-Q (or otherwise made by the Company or on the Company's behalf from time to time in other reports, filings with the Securities and Exchange Commission, news releases, conferences, World Wide Web postings or otherwise) which are not historical facts may be "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995. Forward-looking statements are based on, and include statements about, Southwest's estimates, expectations, beliefs, intentions, or strategies for the future, and the assumptions underlying these forward-looking statements. Specific forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts and include, without limitation, statements related to the following: our expectations with respect to revenues and operating expenses; our growth expectations; our liquidity, including our anticipated needs for, and sources of, funds; our initiatives and strategies to improve revenues and control costs, including, without limitation, the anticipated impact of Project Early Departure; our plans and expectations for managing exposure to material increases in jet fuel prices; and our expectations and intentions relating to outstanding litigation. Forward-looking statements are not guarantees of future performance and involve risks and uncertainties that are difficult to predict. Therefore, actual results may differ materially from what is expressed in or indicated by Southwest's forward-looking statements or from historical experience or the Company's present expectations. These factors include, among others:

- (i) the price and availability of aircraft fuel;
- (ii) our ability to timely and effectively prioritize our revenue and cost reduction initiatives and our related ability to timely and effectively implement and maintain the necessary information technology systems and infrastructure to support these initiatives;
- (iii) the extent and timing of our investment of incremental operating expenses and capital expenditures to develop and implement our initiatives and our corresponding ability to effectively control our operating expenses;
- (iv) our dependence on third party arrangements to assist with implementation of certain of our initiatives;
- (v) the impact of governmental regulations on our operating costs, as well as our operations generally;
- (vi) the impact of certain pending technological initiatives in the Company's technology infrastructure, including its point of sale, ticketing, revenue accounting, payroll and financial reporting areas;
- (vii) competitor capacity and load factors; and
- (viii) other factors as set forth in our filings with the Securities and Exchange Commission, including the detailed factors discussed under the heading "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2006.

Caution should be taken not to place undue reliance on the Company's forward-looking statements, which represent the Company's views only as of the date this report is filed. The Company undertakes no obligation to update publicly or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As discussed in Note 5 to the unaudited condensed consolidated financial statements, the Company utilizes financial derivative instruments to hedge its exposure to material increases in jet fuel prices. During the first nine months of 2007, the fair values of the Company's fuel derivative contracts increased significantly. At September 30, 2007, the estimated gross fair value of outstanding contracts was \$1.5 billion, compared to \$1.0 billion at December 31, 2006.

Outstanding financial derivative instruments expose the Company to credit loss in the event of nonperformance by the counterparties to the agreements. However, the Company does not expect any of the counterparties to fail to meet their obligations. The credit exposure related to these financial instruments is represented by the fair value of contracts with a positive fair value at the reporting date. To manage credit risk, the Company selects and periodically reviews counterparties based on credit ratings, limits its exposure to a single counterparty, and monitors the market position of the program and its relative market position with each counterparty. At September 30, 2007, the Company had agreements with eight counterparties containing early termination rights and/or bilateral collateral provisions whereby security is required if market risk exposure exceeds a specified threshold amount or credit ratings fall below certain levels. At September 30, 2007, the Company held \$1.1 billion in fuel derivative related cash collateral deposits under these bilateral collateral provisions. These collateral deposits serve to decrease, but not totally eliminate, the credit risk associated with the Company's hedging program. The cash deposits, which can have a significant impact on the Company's cash balance, are included in Accrued liabilities on the unaudited Condensed Consolidated Balance Sheet. Cash flows as of and for a particular operating period are included as Operating cash flows in the unaudited Condensed Consolidated Statement of Cash Flows. See also Note 7 to the unaudited condensed consolidated financial statements.

See Item 7A "Quantitative and Qualitative Disclosures About Market Risk" in the Company's Annual Report on Form 10-K for the year ended December 31, 2006, and Note 5 to the unaudited condensed consolidated financial statements for further information about Market Risk.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures designed to ensure that it is able to collect the information it is required to disclose in the reports it files with the Securities and Exchange Commission (SEC), and to record, process, summarize, and disclose this information within the time periods specified in the rules of the SEC, including controls and procedures designed to ensure that this information is accumulated and communicated to the Company's management, including its Chief Executive and Chief Financial Officers, as appropriate to allow timely decisions regarding required disclosure. Based on an evaluation of the Company's disclosure controls and procedures as of the end of the period covered by this report conducted by the Company's management, with the participation of the Chief Executive and Chief Financial Officers, the Chief Executive and Chief Financial Officers believe that these controls and procedures are effective to ensure that the Company is able to collect, process, and disclose the information it is required to disclose in the reports it files with the SEC within the required time periods.

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Internal Control over Financial Reporting

There were no changes in the Company's internal control over financial reporting (as defined in Rules 13(a)-15(f) and 15(d)-15(f) under the Exchange Act) during the fiscal quarter ended September 30, 2007, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The Company is subject to various legal proceedings and claims arising in the ordinary course of business, including, but not limited to, examinations by the Internal Revenue Service (IRS). The IRS regularly examines the Company's federal income tax returns and, in the course thereof, proposes adjustments to the Company's federal income tax liability reported on such returns. It is the Company's practice to vigorously contest those proposed adjustments it deems lacking of merit.

The Company's management does not expect that the outcome in any of its currently ongoing legal proceedings or the outcome of any proposed adjustments presented to date by the IRS, individually or collectively, will have a material adverse effect on the Company's financial condition, results of operations, or cash flow.

Item 1A. Risk Factors

There have been no material changes to the factors disclosed in Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2006.

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

(c)

<u>Period</u>	Issuer Purchases of Equity Securities (1)			
	(a)	(b)	(c)	(d)
	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum dollar value that may yet be purchased under the plans or programs
July 1, 2007 through July 31, 2007	12,750,000	\$ 15.42	12,750,000	\$ 129,940,913
August 1, 2007 through August 31, 2007	8,100,000	\$ 15.65	8,100,000	\$ 3,146,478
September 1, 2007 through September 30, 2007	<u>208,000</u>	\$ 15.13	<u>208,000</u>	\$ -
Total	21,058,000		21,058,000	

(1) On May 16, 2007, the Company publicly announced a program for the repurchase of up to \$500 million of the Company's Common Stock. This program was completed during September 2007, resulting in the purchase of 32.9 million shares. Repurchases for this program were made in accordance with applicable securities laws in the open market or in private transactions from time to time, depending on market conditions.

Item 3. Defaults upon Senior Securities

None

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

None

Item 5. Other Information

None

Item 6. Exhibits

a) Exhibits

- 3.1 Restated Articles of Incorporation of Southwest (incorporated by reference to Exhibit 4.1 to Southwest's Registration Statement on Form S-3 (File No. 33-52155)); Amendment to Restated Articles of Incorporation of Southwest (incorporated by reference to Exhibit 3.1 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 1996 (File No. 1-7259)); Amendment to Restated Articles of Incorporation of Southwest (incorporated by reference to Exhibit 3.1 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 1998 (File No. 1-7259)); Amendment to Restated Articles of Incorporation of Southwest (incorporated by reference to Exhibit 4.2 to Southwest's Registration Statement on Form S-8 (File No. 333-82735)); Amendment to Restated Articles of Incorporation of Southwest (incorporated by reference to Exhibit 3.1 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2001 (File No. 1-7259)); Articles of Amendment to Articles of Incorporation of Southwest Airlines Co. (incorporated by reference to Exhibit 3.1 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2007 (File No. 1-7259)).
- 3.2 Amended and Restated Bylaws of Southwest, effective September 20, 2007 (incorporated by reference to Exhibit 3.1 to Southwest's Current Report on Form 8-K dated September 20, 2007 (File No. 1-7259)).
- 10.1 Supplemental Agreement No. 54 to Purchase Agreement No. 1810, dated January 19, 1994, between The Boeing Company and Southwest.(1)
- 10.2 Supplemental Agreement No. 55 to Purchase Agreement No. 1810, dated January 19, 1994, between The Boeing Company and Southwest.(1)
- 10.3 Employment Contract, dated as of July 15, 2007, between Southwest and Herbert D. Kelleher.
- 10.4 Employment Contract, dated as of July 15, 2007, between Southwest and Gary C. Kelly.
- 10.5 Employment Contract, dated as of July 15, 2007, between Southwest and Colleen C. Barrett.
- 31.1 Rule 13a-14(a) Certification of Chief Executive Officer
- 31.2 Rule 13a-14(a) Certification of Chief Financial Officer
- 32.1 Section 1350 Certifications of Chief Executive Officer and Chief Financial Officer

(1) Pursuant to 17 CRF 240.24b-2, confidential information has been omitted and has been filed separately with the Securities and Exchange Commission pursuant to a Confidential Treatment Application filed with the Commission.

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.

SOUTHWEST AIRLINES CO.

October 19, 2007

By /s/ Laura Wright

Laura Wright
Chief Financial Officer
(On behalf of the Registrant and in
her capacity as Principal Financial
and Accounting Officer)

EXHIBIT INDEX

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(1) Pursuant to 17 CRF 240.24b-2, confidential information has been omitted and has been filed separately with the Securities and Exchange Commission pursuant to a Confidential Treatment Application filed with the Commission.

CONFIDENTIAL TREATMENT

Supplemental Agreement No. 54

to

Purchase Agreement No. 1810

between

THE BOEING COMPANY

and

SOUTHWEST AIRLINES CO.

Relating to Boeing Model 737-7H4 Aircraft (the Aircraft)

THIS SUPPLEMENTAL AGREEMENT, entered into as of July 17, 2007, by and between THE BOEING COMPANY, a Delaware corporation with principal offices in Seattle, Washington, (Boeing) and SOUTHWEST AIRLINES CO., a Texas corporation with principal offices in Dallas, Texas (Buyer);

WHEREAS, the parties hereto entered into Purchase Agreement No. 1810 dated January 19, 1994, relating to Boeing Model 737-7H4 aircraft (the Agreement) and;

WHEREAS, Buyer has agreed to the following changes to the Contract Delivery Month of certain four (4) Block T-W-2a Firm Aircraft (Four Firm Aircraft):

Was

New

and;

WHEREAS, Buyer has agreed to exercise certain twenty-five (25) Option Aircraft into Firm Aircraft (Block T-W-2 Aircraft) scheduled for delivery in the Contract Delivery Month as follows (Twenty-Five Firm Aircraft):

*** Pursuant to 17 CFR 240.24b-2, confidential information has been omitted and has been filed separately with the Securities and Exchange Commission pursuant to a Confidential Treatment Application filed with the Commission.

P.A. No. 1810
K/SWA

SA-54-1

Was - Option

New - Firm

and;

WHEREAS,***;

NOW THEREFORE, in consideration of the mutual covenants herein contained, the parties agree to amend the Agreement as follows:

1. The Table of Contents of the Agreement is deleted in its entirety and a new Table of Contents is attached hereto and incorporated into the Agreement by this reference.
2. Table 1 is deleted in its entirety and replaced by a new Table 1 which is attached hereto and is incorporated into the Agreement by this reference.
3. Table 2 is deleted in its entirety and replaced by a new Table 2 which is attached hereto and is incorporated into the Agreement by this reference.
4. Letter Agreement No. 6-1162-JMG-669R7 entitled *** is replaced and superseded by Letter Agreement No. 6-1162-JMG-669R8 attached hereto.
5. All references in the Letter Agreements associated with Purchase Agreement No. 1810 shall be deemed to refer to the purchase by Buyer of four hundred (400) Model 737-7H4 Aircraft, eighty-six (86) Model 737-7H4 Option Aircraft and fifty-four (54) Model 737-7H4 Purchase Right Aircraft, to the extent such reference is not specifically addressed herein.

Upon execution of this Supplemental Agreement on or before July 31, 2007, Boeing will return to Buyer *** which are advance payments for the Four Firm Aircraft paid by Buyer less advance payments due on the Twenty-Five Firm Aircraft.

The Agreement will be deemed to be supplemented to the extent herein provided and as so supplemented will continue in full force and effect.

EXECUTED IN DUPLICATE as of the day and year first above written.

THE BOEING COMPANY

SOUTHWEST AIRLINES CO.

By: /s/ Nobuko Wiles

By: /s/ Laura Wright

Its: Attorney-In-Fact

Its: SVP Finance & CFO

P.A. No. 1810
K/SWA

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6-1162-JMG-747R1	***	SA-36
6-1162-CHL-217	Rescheduled Flight Test Aircraft	SA-32
6-1162-NIW-606R1	***	SA-36
6-1162-NIW-640	Early Delivery of Two April 2004 Aircraft	SA-35
6-1162-NIW-889	Warranty - Exterior Color Schemes and Markings for YA143 and on	SA-39
6-1162-NIW-1142	***	SA-43
6-1162-NIW-1369	***	SA-46

**Table 1 to
Purchase Agreement No. 1810
Aircraft Information Table**

	Base Aircraft Price	Special Features	Aircraft Basic Price	Base Year Dollars
Block A, B, C, D & E Aircraft	***	***	***	July 1992
Block F & G Aircraft	***	***	***	July 1992
Block H Aircraft	***	***	***	July 1992
Block I Aircraft	***	***	***	July 1992
Block J Aircraft	***	***	***	July 1992
Block K Aircraft	***	***	***	July 1992
Block K-W Aircraft	***	***	***	July 1992
Block L Aircraft	***	***	***	July 1992
Block T Aircraft	***	***	***	July 1999
Block T-W Aircraft	***	***	***	July 1999
Block T-W-1 / T-W-1a Aircraft	***	***	***	July 1999
Block T-W-2 / T-W-2a Aircraft	***	***	***	July 1999

Block K-W Aircraft: Block K airplanes with production winglets installation

Block T-W Aircraft: Block T airplanes with production winglets installation

Block T-W-1 / T-W-1a Aircraft: Firm Aircraft contracted to deliver from May 1, 2006 through June 2008 at the signing of SA-47 -- (T-W-1a Aircraft -- Advance Payment Schedule per LA 6-1162-JGM-669)

Block T-W-2 / T-W-2a Aircraft: U-W-1 Option Aircraft which becomes Firm Aircraft after signing of SA-47 and

Firm Aircraft contracted to deliver in July 2008 and on at the signing of SA47 --

(T-W-2a Aircraft -- Advance Payment Schedule per LA 6-1162-JGM-669)

**Table 1 to
Purchase Agreement No. 1810
Aircraft Information Table**

Delivery Date	Number of Aircraft	Aircraft Block	Escalation Estimate Adv Payment Base Price Per A/P	Serial Number
Dec-2000	2	E	***	
Jan-2001	1	E	***	
Feb-2001	1	E	***	
Mar-2001	2	E	***	
Jun-2001	3	E	***	
Sep-2001	3	E	***	
Oct-1998	1	F	***	
Nov-1998	2	F	***	
Dec-1998	2	F	***	
Mar-1999	2	G	***	
Jun-1999	2	H	***	
Jul-1999	1	H	***	
Aug-1999	1	H	***	
Sep-1999	2	H	***	
Oct-1999	1	H	***	
Mar-2000	1	H	***	
Apr-2000	2	H	***	
Sep-2000	1	H	***	
Oct-2000	2	H	***	
Mar-2001	2	H	***	
Apr-2001	1	H	***	
Oct-2001	3	H	***	
Nov-2001	2	I	***	
Dec-2001	1	I	***	
Jan-2002	1	I	***	
Mar-2002	4	I	***	
Apr-2002	2	I	***	
Dec-2002	2	I	***	
May-2003	1	I	***	
Jun-2003	2	I	***	
Jul-2003	1	I	***	
Aug-2003	1	I	***	
Sep-2003	3	I	***	
Nov-2002	1	J	***	
Dec-2002	1	J	***	
Nov-2003	2	J	***	
Dec-2003	2	J	***	
Mar-2004	1	J	***	
Mar-2004	1	K	***	
Apr-2004	3	K	***	
May-2004	1	K	***	
Jun-2004	2	K	***	
Jul-2004	2	K	***	
Sep-2004	1	K-W	***	

**Table 1 to
Purchase Agreement No. 1810
Aircraft Information Table**

Oct-2004	4	K-W	***
Oct-1999	1	L	***
Nov-1999	2	L	***
Dec-1999	1	L	***
Jun-2000	3	L	***
Jul-2000	3	L	***
Sep-2000	1	L	***
Oct-2000	1	L	***
Nov-2000	4	L	***
Dec-2000	1	L	***
Jan-2001	1	L	***
Feb-2001	1	L	***
Jul-2001	1	L	***
Sep-2001	1	L	***
Oct-2001	1	L	***
Mar-2003	2	L	***
Jul-2003	1	L	***
Aug-2003	2	L	***
Nov-2001	1	T	***
Feb-2002	1	T	***
Jan-2004	2	T	***
Feb-2004	1	T	***
Apr-2004	3	T	***
May-2004	1	T	***
Jun-2004	6	T	***
Jul-2004	2	T	***
Aug-2004	6	T-W	***
Sep-2004	4	T-W	***
Oct-2004	0	T-W	***
Nov-2004	3	T-W	***
Dec-2004	3	T-W	***
Jan-2005	5	T-W	***
Feb-2005	3	T-W	***
Mar-2005	4	T-W	***
Apr-2005	4	T-W	***
May-2005	2	T-W	***
Jun-2005	4	T-W	***
Jul-2005	2	T-W	***
Aug-2005	2	T-W	***
Sep-2005	3	T-W	***
Oct-2005	2	T-W	***
Nov-2005	2	T-W	***
Dec-2005	1	T-W	***
Jan-2006	1	T-W	***
Feb-2006	4	T-W	***
Mar-2006	3	T-W	***
Apr-2006	2	T-W	***
May-2006	5	T-W-1	***

**Table 1 to
Purchase Agreement No. 1810
Aircraft Information Table**

Jun-2006	5	T-W-1	***	
Jul-2006	3	T-W-1	***	
Aug-2006	3	T-W-1	***	
Sep-2006	3	T-W-1	***	
Oct-2006	1	T-W-1	***	
Nov-2006	2	T-W-1	***	
Dec-2006	2	T-W-1	***	
Jan-2007	2	T-W-1	***	
Feb-2007	3	T-W-1	***	
Mar-2007	2	T-W-1	***	
Apr-2007	3	T-W-1	***	
May-2007	3	T-W-1	***	
Jun-2007	2	T-W-1	***	
Jun-2007	1	T-W-1a	***	36528
Jul-2007	2	T-W-1	***	
Jul-2007	1	T-W-1a	***	36610
Aug-2007	2	T-W-1	***	
Aug-2007	3	T-W-1a	***	36611, 36632 & 36633
Sep-2007	2	T-W-1	***	
Sep-2007	1	T-W-1a	***	36612
Oct-2007	2	T-W-1	***	
Oct-2007	1	T-W-1a	***	36613
Nov-2007	2	T-W-1	***	
Nov-2007	1	T-W-1a	***	36614
Dec-2007	2	T-W-1	***	
Dec-2007	1	T-W-1a	***	36615
Jan-2008	1	T-W-1	***	
Jan-2008	2	T-W-1a	***	36616 & 36617
Jan-2008	1	T-W-2	***	36887
Feb-2008	1	T-W-1	***	
Feb-2008	3	T-W-1a	***	36618, 36619 & 36620
Mar-2008	1	T-W-1	***	
Mar-2008	2	T-W-1a	***	36621 & 36622
Mar-2008	1	T-W-2	***	36888
Apr-2008	1	T-W-1	***	
Apr-2008	2	T-W-1a	***	36623 & 36624
May-2008	1	T-W-1	***	
May-2008	2	T-W-1a	***	36625 & 36626
Jun-2008	1	T-W-1	***	
Jun-2008	2	T-W-1a	***	36627 & 36628
Jul-2008	2	T-W-2a	***	
Jul-2008	2	T-W-2	***	36889 & 36890
Aug-2008	1	T-W-2	***	36891
Oct-2008	1	T-W-2a	***	
Nov-2008	1	T-W-2a	***	
Dec-2008	1	T-W-2a	***	
Jan-2009	1	T-W-2a	***	
Feb-2009	2	T-W-2a	***	

**Table 1 to
Purchase Agreement No. 1810
Aircraft Information Table**

Mar-2009	2	T-W-2a	***
Apr-2009	2	T-W-2a	***
May-2009	2	T-W-2a	***
Jun-2009	2	T-W-2a	***
Jul-2009	2	T-W-2a	***
Aug-2009	1	T-W-2a	***
Sep-2009	1	T-W-2a	***
Oct-2009	1	T-W-2a	***
Nov-2009	1	T-W-2a	***
Dec-2009	1	T-W-2a	***
Jan-2010	1	T-W-2a	***
Feb-2010	1	T-W-2a	***
Mar-2010	1	T-W-2a	***
Apr-2010	1	T-W-2a	***
May-2010	1	T-W-2a	***
Jun-2010	1	T-W-2a	***
Jul-2010	1	T-W-2a	***
Aug-2010	1	T-W-2a	***
Sep-2010	1	T-W-2a	***
Oct-2010	1	T-W-2a	***
Jan-2011	1	T-W-2a	***
Feb-2011	1	T-W-2a	***
Mar-2011	1	T-W-2a	***
Apr-2011	1	T-W-2a	***
May-2011	1	T-W-2a	***
Jun-2011	1	T-W-2a	***
Jul-2011	1	T-W-2a	***
Aug-2011	1	T-W-2a	***
Sep-2011	1	T-W-2a	***
Oct-2011	1	T-W-2a	***
Jan-2012	1	T-W-2a	***
Feb-2012	1	T-W-2a	***
Mar-2012	1	T-W-2a	***
Apr-2012	1	T-W-2a	***
May-2012	1	T-W-2a	***
Jun-2012	1	T-W-2a	***
Jul-2012	1	T-W-2a	***
Aug-2012	1	T-W-2a	***
Sep-2012	1	T-W-2a	***
Oct-2012	1	T-W-2a	***
Jan-2013	2	T-W-2a	***
Feb-2013	1	T-W-2a	***
Mar-2013	1	T-W-2a	***
Mar-2013	1	T-W-2	***
Apr-2013	1	T-W-2	***
May-2013	1	T-W-2	***
Jun-2013	2	T-W-2	***
Jul-2013	1	T-W-2	***

Table 1 to
Purchase Agreement No. 1810
Aircraft Information Table

Aug-2013	2	T-W-2	***
Sep-2013	2	T-W-2	***
Oct-2013	2	T-W-2	***
Nov-2013	1	T-W-2	***
Dec-2013	2	T-W-2	***
Jan-2014	1	T-W-2	***
Feb-2014	1	T-W-2	***
Mar-2014	1	T-W-2	***
Apr-2014	1	T-W-2	***
May-2014	1	T-W-2	***
Jun-2014	1	T-W-2	***
Jul-2014	1	T-W-2	***
Aug-2014	1	T-W-2	***
Sep-2014	1	T-W-2	***
Oct-2014	1	T-W-2	***

Table 2 to Purchase Agreement No. 1810
(Letter Agreement No. 6-1162-RLL-933R20)
Option Aircraft Information Table

Price Description of Option Aircraft:

	Base Aircraft Price	Special Features	Aircraft Basic Price	Base Year Dollars
Block U Option Aircraft (without Winglets)	***	***	***	July 1999
Block U-W Option Aircraft (with Winglets)	***	***	***	July 1999
Block U-W-1 Option Aircraft	***	***	***	July 1999

Delivery of Purchase Right Aircraft:

Delivery Period of Purchase Right Aircraft:

Condition of Offer for Purchase Right Aircraft:

Quantity
Complete delivery not later than Dec. 31, 2014
Subject to Available Position
54

Remaining Option Aircraft:

86

**Table 2 to Purchase Agreement No. 1810
(Letter Agreement No. 6-1162-RLL-933R20)
Option Aircraft Information Table**

Aircraft Delivery Mo. & Yr.	Number of Option Aircraft	Option Aircraft Block	Adv Payment Base Price Per Option Aircraft	Option Exercise
Apr-2009	2	U-W-1	***	December 3, 2007
May-2009	1	U-W-1	***	January 1, 2008
Jun-2009	1	U-W-1	***	February 1, 2008
Jul-2009	2	U-W-1	***	March 3, 2008
Aug-2009	1	U-W-1	***	April 1, 2008
Oct-2009	1	U-W-1	***	June 2, 2008
Nov-2009	1	U-W-1	***	July 1, 2008
Dec-2009	1	U-W-1	***	August 1, 2008
Jan-2010	1	U-W-1	***	September 1, 2008
Feb-2010	1	U-W-1	***	October 1, 2008
Mar-2010	1	U-W-1	***	November 3, 2008
Apr-2010	1	U-W-1	***	December 1, 2008
May-2010	2	U-W-1	***	January 1, 2009
Jun-2010	3	U-W-1	***	February 2, 2009
Jul-2010	2	U-W-1	***	March 2, 2009
Aug-2010	2	U-W-1	***	April 1, 2009
Sep-2010	2	U-W-1	***	May 1, 2009
Oct-2010	3	U-W-1	***	June 1, 2009
Nov-2010	3	U-W-1	***	July 1, 2009
Dec-2010	3	U-W-1	***	August 3, 2009
Jan-2011	1	U-W-1	***	September 1, 2009
Feb-2011	2	U-W-1	***	October 1, 2009
Mar-2011	1	U-W-1	***	November 2, 2009
Apr-2011	1	U-W-1	***	December 1, 2009
May-2011	2	U-W-1	***	January 1, 2010
Jun-2011	2	U-W-1	***	February 1, 2010
Jul-2011	2	U-W-1	***	March 1, 2010
Aug-2011	2	U-W-1	***	April 1, 2010
Sep-2011	2	U-W-1	***	May 3, 2010
Oct-2011	2	U-W-1	***	June 1, 2010
Nov-2011	3	U-W-1	***	July 1, 2010
Dec-2011	2	U-W-1	***	August 2, 2010
Jan-2012	3	U-W-1	***	September 1, 2010
Feb-2012	3	U-W-1	***	October 1, 2010
Mar-2012	2	U-W-1	***	November 1, 2010
Apr-2012	3	U-W-1	***	December 1, 2010
May-2012	3	U-W-1	***	January 3, 2011
Jun-2012	3	U-W-1	***	February 1, 2011
Jul-2012	2	U-W-1	***	March 1, 2011
Aug-2012	2	U-W-1	***	April 1, 2011
Sep-2012	2	U-W-1	***	May 2, 2011
Oct-2012	2	U-W-1	***	June 1, 2011
Nov-2012	3	U-W-1	***	July 1, 2011
Dec-2012	2	U-W-1	***	August 1, 2011
Total	86			

The Boeing Company
P.O. Box 3707
Seattle, WA 98124-220

6-1162-JMG-669R8

Southwest Airlines Co.
P.O. Box 36611 - Love Field
Dallas, Texas 75235

Subject: ***

This Letter Agreement amends Purchase Agreement No. 1810 dated as of January 19, 1994 (the Agreement) between The Boeing Company (Boeing) and Southwest Airlines Co. (Buyer) relating to Model 737 aircraft:

1) ***

2) ***

All terms used and not defined herein will have the same meaning as in the Agreement.

- 1. ***
- 2. ***
- 3. ***
- 4. ***
- 5. ***
- 6. ***
- 7. ***
- 8. ***
- 9. ***
- 10. ***
- 11. ***
- 12. ***
- 13. ***
- 14. ***

15. Confidential Treatment

Buyer understands that certain commercial and financial information contained in this Letter Agreement including any attachments hereto is considered by Boeing as confidential. Buyer agrees that it will treat this Letter Agreement and the information contained herein as confidential and will not, without the prior written consent of Boeing, disclose this Letter Agreement or any information contained herein to any other person or entity except as provided in Letter Agreement No. 6-1162-RLI-934, as amended.

P.A. No. 1810
K/SWA

SA-54

Southwest Airlines Co.
6-1162-JMG-669R8

Very truly yours,

THE BOEING COMPANY

By: /s/ Nobuko Wiles

Its: Attorney-In-Fact

ACCEPTED AND AGREED TO this

date: July 17, 2007

SOUTHWEST AIRLINES CO.

By: /s/ Scott Topping

Its: VP Treasurer

P.A. No. 1810
K/SWA

SA-54

P.A. No. 1810
K/SWA

SA-54

Southwest Airlines Co.

Project ID: 48667
Change No. 3400MK3098
Dated: July 16, 2007

Model: 737-300/-500

Project Title: AVIONICS UPGRADE - SECOND FLIGHT MANAGEMENT COMPUTER SYSTEM (FMCS) AND INSTALLATION AND ACTIVATION OF DUAL GLOBAL POSITIONING SYSTEM SENSOR (GPSS) - PHASE I

Description of Change:

BACKGROUND:

This effort shall be accomplished in two phases:

Phase I - Second FMC installation and installation and activation of dual GPSS. No Required Navigation Performance Special Aircraft and Aircrew Authorization Required (RNP/SAAAR) capability will be provided during this phase.

Phase II - Installation of Large Area Displays with activation of RNP/SAAAR.

Each phase will be independently accomplished with a FAA certification and Service Bulletin at the completion of each phase.

PHASE I REQUIREMENTS

A. REVIEW SOUTHWEST AIRLINES (SWA) SUPPLEMENTAL TYPE CERTIFICATES (STCs) TO DETERMINE ACCEPTABILITY FOR REFERENCE UNDER BOEING TYPE DESIGN

1.0 CUSTOMER INFORMATION

1.1 Contracting Party: Southwest Airlines (SWA)

1.2 Requesting Party: Boeing Technical Services & Modifications Avionics Business Unit

2.0 PROJECT BACKGROUND

Southwest Airlines (SWA) is interested in implementing RNP/SAAAR and make the flight-instrument panel look like the 737-NG for their 737 fleet.

3.0 STATEMENT OF WORK

3.1 Boeing will review customer provided data on LRU locations, installed by STCs in order to avoid any conflict or interference with the Boeing design.

3.2 Boeing Deliverables to Customer:

The deliverables from this effort will be any findings that will affect the implementation of the enclosed work-statement. The findings will be communicated to the customer, Southwest Airlines.

3.3 Customer is responsible for delivery of all data on LRU locations installed by STCs that may impact the areas of change. Also, the Customer will be responsible for the re-certification of any impacted STC as a result of the modification installations.

B. NAVIGATION - DUAL FLIGHT MANAGEMENT COMPUTER SYSTEM (FMCS) - INSTALLATION

EQUIPMENT NOTES:

PREREQUISITE NOTES

ASSUMPTIONS NOTES

.***

C. FLIGHT MANAGEMENT COMPUTER SYSTEM (FMCS) - GPS ENABLE - FEATURE ACTIVATION

PREREQUISITE NOTES

ASSUMPTIONS NOTES:

D. DUAL GPSS – ROCKWELL COLLINS GPSS P/N 822-2189-001 – INSTALLATION

EQUIPMENT NOTES:

PREREQUISITE NOTES:

ASSUMPTIONS NOTES:

**

*E. PROGRAM INTEGRATED AIRPLANE TEST, VALIDATION, & CERTIFICATION

REMOTE CERTIFICATION NOTES:

Special Notes:
Additional feature activation requires separate projects.

Additional Project Estimating Notes:

The following projects are listed to help with estimating this project.

TECHNICAL SERVICES AGREEMENT - REVIEW SOUTHWEST AIRLINES (SWA) SUPPLEMENTAL TYPE CERTIFICATES (STCs) TO DETERMINE ACCEPTABILITY FOR REFERENCE UNDER BOEING TYPE DESIGN (ref PID-26454)

NAVIGATION - DUAL FLIGHT MANAGEMENT COMPUTER SYSTEM (FMCS) - LEAN GLOBAL ENTERPRISE - INSTALLATION SUPPORTING RNAV & RNAV (GPS) OPERATIONAL CAPABILITY (ref PID-43332)

FLIGHT MANAGEMENT COMPUTER SYSTEM (FMCS) - GPS ENABLE - FEATURE ACTIVATION (PID- 47210)

DUAL GNSSU - HONEYWELL KGS 200 - INSTALLATION – CERTIFICATION (PID- 43333)

LARGE AREA DISPLAY SYSTEM - SMITHS INDUSTRIES - INSTALLATION OF BFE SMART DISPLAY UNITS (DUAL CHANNEL) ON NON-EFIS AIRPLANES, INTEGRATED STANDBY FLIGHT DISPLAY (ISFD) (ref PID-26496)

FLIGHT MANAGEMENT COMPUTER SYSTEM - (RNP/SAAAR, GLS CAT I & IAN) - IMPLEMENTATION AND CERTIFICATION (ref PID-26501)

PROGRAM INTEGRATED AIRPLANE TEST, VALIDATION, & CERTIFICATION (ref PID-26529)

Material/Equipment List:

Similar To	Part Number	CAT	Part Qty	Part Description	Supplier Name
	S242A600-1001		BFE	1	CDU
	10-62225-003		BFE	1	FMC
	TBD		BFE	1	WXR Control Panel
	822-2189-001		BFE	2	GNS 4000S
	822-2033-001		BFE	2	GNS ANTENNA
	69-73713-17		BFE	1	Mode Select Panel
	69-37399-12		BFE	2	IRS MASTER CAUTION UNIT



Southwest Airlines Co.

Project ID: 48668
Change No: 3100MK3017
Dated: July 16, 2007

Model: 737-300/-500

Project Title: AVIONICS UPGRADE - INSTALL LARGE AREA DISPLAY SYSTEM (LADS) AND ACTIVATION OF REQUIRED NAVIGATION PERFORMANCE SPECIAL AIRCRAFT AND AIRCREW AUTHORIZATION REQUIRED (RNP/SAAAR) - PHASE II

Description of Change:
BACKGROUND:
This effort shall be accomplished in two phases:
Phase I - Second FMC installation and installation and activation of dual GNSS. No Required Navigation Performance Special Aircraft and Aircrew Authorization Required (RNP/SAAAR) capability will be provided during this phase.

Phase II - Installation of Large Area Displays with activation of RNP/SAAAR.

Each phase will be independently accomplished with a FAA certification and Service Bulletin at the completion of each phase.

PHASE II REQUIREMENTS

A. REVIEW SOUTHWEST AIRLINES (SWA) SUPPLEMENTAL TYPE CERTIFICATES (STCs) TO DETERMINE ACCEPTABILITY FOR REFERENCE UNDER BOEING TYPE DESIGN

1.0 CUSTOMER INFORMATION

- 1.1 Contracting Party: Southwest Airlines (SWA)
- 1.2 Requesting Party: Boeing Technical Services & Modifications Avionics Business Unit

2.0 PROJECT BACKGROUND

Southwest Airlines (SWA) has requested a proposal to upgrade their 737-300/-500 fleet to include GPS (RNAV) and RNP/SAAR capability. The changes requested include an upgrade to the Flight Deck with a Large Area Display System (LADS) that will be similar to their 737NG aircraft.

3.0 STATEMENT OF WORK

B. LARGE AREA DISPLAY SYSTEM - SMITHS INDUSTRIES - INSTALLATION OF BFE SMART DISPLAY UNITS (DUAL CHANNEL) ON NON-EFIS AIRPLANES AND INTEGRATED STANDBY INSTRUMENT SYSTEM (ISIS)

Equipment Notes:

Assumption Notes:

C. AVIONICS UPGRADE to COMPLY WITH RNP/SAAAR REQUIREMENTS (REF.AC90-101)

The following equipment upgrades in addition to the Large Area Display System are required to implement RNP SAAAR requirements.

Flight Control Computer (FCC):

An update to the existing -4 FCC is required to introduce RNP/SAAAR capability as well as other FCC functions deemed necessary to ensure RNP/SAAAR implementation is operationally common with the 737NG. FCC updates are required to ensure appropriate communication exists between the FCC, FMC, and Large Display System for RNP/SAAAR capture and deviation commands.

D. PROGRAM INTEGRATED AIRPLANE TEST, VALIDATION, & CERTIFICATION

This project captures all of the integrated flight test and certification activity associated with the following system incorporation into SWA 737-300/500 fleet.

Phase II Certification Activity

REMOTE CERTIFICATION NOTES:

Material/Equipment List:

Similar To	Part Number	CAT	Part Qty	Part Description	Supplier Name
	10-62038-new		BFE	2	Flight Control Computer
	TBD		BFE	2	Smart Display Unit
	TBD		BFE	2	EFIS Control Panel
	TBD		BFE	1	ISDS (Integrated Standby Display System)
	TBD		BFE	1	Dedicated Battery Charger
	TBD		BFE	1	OPS, Smart Display
	980-4700-042		BFE		Digital Flight Data Recorder
	967-0212-001		BFE		Digital Flight Data Acquisition Unit
	TBD		BFE	2	Display Control Panel

Southwest Airlines Co.

Model:
737-
700

Project ID: 47917
Change No: 3162MK3580
Dated: 5/25/2007

Project Title:
COMMON DISPLAY SYSTEM - NAVIGATION PERFORMANCE SCALES - ENABLE

Description of Change:
Provide an FAA approved service bulletin and required Common Display System (CDS) and Flight Management Computer System (FMCS) Operational Program Configuration (OPC) software diskettes to enable the Navigation Performance Scales (NPS) feature.

Feature Notes:

Material/Equipment List:					
<u>Similar To</u>	<u>Part Number</u>	<u>CAT</u>	<u>Part Qty.</u>	<u>Part Description</u>	<u>Supplier Name</u>
þ	998-2512-504	BFE	1	DFDAU Mandatory Software (disk 963-2000-025)	Honeywell
þ	998-2513-504	BFE	1	DFDAU 429 Broadcast Software (disk 963-2100-025)	Honeywell
þ	L034870003	BFE	1	DFDAU Software (disk 360-03834-003)	SAGEM
þ	3102-TDY-M14-01	BFE	1	DFDAU Software (disk 2237274-06) (requires -8XX LRU part number)	Teledyne

Note: ***

Southwest Airlines Co.

Project ID:
Change No:
Dated:

47918
3461MK3AIY
5/25/2007

Model:
737-700

Project Title:
FLIGHT MANAGEMENT COMPUTER SYSTEM (FMCS) - FEATURE REVISIONS

Description of Change:
Provide an FAA approved service bulletin and Flight Management Computer System (FMCS) Operational Program Configuration (OPC) software, and/or wiring instructions, as required, to enable the following features in the FMC:

Material/Equipment List:					
<u>Similar To</u>	<u>Part Number</u>	<u>CAT</u>	<u>Part Qty</u>	<u>Part Description</u>	<u>Supplier Name</u>
h	4082260-939 (Boeing Spec #: 10-62038-239)	BFE	1	Mode Control Panel	Honeywell

Note: ***

CONFIDENTIAL TREATMENT

Supplemental Agreement No. 55

to

Purchase Agreement No. 1810

between

THE BOEING COMPANY

and

SOUTHWEST AIRLINES CO.

Relating to Boeing Model 737-7H4 Aircraft (the Aircraft)

THIS SUPPLEMENTAL AGREEMENT, entered into as of August 31, 2007, by and between THE BOEING COMPANY, a Delaware corporation with principal offices in Seattle, Washington, (Boeing) and SOUTHWEST AIRLINES CO., a Texas corporation with principal offices in Dallas, Texas (Buyer);

WHEREAS, the parties hereto entered into Purchase Agreement No. 1810 dated January 19, 1994, relating to Boeing Model 737-7H4 aircraft (the Agreement) and;

WHEREAS, Boeing and Buyer have agreed to revise the Contract Delivery Month of one 737-7H4 Aircraft bearing Manufacturer's Serial Number 32542 to October 2007 from November 2007 (Acceleration Aircraft) and;

NOW THEREFORE, in consideration of the mutual covenants herein contained, the parties agree to amend the Agreement as follows:

1. The Table of Contents of the Agreement is deleted in its entirety and a new Table of Contents is attached hereto and incorporated into the Agreement by this reference.

*****Pursuant to 17 CFR 240.24b-2, confidential information has been omitted and has been filed separately with the Securities and Exchange Commission pursuant to a Confidential Treatment Application filed with the Commission.**

2. Table 1 is deleted in its entirety and replaced by a new Table 1 attached hereto, reflecting deletion of one Block T-W-1 Aircraft with a Contract Delivery Month of November 2007 and addition of one Block T-W-1 Aircraft with a Contract Delivery Month of October 2007.
3. All references in the Letter Agreements associated with Purchase Agreement No. 1810 shall be deemed to refer to the purchase by Buyer of four hundred (400) Model 737-7H4 Aircraft, eighty-six (86) Model 737-7H4 Option Aircraft and fifty-four (54) Model 737-7H4 Purchase Right Aircraft, to the extent such reference is not specifically addressed herein.
4. There will be no Advance Payments adjustment relating to the Acceleration Aircraft made at execution of this Supplemental Agreement. The Advance Payment received by Boeing from Buyer for the Acceleration Aircraft will be applied to the Purchase Price for the Acceleration Aircraft along with applicable credits at the time of delivery.

The Agreement will be deemed to be supplemented to the extent herein provided and as so supplemented will continue in full force and effect.

EXECUTED IN DUPLICATE as of the day and year first above written.

THE BOEING COMPANY

SOUTHWEST AIRLINES CO.

By: /s/ Nobuko Wiles

By: /s/ Scott Topping

Its: Attorney-In-Fact

Its: VP & Treasurer

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**Table 1 to
Purchase Agreement No. 1810
Aircraft Information Table**

	Base Aircraft Price	Special Features	Aircraft Basic Price	Base Year Dollars
Block A, B, C, D & E Aircraft	***	***	***	July 1992
Block F & G Aircraft	***	***	***	July 1992
Block H Aircraft	***	***	***	July 1992
Block I Aircraft	***	***	***	July 1992
Block J Aircraft	***	***	***	July 1992
Block K Aircraft	***	***	***	July 1992
Block K-W Aircraft	***	***	***	July 1992
Block L Aircraft	***	***	***	July 1992
Block T Aircraft	***	***	***	July 1999
Block T-W Aircraft	***	***	***	July 1999
Block T-W-1 / T-W-1a Aircraft	***	***	***	July 1999
Block T-W-2 / T-W-2a Aircraft	***	***	***	July 1999

Block K-W Aircraft: Block K airplanes with production winglets installation

Block T-W Aircraft: Block T airplanes with production winglets installation

Block T-W-1 / T-W-1a Aircraft: Firm Aircraft contracted to deliver from May 1, 2006 through June 2008 at the signing of SA-47 -- (T-W-1a Aircraft -- Advance Payment Schedule per LA 6-1162-JGM-669)

Block T-W-2 / T-W-2a Aircraft: U-W-1 Option Aircraft which became Firm Aircraft after signing of SA-47 and Firm Aircraft contracted to deliver in July 2008 forward at the signing of SA47 -- (T-W-2a Aircraft -- Advance Payment Schedule per LA 6-1162-JGM-669)

**Table 1 to
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Delivery Date	Number of Aircraft	Aircraft Block	Escalation Estimate	Serial Number
			Adv Payment Base Price Per A/P	
Dec-2000	2	E	***	
Jan-2001	1	E	***	
Feb-2001	1	E	***	
Mar-2001	2	E	***	
Jun-2001	3	E	***	
Sep-2001	3	E	***	
Oct-1998	1	F	***	
Nov-1998	2	F	***	
Dec-1998	2	F	***	
Mar-1999	2	G	***	
Jun-1999	2	H	***	
Jul-1999	1	H	***	
Aug-1999	1	H	***	
Sep-1999	2	H	***	
Oct-1999	1	H	***	
Mar-2000	1	H	***	
Apr-2000	2	H	***	
Sep-2000	1	H	***	
Oct-2000	2	H	***	
Mar-2001	2	H	***	
Apr-2001	1	H	***	
Oct-2001	3	H	***	
Nov-2001	2	I	***	
Dec-2001	1	I	***	
Jan-2002	1	I	***	
Mar-2002	4	I	***	
Apr-2002	2	I	***	
Dec-2002	2	I	***	
May-2003	1	I	***	
Jun-2003	2	I	***	
Jul-2003	1	I	***	
Aug-2003	1	I	***	
Sep-2003	3	I	***	
Nov-2002	1	J	***	
Dec-2002	1	J	***	
Nov-2003	2	J	***	
Dec-2003	2	J	***	
Mar-2004	1	J	***	
Mar-2004	1	K	***	
Apr-2004	3	K	***	
May-2004	1	K	***	
Jun-2004	2	K	***	
Jul-2004	2	K	***	

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Sep-2004	1	K-W	***
Oct-2004	4	K-W	***
Oct-1999	1	L	***
Nov-1999	2	L	***
Dec-1999	1	L	***
Jun-2000	3	L	***
Jul-2000	3	L	***
Sep-2000	1	L	***
Oct-2000	1	L	***
Nov-2000	4	L	***
Dec-2000	1	L	***
Jan-2001	1	L	***
Feb-2001	1	L	***
Jul-2001	1	L	***
Sep-2001	1	L	***
Oct-2001	1	L	***
Mar-2003	2	L	***
Jul-2003	1	L	***
Aug-2003	2	L	***
Nov-2001	1	T	***
Feb-2002	1	T	***
Jan-2004	2	T	***
Feb-2004	1	T	***
Apr-2004	3	T	***
May-2004	1	T	***
Jun-2004	6	T	***
Jul-2004	2	T	***
Aug-2004	6	T-W	***
Sep-2004	4	T-W	***
Oct-2004	0	T-W	***
Nov-2004	3	T-W	***
Dec-2004	3	T-W	***
Jan-2005	5	T-W	***
Feb-2005	3	T-W	***
Mar-2005	4	T-W	***
Apr-2005	4	T-W	***
May-2005	2	T-W	***
Jun-2005	4	T-W	***
Jul-2005	2	T-W	***
Aug-2005	2	T-W	***
Sep-2005	3	T-W	***
Oct-2005	2	T-W	***
Nov-2005	2	T-W	***
Dec-2005	1	T-W	***
Jan-2006	1	T-W	***
Feb-2006	4	T-W	***
Mar-2006	3	T-W	***

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Apr-2006	2	T-W	***	
May-2006	5	T-W-1	***	
Jun-2006	5	T-W-1	***	
Jul-2006	3	T-W-1	***	
Aug-2006	3	T-W-1	***	
Sep-2006	3	T-W-1	***	
Oct-2006	1	T-W-1	***	
Nov-2006	2	T-W-1	***	
Dec-2006	2	T-W-1	***	
Jan-2007	2	T-W-1	***	
Feb-2007	3	T-W-1	***	
Mar-2007	2	T-W-1	***	
Apr-2007	3	T-W-1	***	
May-2007	3	T-W-1	***	
Jun-2007	2	T-W-1	***	
Jun-2007	1	T-W-1a	***	36528
Jul-2007	2	T-W-1	***	
Jul-2007	1	T-W-1a	***	36610
Aug-2007	2	T-W-1	***	
Aug-2007	3	T-W-1a	***	36611, 36632 & 36633
Sep-2007	2	T-W-1	***	
Sep-2007	1	T-W-1a	***	36612
Oct-2007	3	T-W-1	***	
Oct-2007	1	T-W-1a	***	36613
Nov-2007	1	T-W-1	***	
Nov-2007	1	T-W-1a	***	36614
Dec-2007	2	T-W-1	***	
Dec-2007	1	T-W-1a	***	36615
Jan-2008	1	T-W-1	***	
Jan-2008	2	T-W-1a	***	36616 & 36617
Jan-2008	1	T-W-2	***	36887
Feb-2008	1	T-W-1	***	
Feb-2008	3	T-W-1a	***	36618, 36619 & 36620
Mar-2008	1	T-W-1	***	
Mar-2008	2	T-W-1a	***	36621 & 36622
Mar-2008	1	T-W-2	***	36888
Apr-2008	1	T-W-1	***	
Apr-2008	2	T-W-1a	***	36623 & 36624
May-2008	1	T-W-1	***	
May-2008	2	T-W-1a	***	36625 & 36626
Jun-2008	1	T-W-1	***	
Jun-2008	2	T-W-1a	***	36627 & 36628
Jul-2008	2	T-W-2a	***	
Jul-2008	2	T-W-2	***	36889 & 36890
Aug-2008	1	T-W-2a	***	
Oct-2008	1	T-W-2a	***	
Nov-2008	1	T-W-2a	***	

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Dec-2008	1	T-W-2a	***	
Jan-2009	1	T-W-2a	***	
Feb-2009	2	T-W-2a	***	
Mar-2009	2	T-W-2a	***	
Apr-2009	2	T-W-2a	***	
May-2009	2	T-W-2a	***	
Jun-2009	2	T-W-2a	***	
Jul-2009	2	T-W-2a	***	
Aug-2009	1	T-W-2a	***	
Sep-2009	1	T-W-2a	***	
Oct-2009	1	T-W-2a	***	
Nov-2009	1	T-W-2a	***	
Dec-2009	1	T-W-2a	***	
Jan-2010	1	T-W-2a	***	
Feb-2010	1	T-W-2a	***	
Mar-2010	1	T-W-2a	***	
Apr-2010	1	T-W-2a	***	
May-2010	1	T-W-2a	***	
Jun-2010	1	T-W-2a	***	
Jul-2010	1	T-W-2a	***	
Aug-2010	1	T-W-2a	***	
Sep-2010	1	T-W-2a	***	
Oct-2010	1	T-W-2a	***	
Jan-2011	1	T-W-2a	***	
Feb-2011	1	T-W-2a	***	
Mar-2011	1	T-W-2a	***	
Apr-2011	1	T-W-2a	***	
May-2011	1	T-W-2a	***	
Jun-2011	1	T-W-2a	***	
Jul-2011	1	T-W-2a	***	
Aug-2011	1	T-W-2a	***	
Sep-2011	1	T-W-2a	***	
Oct-2011	1	T-W-2a	***	
Jan-2012	1	T-W-2a	***	
Feb-2012	1	T-W-2a	***	
Mar-2012	1	T-W-2a	***	
Apr-2012	1	T-W-2a	***	
May-2012	1	T-W-2a	***	
Jun-2012	1	T-W-2a	***	
Jul-2012	1	T-W-2a	***	
Aug-2012	1	T-W-2a	***	
Sep-2012	1	T-W-2a	***	
Oct-2012	1	T-W-2a	***	
Jan-2013	1	T-W-2	***	36891
Jan-2013	1	T-W-2a	***	
Feb-2013	1	T-W-2a	***	
Mar-2013	1	T-W-2a	***	

**Table 1 to
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Mar-2013	1	T-W-2	***
Apr-2013	1	T-W-2	***
May-2013	1	T-W-2	***
Jun-2013	2	T-W-2	***
Jul-2013	1	T-W-2	***
Aug-2013	2	T-W-2	***
Sep-2013	2	T-W-2	***
Oct-2013	2	T-W-2	***
Nov-2013	1	T-W-2	***
Dec-2013	2	T-W-2	***
Jan-2014	1	T-W-2	***
Feb-2014	1	T-W-2	***
Mar-2014	1	T-W-2	***
Apr-2014	1	T-W-2	***
May-2014	1	T-W-2	***
Jun-2014	1	T-W-2	***
Jul-2014	1	T-W-2	***
Aug-2014	1	T-W-2	***
Sep-2014	1	T-W-2	***
Oct-2014	1	T-W-2	***

EMPLOYMENT CONTRACT

THIS EMPLOYMENT CONTRACT (hereinafter referred to as this "Agreement"), dated as of July 15, 2007, by and between **HERBERT D. KELLEHER** (hereinafter referred to as the "Employee"), a resident of Dallas, Texas, and **SOUTHWEST AIRLINES CO.** (hereinafter referred to as "Southwest", which term shall include its subsidiary companies where the context so admits), a Texas corporation,

WITNESSETH:

WHEREAS the Employee has served as an officer of Southwest since February 1, 1982, initially pursuant to an Employment Contract dated as of February 1, 1982, later pursuant to Employment Contracts dated as of January 1, 1985, January 1, 1988, January 1, 1992, January 1, 1996, January 1, 2001 and most recently pursuant to an Employment Contract dated as of July 15, 2004 (such Employment Contracts being referred to collectively as the "Old Contracts"); and

WHEREAS the Employee and Southwest desire to enter into a successor agreement for the continuing services of the Employee and to amend and restate certain provisions of the Old Contracts;

NOW, THEREFORE, for and in consideration of the premises and the mutual covenants and promises contained herein, Southwest and the Employee agree as follows:

I. POSITION, DUTIES AND AUTHORITY

- A. POSITIONS; RETIREMENT FROM OFFICE; AND CONTINUED EMPLOYMENT.** The Employee shall perform such corporate duties and discharge such corporate responsibilities as are designated by the Board of Directors and he shall serve as both Chairman of the Board and Chairman of the Executive Committee of the Board without additional compensation hereunder. Effective at the Annual Meeting of Shareholders for Southwest to be held in May 2008, the Employee shall retire from the Board of Directors of Southwest and from his positions as Chairman of the Board and Chairman of the Executive Committee of the Board. Notwithstanding such retirements, Employee shall remain an employee of Southwest through July 14, 2013, and during the period of such employment the Employee shall discharge the obligations set forth in Paragraph I-B of this Agreement. The Employee may elect to terminate his employment at any time prior to July 15, 2013 as provided in Paragraph V-E of this Agreement.
- B. DUTIES.** For so long as Employee remains Chairman of the Board of Directors hereunder, the Employee's duties shall include responsibility for overseeing the implementation of Southwest's current and long range business policies and programs and handling such other functions or segments of Southwest's business as may be directed from time to time by the Board of Directors. Thereafter, the Employee agrees that he shall make himself generally available at the offices of Southwest in order to consult, upon request, with the Chief Executive Officer of Southwest, or his designees, as to the business, properties or operations of Southwest. At all times during his employment the Employee shall generally conform to all policies of Southwest as they may apply to an employee of his level of duties and obligations.
- C. AUTHORITY.** The Employee shall be vested with all authority reasonably necessary to carry out his duties and responsibilities as set forth in this Article I.
- D. NECESSARY SUPPORT AND ENVIRONMENT.** Throughout the term of this Agreement, the Employee shall be provided with the office suite and appurtenances thereto that he occupied, and utilized, on July 15, 2007 and with the staff support that he received as of such date.

II. EMPLOYEE'S OBLIGATIONS

- A. **TIME AND EFFORTS.** During the term of his employment hereunder, the Employee shall devote such time and effort as is required to discharge his duties hereunder.
- B. **NON-COMPETITION.** The Employee recognizes and understands that in performing the duties and responsibilities of his employment as outlined in this Agreement and pursuant to his employment at Southwest prior to the execution of this Agreement, the Employee has occupied and will occupy a position of trust and confidence, pursuant to which the Employee has developed and acquired and will develop and acquire experience and knowledge with respect to various aspects of the business of Southwest and the manner in which such business is conducted. It is the expressed intent and agreement of the Employee and Southwest that such knowledge and experience shall be used in the furtherance of the business interests of Southwest and not in any manner which would be detrimental to such business interests of Southwest. The Employee therefore agrees that, so long as the Employee is employed pursuant to this Agreement, unless he first secures the consent of the Board of Directors of Southwest, the Employee will not invest, engage or participate in any manner whatsoever, either personally or in any status or capacity (other than as a shareholder of less than one percent [1%] of the capital stock of a publicly owned corporation), in any business or other entity organized for profit engaged in significant competition with Southwest in the conduct of its air carrier operations anywhere in the States of Texas, Louisiana, Oklahoma, New Mexico, Missouri, Arizona, Nevada, California, Arkansas, Alabama, Tennessee, Kentucky, Michigan, Indiana, Ohio, Maryland, Illinois, Utah, Washington, Oregon, Nebraska, Florida, Idaho, Mississippi, New Hampshire, New York, Rhode Island, Connecticut, North Carolina, Virginia, Pennsylvania, and Colorado. Although the Employee and Southwest regard such restrictions as reasonable for the purpose of preserving Southwest and its proprietary rights, in the event that the provisions of this Paragraph II-B should ever be deemed to exceed the time or geographic limitations permitted by applicable laws, then such provisions shall be reformed to the maximum time or geographic limitations permitted by applicable laws.

III. TERM

- A. **TERM.** This Agreement and the Employee's employment hereunder shall commence and become effective on and as of July 15, 2007. The term of such employment shall expire on July 15, 2013, unless extended by consent of the parties hereto or earlier terminated pursuant to the provisions of Article V.

IV. EMPLOYEE'S COMPENSATION

- A. **BASE SALARY.** The Employee's annual Base Salary for each year during the term of this Agreement shall be \$400,000. The Employee's Base Salary shall be payable to the Employee in equal semi-monthly installments and shall be subject to such payroll and withholding deductions as may be required by law.
- B. **PERFORMANCE BONUS.** The Board of Directors of Southwest (or the Compensation Committee thereof) may grant a Performance Bonus to the Employee, in addition to his Base Salary, at such times and in such amounts as such Board (or Committee) may determine.
- C. **DEFERRED COMPENSATION.** In addition to the Base Salary provided for in Paragraph IV-A above, Southwest shall continue to set aside on its books, as provided in Paragraph IV-C of each of the Old Contracts, a special ledger Deferred Compensation Account (the "Account") for the Employee, and shall credit thereto Deferred Compensation determined as hereinafter provided. (Southwest at its election may fund the payment of Deferred Compensation by setting aside and investing such funds as Southwest may from time to time determine. Neither the establishment of the Account, the crediting of Deferred Compensation thereto, nor the setting aside of any funds shall be deemed to create a trust. Legal and equitable title to any funds set aside shall remain in Southwest, and the Employee shall have no security or other interest in such funds. Any funds so set aside or invested shall remain subject to the claims of the creditors of Southwest, present and future.) For each full or partial calendar year as the Employee shall remain in the employment of Southwest under this Agreement, Deferred Compensation shall accumulate in an amount equal to any contributions (including forfeitures but excluding any elective deferrals actually returned to the Employee) which would otherwise have been made by Southwest on behalf of the Employee to the Southwest Airlines Co. Profitsharing Plan and Southwest Airlines Co. 401(k) Plan, but which exceed the amount permitted to be so contributed due to the limitations under Sections 415(c) (the "415(c) Excess Amount") and 401(a)(17) of the Internal Revenue Code. If such employment shall terminate prior to December 31 in any calendar year, then Deferred Compensation shall accumulate and be calculated as provided under the terms of Southwest's Profitsharing Plan. Employee hereby elects not to invest the 415(c) Excess Amount in Southwest's 2005 Excess Benefit Plan (or any successor plan).

The Deferred Compensation credited to the Account (including the Interest hereinafter provided) shall be paid to the Employee (or to the executors or administrators of his estate) at the rate of \$200,000 per calendar year (subject to such payroll and withholding deductions as may be required by law), commencing with the calendar year following the year in which (i) the Employee shall attain the age of eighty-two (82) or (ii) the Employee's employment with Southwest shall terminate (whether such termination is under this Agreement or otherwise and whether it is before, on or after the expiration of the initial term set forth in Paragraph III-A above, and irrespective of the cause thereof), whichever shall occur later, and continuing until the entire amount of Deferred Compensation and Interest credited to the Account shall have been paid. Although the total amount of Deferred Compensation ultimately payable to the Employee hereunder shall be computed in accordance with the provisions set forth above, there shall be accrued and credited to the Account, beginning on January 1, 2007 (if not so accrued and credited pursuant to the Old Contracts, and if so accrued and credited, then beginning on January 1, 2008) and continuing annually thereafter until the entire balance of the account has been distributed (whether such distribution takes place during the term of this Agreement or thereafter), amounts equal to simple interest at the rate of ten percent (10%) per annum, compounded annually ("Interest"), on the accrued and unpaid balance of the Deferred Compensation credited to the Account as of the preceding December 31. The Deferred Compensation and Interest to be paid in any one calendar year shall be paid on the first business day of such calendar year; provided, however, that if the event triggering commencement of payment of Deferred Compensation and Interest is Employee's termination of employment with Southwest, payment of the first of such annual Deferred Compensation and Interest payments shall be deferred to the extent necessary to cause such payment to comply with the six month deferral rule described in Section 409A(a)(2)(B) of the Internal Revenue Code if Employee at his termination of employment with Southwest is a "specified employee" within the meaning of such section. No right, title, interest or benefit under this Paragraph IV-C shall ever be liable for or charged with any of the torts or obligations of the Employee or any person claiming under him, or be subject to seizure by any creditor of the Employee or any person claiming under him. Neither the Employee nor any person claiming under him shall have the power to anticipate or dispose of any right, title, interest or benefit under this Paragraph IV-C in any manner until the same shall have been actually distributed by Southwest.

Except with respect to the 415(c) Excess Amount elections, Paragraph IV-C of each of the Old Contracts is hereby amended and restated to conform to the provisions set forth herein.

- D. **DISABILITY INSURANCE.** During the term of this Agreement, Southwest shall provide long term disability insurance providing for payment, in the event of disability of the Employee, of \$10,000 per month to age eighty-two (82). Except as to amounts payable, the terms and conditions of such policy shall be identical, or substantially similar, to the disability insurance provided by Southwest for its other officers as of the date of this Agreement.
- E. **MEDICAL AND DENTAL EXPENSES.** During the term of this Agreement, the Employee shall remain eligible to participate in any medical benefit plan or program that Southwest makes available to its employees generally. Upon termination of his employment with Southwest, the Employee shall be eligible to participate in any non-contract retiree medical benefit plan or program that Southwest may then make available to its retirees generally. Southwest shall reimburse the Employee for all his out-of-pocket expenses (including specifically all premiums and deductibles) that the Employee may incur for himself and his spouse under any such Southwest plan or program during the term of this Agreement.
- F. **STOCK OPTION GRANT.** In connection with its approval of the terms of this Agreement on July 19, 2007, the Compensation Committee of the Board of Directors granted to the Employee ten-year options to purchase 60,000 shares of its common stock. Such options were granted pursuant to the Company's 2007 Equity Incentive Plan and became exercisable with respect to 100% of the shares of Common Stock covered thereby on the date of grant. Such options shall be incentive stock options to the maximum extent permissible under the terms of the 2007 Equity Incentive Plan. The exercise price of such options shall be the fair market value of Southwest's common stock on July 19, 2007 or the date of approval of the form of this Agreement by the Compensation Committee, whichever is higher.
- G. **OTHER BENEFITS.** The Employee shall be eligible to continue to participate in all employee pension, profit-sharing, stock purchase, group insurance and other benefit plans or programs in effect for Southwest managerial employees generally to the extent of and in accordance with the rules and agreements governing such plans or programs, so long as same shall be in effect, with full service credit where relevant for the Employee's prior employment by Southwest. Southwest shall reimburse the Employee for reasonable expenses incurred by him in the performance of his duties and responsibilities hereunder. The Employee shall be entitled to vacation of three (3) weeks per year or such longer period as may be established from time to time by Southwest for its managerial employees generally.

V. TERMINATION PROVISIONS

- A. **EXPIRATION OR DEATH.** The Employee's employment hereunder shall terminate on July 15, 2013 (or such later date to which the term of this Agreement may be extended by consent of the parties hereto, in either case without prejudice to the Employee's privilege to remain an employee of Southwest thereafter), or upon the Employee's death, whichever shall first occur, without further obligation or liability of either party hereunder, except for Southwest's obligation to pay Deferred Compensation as provided in Paragraph IV-C of this Agreement.
- B. **TERMINATION FOR CAUSE.** Southwest may terminate the Employee's employment hereunder upon the determination by a majority of its whole Board of Directors that the Employee has willfully failed and refused to perform his duties and to discharge his responsibilities hereunder. Such determination shall be final and conclusive. If the Board of Directors of Southwest makes such determination, Southwest may (a) terminate the Employee's employment, effective immediately or at a subsequent date, or (b) condition his continued employment upon the circumstances and place a reasonable limitation upon the time within which the Employee shall comply with such considerations or requirements. If termination is so effected, Southwest shall have no further liability to the Employee hereunder except for the obligation to pay Deferred Compensation as provided in Paragraph IV-C hereof.
- C. **TERMINATION FOR DISABILITY.** Southwest may terminate the Employee's employment hereunder on account of any disabling illness, hereby defined to include any emotional or mental disorders, physical diseases or injuries as a result of which the Employee is, for a continuous period of ninety (90) days, unable to perform his duties hereunder. Southwest shall give to the Employee ninety (90) days' notice of its intention to effect such termination pursuant to this Paragraph V-C. If, within such notice period, the Employee shall have recovered from his disability sufficiently well to resume performance of his duties (although still undergoing treatment or rehabilitation), Southwest shall not have the right to effect such termination. If such disabling illness occurs as a result of a job-related cause, Southwest shall continue to pay the Employee regular installments of his Base Salary in effect at the time of such termination for the remainder of the term of this Agreement in accordance with Southwest's regular payroll practices; provided that, payment shall be deferred to the extent necessary to cause such payment to comply with the six month deferral rule described in Section 409A(a)(2)(B) of the Internal Revenue Code if Employee at his termination of employment with Southwest is a "specified employee" as defined in such section. It is expressly understood and agreed, however, that any obligation of Southwest to continue to pay the Employee his Base Salary pursuant to this Paragraph V-C shall be reduced by the amount of any proceeds of long-term disability insurance provided for the Employee pursuant to Paragraph IV-D above, and shall also be reduced by the amount of the proceeds of any worker's compensation or other benefits which the Employee receives as a result of or growing out of his disabling illness.
- D. **CHANGE OF CONTROL TERMINATION.** In the event of any change of control of Southwest, the Employee may, at his option, terminate his employment hereunder by giving to Southwest notice thereof no later than sixty (60) days after the Employee shall have determined or ascertained that such change has occurred, irrespective whether Southwest shall have purported to terminate this Agreement after such event but prior to receipt of such notice. If termination is so effected, no later than the date of such termination Southwest shall pay the Employee as "severance pay" a lump sum equal to (i) \$750,000 plus (ii) an amount equal to the unpaid installments of his Base Salary in effect at the time of such termination for the remaining term of this Agreement; provided, however, that if Employee is at his termination of employment with Southwest a "specified employee" within the meaning of Section 409A(a)(2)(B) of the Internal Revenue Code, payment of the "severance pay" shall be deferred to the extent necessary to cause such payment to comply with the six month deferral rule described in such section. If termination is so effected, Southwest shall have no other further liability to the Employee hereunder except for its obligation to pay Deferred Compensation as provided in Paragraph IV-C above. For purposes of this Paragraph V-D, a "change of control of Southwest" shall be deemed to occur if (i) a third person, including a "group" as determined in accordance with Section 13(d)(3) of the Securities Exchange Act of 1934, becomes the beneficial owner of shares of Southwest having twenty percent (20%) or more of the total number of votes that may be cast for the election of directors of Southwest, or (ii) as a result of, or in connection with, any cash tender or exchange offer, merger or other business combination, sale of assets or contested election, or any combination of the foregoing transactions (herein called a "Transaction"), the persons who were directors of Southwest before the Transaction shall cease to constitute a majority of the Board of Directors of Southwest or any successor to Southwest.
- E. **VOLUNTARY TERMINATION.** The Employee's employment hereunder shall terminate forthwith upon his resignation and its acceptance by Southwest, without further obligation or liability of either party hereunder, except for Southwest's obligation to pay Deferred Compensation as provided in Paragraph IV-C above.

VI. MISCELLANEOUS

- A. ASSIGNABILITY, ETC.** The rights and obligations of Southwest hereunder shall inure to the benefit of and shall be binding upon the successors and assigns of Southwest; provided, however, Southwest's obligations hereunder may not be assigned without the prior approval of the Employee. This Agreement is personal to the Employee and may not be assigned by him.
- B. NO WAIVERS.** Failure to insist upon strict compliance with any provision hereof shall not be deemed a waiver of such provision or any other provision hereof.
- C. AMENDMENTS.** This Agreement may not be modified except by an agreement in writing executed by the parties hereto.
- D. NOTICES.** Any notice required or permitted to be given under this Agreement shall be in writing and shall be deemed to have been given to the person affected by such notice when personally delivered or when deposited in the United States mail, certified mail, return receipt requested and postage prepaid, and addressed to the party affected by such notice at the address indicated on the signature page hereof.
- E. SEVERABILITY.** The invalidity or unenforceability of any provision hereof shall not affect the validity or enforceability of any other provision hereof.
- F. COUNTERPARTS.** This Agreement may be executed in multiple counterparts, each of which shall be deemed an original but all of which taken together shall constitute a single instrument.
- G. ENTIRE AGREEMENT.** This Agreement contains all of the terms and conditions agreed upon by the parties hereto respecting the subject matter hereof, and all other prior agreements, oral or otherwise, regarding the subject matter of this Agreement shall be deemed to be superseded as of the date of this Agreement and not to bind either of the parties hereto.
- H. GOVERNING LAW.** This Agreement shall be subject to and governed by the laws of the State of Texas.

IN WITNESS WHEREOF, the Employee has set his hand hereto and Southwest has caused this Agreement to be signed in its corporate name and behalf by the Chairman of the Compensation Committee of the Board of Directors who is thereunto duly authorized all as of the day and year first above written.

SOUTHWEST AIRLINES CO.

By /s/ David Biegler
David Biegler
Chairman, Compensation Committee of the
Board of Directors

THE EMPLOYEE

By /s/ Herbert D. Kelleher
Herbert D. Kelleher

Address: P.O. Box 36611
Dallas, Texas 75235-1611

EMPLOYMENT CONTRACT

THIS EMPLOYMENT CONTRACT (hereinafter referred to as this "Agreement"), dated as of July 15, 2007, by and between **GARY C. KELLY** (hereinafter referred to as the "Employee"), a resident of Dallas, Texas, and **SOUTHWEST AIRLINES CO.** (hereinafter referred to as "Southwest", which term shall include its subsidiary companies where the context so admits), a Texas corporation,

WITNESSETH:

WHEREAS the Employee has served as Chief Executive Officer of Southwest since July 15, 2004, pursuant to an Employment Contract dated as of such date (the "Old Contract"); and

WHEREAS the Employee and Southwest desire to enter into a successor agreement for the continuing full-time services of the Employee, and to amend and restate certain provisions of the Old Contract;

NOW, THEREFORE, for and in consideration of the premises and the mutual covenants and promises contained herein, Southwest and the Employee agree as follows:

I. POSITION, DUTIES AND AUTHORITY

- A. POSITIONS, DUTIES AND RESPONSIBILITIES.** The Employee shall serve as Chief Executive Officer of Southwest, and, for so long as he shall be elected to the Board of Directors of Southwest and so designated by the Board, he shall serve as Vice Chairman of the Board without additional compensation hereunder. The Employee's duties and responsibilities as Chief Executive Officer shall include general oversight of the operational performance of Southwest; managing costs and generating revenues in order to achieve excellent financial performance; representing Southwest to its multitude of exterior constituencies; implementing Southwest's current and long range business policies and programs; handling, or overseeing, major contract negotiations; and, in general, maintaining employee morale and *esprit de corps*. In addition, he shall perform such other corporate duties and discharge such other corporate responsibilities as are specified in the bylaws of Southwest or are designated from time to time by either the Chairman of the Board of Directors of Southwest or the full Board of Directors.
- B. AUTHORITY.** The Employee shall be vested with all authority reasonably necessary to carry out his duties and responsibilities as set forth in this Article I.
- C. NECESSARY SUPPORT AND ENVIRONMENT.** The Employee shall be provided with the secretarial and other support personnel (including a full-time administrative assistant) and general working environment (including a private, furnished office) reasonably necessary for him to carry out his duties and responsibilities as set forth in this Article I.

II. EMPLOYEE'S OBLIGATIONS

- A. **TIME AND EFFORT.** During the term of his employment hereunder, the Employee shall devote such time and effort as is required to perform his duties and to discharge his responsibilities hereunder. The Employee shall generally conform with all policies of Southwest as they apply to a person of his level of duties and responsibilities.
- B. **NON-COMPETITION.** The Employee recognizes and understands that in performing the duties and responsibilities of his employment as outlined in this Agreement and pursuant to his employment at Southwest prior to the execution of this Agreement, the Employee has occupied and will occupy a position of trust and confidence, pursuant to which the Employee has developed and acquired and will develop and acquire experience and knowledge with respect to various aspects of the business of Southwest and the manner in which such business is conducted. It is the expressed intent and agreement of the Employee and Southwest that such knowledge and experience shall be used in the furtherance of the business interests of Southwest and not in any manner which would be detrimental to such business interests of Southwest. The Employee therefore agrees that, so long as the Employee is employed pursuant to this Agreement, unless he first secures the consent of the Board of Directors of Southwest, the Employee will not invest, engage or participate in any manner whatsoever, either personally or in any status or capacity (other than as a shareholder of less than one percent [1%] of the capital stock of a publicly owned corporation), in any business or other entity organized for profit engaged in significant competition with Southwest in the conduct of its air carrier operations anywhere in the States of Texas, Louisiana, Oklahoma, New Mexico, Missouri, Arizona, Nevada, California, Arkansas, Alabama, Tennessee, Kentucky, Michigan, Indiana, Ohio, Maryland, Illinois, Utah, Washington, Oregon, Nebraska, Florida, Idaho, Mississippi, New Hampshire, New York, Pennsylvania, Rhode Island, Connecticut, North Carolina, Virginia, and Colorado. Although the Employee and Southwest regard such restrictions as reasonable for the purpose of preserving Southwest and its proprietary rights, in the event that the provisions of this Paragraph II-B should ever be deemed to exceed the time or geographic limitations permitted by applicable laws, then such provisions shall be reformed to the maximum time or geographic limitations permitted by applicable laws.

III. TERM

- A. **TERM.** This Agreement and the Employee's employment hereunder shall commence and become effective on and as of July 15, 2007. The term of such employment shall expire on February 1, 2011, unless extended by consent of the parties hereto or earlier terminated pursuant to the provisions of Article V.

IV. EMPLOYEE'S COMPENSATION

- A. **BASE SALARY.** The Employee's annual Base Salary shall be \$424,065. The Board of Directors of Southwest (or the Compensation Committee thereof) may grant a raise to the Employee at such times and in such amounts as such Board (or Committee) may determine. The Employee's Base Salary shall be payable to the Employee in equal semi-monthly installments. The Employee's Base Salary installment payments shall be subject to such payroll and withholding deductions as may be required by law.
- B. **PERFORMANCE BONUS.** The Board of Directors of Southwest (or the Compensation Committee thereof) may grant a Performance Bonus to the Employee, in addition to his Base Salary, at such times and in such amounts as such Board (or Committee) may determine.
- C. **DEFERRED COMPENSATION.** In addition to the Base Salary provided for in Paragraph IV-A above, Southwest shall continue to set aside on its books, as provided in Paragraph IV-C of the Old Contract, a special ledger Deferred Compensation Account (the "Account") for the Employee, and shall credit thereto Deferred Compensation determined as hereinafter provided. (Southwest at its election may fund the payment of Deferred Compensation by setting aside and investing such funds as Southwest may from time to time determine. Neither the establishment of the Account, the crediting of Deferred Compensation thereto, nor the setting aside of any funds shall be deemed to create a trust. Legal and equitable title to any funds set aside shall remain in Southwest, and the Employee shall have no security or other interest in such funds. Any funds so set aside or invested shall remain subject to the claims of the creditors of Southwest, present and future.) For each full or partial calendar year as the Employee shall remain in the employment of Southwest under this Agreement, Deferred Compensation shall accumulate in an amount equal to any contributions (including forfeitures but excluding any elective deferrals actually returned to the Employee) which would otherwise have been made by Southwest on behalf of the Employee to the Southwest Airlines Co. Profitsharing Plan and Southwest Airlines Co. 401(k) Plan, but which exceed the amount permitted to be so contributed due to the limitations under Sections 415(c) (the "415(c) Excess Amount") and 401(a)(17) of the Internal Revenue Code. If such employment shall terminate prior to December 31 in any calendar year, then Deferred Compensation shall accumulate and be calculated as provided under the terms of Southwest's Profitsharing Plan. Employee hereby elects not to invest the 415(c) Excess Amount in Southwest's 2005 Excess Benefit Plan (or any successor plan).

The Deferred Compensation credited to the Account (including the Interest hereinafter provided) shall be paid to the Employee at the rate of \$200,000 per calendar year (subject to such payroll and withholding deductions as may be required by law), commencing with the calendar year following the year in which (i) the Employee shall become sixty-five (65) or (ii) the Employee's employment with Southwest shall terminate (whether such termination is under this Agreement or otherwise and whether it is before, on or after the expiration of the initial term set forth in Paragraph III-A above, and irrespective of the cause thereof), whichever shall occur later, and continuing until the entire amount of Deferred Compensation and Interest credited to the Account shall have been paid. Although the total amount of Deferred Compensation ultimately payable to the Employee hereunder shall be computed in accordance with the provisions set forth above, there shall be accrued and credited to the Account, beginning on January 1, 2007 (if not so accrued and credited pursuant to the Old Contract, and if so accrued and credited, then beginning on January 1, 2008) and continuing annually thereafter until the entire balance of the account has been distributed (whether such distribution takes place during the term of this Agreement or thereafter), amounts equal to simple interest at the rate of ten percent (10%) per annum, compounded annually ("Interest"), on the accrued and unpaid balance of the Deferred Compensation credited to the Account as of the preceding December 31. The Deferred Compensation and Interest to be paid in any one calendar year shall be paid on the first business day of such calendar year; provided, however, that if the event triggering commencement of payment of Deferred Compensation and Interest is Employee's termination of employment with Southwest, payment of the first of such annual Deferred Compensation and Interest payments shall be deferred to the extent necessary to cause such payment to comply with the six month deferral rule described in Section 409A(a)(2)(B) of the Internal Revenue Code if Employee at his termination of employment with Southwest is a "specified employee" within the meaning of such section. Notwithstanding the foregoing, in the event of the Employee's death, then the unpaid balance of the Deferred Compensation (together with any accrued Interest thereon) shall be paid to the executors or administrators of the Employee's estate in cash in one lump sum on the first business day of the calendar year next following the calendar year in which the Employee shall have died. No right, title, interest or benefit under this Paragraph IV-C shall ever be liable for or charged with any of the torts or obligations of the Employee or any person claiming under him, or be subject to seizure by any creditor of the Employee or any person claiming under him. Neither the Employee nor any person claiming under him shall have the power to anticipate or dispose of any right, title, interest or benefit under this Paragraph IV-C in any manner until the same shall have been actually distributed by Southwest.

Except with respect to the 415(c) Excess Amount elections, Paragraph IV-C of the Old Contract is hereby amended and restated to conform to the provisions set forth herein.

- D. DISABILITY INSURANCE.** During the term of this Agreement, Southwest shall provide long term disability insurance providing for payment, in the event of disability of the Employee, of \$10,000 per month to age seventy (70). Except as to amounts payable, the terms and conditions of such policy shall be identical, or substantially similar, to the disability insurance provided by Southwest for its other officers as of the date of this Agreement.
- E. MEDICAL AND DENTAL EXPENSES.** During the term of this Agreement, the Employee shall remain eligible to participate in any medical benefit plan or program that Southwest makes available to its employees generally. Upon termination of his employment with Southwest, the Employee shall be eligible to participate in any non-contract retiree medical benefit plan or program that Southwest may then make available to its retirees generally. Southwest shall reimburse the Employee for all his out-of-pocket expenses (including specifically all premiums and deductibles) that the Employee may incur for himself, his spouse and his children under any such Southwest plan or program during the term of this Agreement. In addition, Southwest shall pay Employee the sum of \$10,000 per year to be applied to any supplemental insurance needs he may have, such amount to be payable on August 1 of each year during the term of this Agreement, beginning August 1, 2007.
- F. STOCK OPTION GRANT.** In connection with its approval of the terms of this Agreement on July 19, 2007, the Compensation Committee of the Board of Directors granted to the Employee ten-year options to purchase 150,000 shares of its common stock. Such options were granted pursuant to the Company's 2007 Equity Incentive Plan and one-third of such options were exercisable immediately and one-third will become exercisable on each of July 15, 2008 and July 15, 2009. Such options shall be incentive stock options to the maximum extent permissible under the terms of the 2007 Equity Incentive Plan. The exercise price of such options shall be the fair market value of Southwest's common stock on July 19, 2007 or the date of approval of the form of this Agreement by the Compensation Committee, whichever is higher.
- G. OTHER BENEFITS.** The Employee shall be eligible to continue to participate in all employee pension, profit-sharing, stock purchase, group insurance and other benefit plans or programs in effect for Southwest managerial employees generally to the extent of and in accordance with the rules and agreements governing such plans or programs, so long as same shall be in effect, with full service credit where relevant for the Employee's prior employment by Southwest. Southwest shall reimburse the Employee for reasonable expenses incurred by him in the performance of his duties and responsibilities hereunder. The Employee shall be entitled to vacation of three (3) weeks per year or such longer period as may be established from time to time by Southwest for its managerial employees generally.

V. TERMINATION PROVISIONS

- A. **EXPIRATION OR DEATH.** The Employee's employment hereunder shall terminate on February 1, 2011 (or such later date to which the term of this Agreement may be extended by consent of the parties hereto, in either case without prejudice to the Employee's privilege to remain an employee of Southwest thereafter), or upon the Employee's death, whichever shall first occur, without further obligation or liability of either party hereunder, except for Southwest's obligation to pay Deferred Compensation as provided in Paragraph IV-C of this Agreement.
- B. **TERMINATION FOR CAUSE.** Southwest may terminate the Employee's employment hereunder upon the determination by a majority of its whole Board of Directors that the Employee has willfully failed and refused to perform his duties and to discharge his responsibilities hereunder. Such determination shall be final and conclusive. If the Board of Directors of Southwest makes such determination, Southwest may (a) terminate the Employee's employment, effective immediately or at a subsequent date, or (b) condition his continued employment upon the circumstances and place a reasonable limitation upon the time within which the Employee shall comply with such considerations or requirements. If termination is so effected, Southwest shall have no further liability to the Employee hereunder except for the obligation to pay Deferred Compensation as provided in Paragraph IV-C hereof.
- C. **TERMINATION FOR DISABILITY.** Southwest may terminate the Employee's employment hereunder on account of any disabling illness, hereby defined to include any emotional or mental disorders, physical diseases or injuries as a result of which the Employee is, for a continuous period of ninety (90) days, unable to perform his duties hereunder. Southwest shall give to the Employee ninety (90) days' notice of its intention to effect such termination pursuant to this Paragraph V-C. If, within such notice period, the Employee shall have recovered from his disability sufficiently well to resume performance of his duties (although still undergoing treatment or rehabilitation), Southwest shall not have the right to effect such termination. If such disabling illness occurs as a result of a job-related cause, Southwest shall continue to pay the Employee regular installments of his Base Salary in effect at the time of such termination for the remainder of the term of this Agreement in accordance with Southwest's regular payroll practices; provided that, payment shall be deferred to the extent necessary to cause such payment to comply with the six month deferral rule described in Section 409A(a)(2)(B) of the Internal Revenue Code if Employee at his termination of employment with Southwest is a "specified employee" as defined in such section. It is expressly understood and agreed, however, that any obligation of Southwest to continue to pay the Employee his Base Salary pursuant to this Paragraph V-C shall be reduced by the amount of any proceeds of long-term disability insurance provided for the Employee pursuant to Paragraph IV-D above, and shall also be reduced by the amount of the proceeds of any worker's compensation or other benefits which the Employee receives as a result of or growing out of his disabling illness.
- D. **CHANGE OF CONTROL TERMINATION.** In the event of any change of control of Southwest, the Employee may, at his option, terminate his employment hereunder by giving to Southwest notice thereof no later than sixty (60) days after the Employee shall have determined or ascertained that such change has occurred, irrespective whether Southwest shall have purported to terminate this Agreement after such event but prior to receipt of such notice. If termination is so effected, no later than the date of such termination Southwest shall pay the Employee as "severance pay" a lump sum equal to (i) \$750,000 plus (ii) an amount equal to the unpaid installments of his Base Salary in effect at the time of such termination for the remaining term of this Agreement; provided, however, that if Employee is at his termination of employment with Southwest a "specified employee" within the meaning of Section 409A(a)(2)(B) of the Internal Revenue Code, payment of the "severance pay" shall be deferred to the extent necessary to cause such payment to comply with the six month deferral rule described in such section. If termination is so effected, Southwest shall have no other further liability to the Employee hereunder except for its obligation to pay Deferred Compensation as provided in Paragraph IV-C above. For purposes of this Paragraph V-D, a "change of control of Southwest" shall be deemed to occur if (i) a third person, including a "group" as determined in accordance with Section 13(d)(3) of the Securities Exchange Act of 1934, becomes the beneficial owner of shares of Southwest having twenty percent (20%) or more of the total number of votes that may be cast for the election of directors of Southwest, or (ii) as a result of, or in connection with, any cash tender or exchange offer, merger or other business combination, sale of assets or contested election, or any combination of the foregoing transactions (herein called a "Transaction"), the persons who were directors of Southwest before the Transaction shall cease to constitute a majority of the Board of Directors of Southwest or any successor to Southwest.
- E. **VOLUNTARY TERMINATION.** The Employee's employment hereunder shall terminate forthwith upon his resignation and its acceptance by Southwest, without further obligation or liability of either party hereunder, except for Southwest's obligation to pay Deferred Compensation as provided in Paragraph IV-C above.

VI. MISCELLANEOUS

- A. ASSIGNABILITY, ETC.** The rights and obligations of Southwest hereunder shall inure to the benefit of and shall be binding upon the successors and assigns of Southwest; provided, however, Southwest's obligations hereunder may not be assigned without the prior approval of the Employee. This Agreement is personal to the Employee and may not be assigned by him.
- B. NO WAIVERS.** Failure to insist upon strict compliance with any provision hereof shall not be deemed a waiver of such provision or any other provision hereof.
- C. AMENDMENTS.** This Agreement may not be modified except by an agreement in writing executed by the parties hereto.
- D. NOTICES.** Any notice required or permitted to be given under this Agreement shall be in writing in the English language and shall be deemed to have been given to the person affected by such notice when personally delivered or when deposited in the United States mail, certified mail, return receipt requested and postage prepaid, and addressed to the party affected by such notice at the address indicated on the signature page hereof.
- E. SEVERABILITY.** The invalidity or unenforceability of any provision hereof shall not affect the validity or enforceability of any other provision hereof.
- F. COUNTERPARTS.** This Agreement may be executed in multiple counterparts, each of which shall be deemed an original but all of which taken together shall constitute a single instrument.
- G. ENTIRE AGREEMENT.** This Agreement contains all of the terms and conditions agreed upon by the parties hereto respecting the subject matter hereof, and all other prior agreements, oral or otherwise, regarding the subject matter of this Agreement shall be deemed to be superseded as of the date of this Agreement and not to bind either of the parties hereto.
- H. GOVERNING LAW.** This Agreement shall be subject to and governed by the laws of the State of Texas.

IN WITNESS WHEREOF, the Employee has set his hand hereto and Southwest has caused this Agreement to be signed in its corporate name and behalf by the Chairman of the Compensation Committee of the Board of Directors who is thereunto duly authorized, all as of the day and year first above written.

SOUTHWEST AIRLINES CO.

By /s/ David Biegler
David Biegler
Chairman, Compensation Committee of the
Board of Directors

THE EMPLOYEE

By /s/ Gary C. Kelly
Gary C. Kelly

Address: P.O. Box 36611
Dallas, Texas 75235-1611

EMPLOYMENT CONTRACT

THIS EMPLOYMENT CONTRACT (hereinafter referred to as this "Agreement"), dated as of July 15, 2007, by and between **COLLEEN C. BARRETT** (hereinafter referred to as the "Employee"), a resident of Dallas, Texas, and **SOUTHWEST AIRLINES CO.** (hereinafter referred to as "Southwest", which term shall include its subsidiary companies where the context so admits), a Texas corporation,

WITNESSETH:

WHEREAS the Employee has served Southwest since March 1978 in various executive capacities, most recently as President and Secretary pursuant to Employment Contracts dated as of June 19, 2001 and July 15, 2004 (such Employment Contracts being referred to collectively as the "Old Contracts"); and

WHEREAS the Employee and Southwest desire to enter into a successor agreement for the continuing services of the Employee and to amend and restate certain provisions of the Old Contracts;

NOW, THEREFORE, for and in consideration of the premises and the mutual covenants and promises contained herein, Southwest and the Employee agree as follows:

I. POSITION, DUTIES AND AUTHORITY

- A. POSITIONS; RETIREMENT FROM OFFICE; AND CONTINUED EMPLOYMENT.** The Employee shall serve as President of Southwest and, for so long as she shall be a member of the Board of Directors of Southwest, she shall serve in such capacity and as Corporate Secretary to the Board without additional compensation hereunder. Effective at the Annual Meeting of Shareholders of Southwest to be held in May 2008, the Employee shall retire from the Board of Directors of Southwest, and from her position as Corporate Secretary; effective as of July 15, 2008, the Employee shall resign her position as President of the Company. Notwithstanding such retirements and resignations, Employee shall remain an employee of Southwest through July 14, 2013, and during the period of such employment the Employee shall discharge the obligations set forth in Paragraph I-B of this Agreement. The Employee may elect to terminate her employment at any time prior to July 15, 2013, as provided in Paragraph V-E of this Agreement; provided, however, that in such event Southwest shall be relieved of any obligation to make further payments to the Employee under Paragraph IV-A hereunder
- B. DUTIES.** For so long as Employee remains President hereunder, the Employee's duties shall include managing the Customer and Employee relations functions of Southwest; achieving excellent Customer and Employee service quality; preserving the Southwest servant leader culture; and assisting the Chief Executive Officer in implementing Southwest's current and long range business policies and programs; and in general, maintaining Employee morale and esprit de corps. In addition, she shall perform such other corporate duties and discharge such other corporate responsibilities as are specified in the bylaws of Southwest or as designated from time to time by any of the Chairman of the Board of Directors of Southwest, the Chief Executive Officer or the full Board of Directors. Thereafter, the Employee agrees that she shall make herself generally available at the offices of Southwest in order to consult with the Chief Executive Officer of Southwest, or his designees, as to the business, properties or operations of Southwest. At all times during her employment the Employee shall generally conform to all policies of Southwest as they may apply to an employee of her level of duties and obligations.
- C. AUTHORITY.** The Employee shall be vested with all authority reasonably necessary to carry out her duties and responsibilities as set forth in this Article I.
- D. NECESSARY SUPPORT AND ENVIRONMENT.** Throughout the term of this Agreement, the Employee shall be provided with the office suite and appurtenances thereto that she occupied, and utilized, on July 15, 2007 and with the staff support that she received as of such date.

II. EMPLOYEE'S OBLIGATIONS

- A. **TIME AND EFFORTS.** During the term of her employment hereunder, the Employee shall devote such time and effort as is required to discharge her duties hereunder.
- B. **NON-COMPETITION.** The Employee recognizes and understands that in performing the duties and responsibilities of her employment as outlined in this Agreement and pursuant to her employment at Southwest prior to the execution of this Agreement, the Employee has occupied and will occupy a position of trust and confidence, pursuant to which the Employee has developed and acquired and will develop and acquire experience and knowledge with respect to various aspects of the business of Southwest and the manner in which such business is conducted. It is the expressed intent and agreement of the Employee and Southwest that such knowledge and experience shall be used in the furtherance of the business interests of Southwest and not in any manner which would be detrimental to such business interests of Southwest. The Employee therefore agrees that, so long as the Employee is employed pursuant to this Agreement, unless she first secures the consent of the Board of Directors of Southwest, the Employee will not invest, engage or participate in any manner whatsoever, either personally or in any status or capacity (other than as a shareholder of less than one percent [1%] of the capital stock of a publicly owned corporation), in any business or other entity organized for profit engaged in significant competition with Southwest in the conduct of its air carrier operations anywhere in the States of Texas, Louisiana, Oklahoma, New Mexico, Missouri, Arizona, Nevada, California, Arkansas, Alabama, Tennessee, Kentucky, Michigan, Indiana, Ohio, Maryland, Illinois, Utah, Washington, Oregon, Nebraska, Florida, Idaho, Mississippi, New Hampshire, New York, Rhode Island, Connecticut, North Carolina, Virginia, Pennsylvania, and Colorado. Although the Employee and Southwest regard such restrictions as reasonable for the purpose of preserving Southwest and its proprietary rights, in the event that the provisions of this Paragraph II-B should ever be deemed to exceed the time or geographic limitations permitted by applicable laws, then such provisions shall be reformed to the maximum time or geographic limitations permitted by applicable laws.

III. TERM

- A. **TERM.** This Agreement and the Employee's employment hereunder shall commence and become effective on and as of July 15, 2007. The term of such employment shall expire on July 15, 2013, unless extended by consent of the parties hereto or earlier terminated pursuant to the provisions of Article V.

IV. EMPLOYEE'S COMPENSATION

- A. **BASE SALARY.** The Employee's annual Base Salary shall be \$368,752 for the year ended July 15, 2008; thereafter the Employee's annual Base Salary for the balance of the term of this Agreement shall be \$400,000. The Employee's Base Salary shall be payable to the Employee in equal semi-monthly installments and shall be subject to such payroll and withholding deductions as may be required by law.
- B. **PERFORMANCE BONUS.** The Board of Directors of Southwest (or the Compensation Committee thereof) may grant a Performance Bonus to the Employee, in addition to her Base Salary, at such times and in such amounts as such Board (or Committee) may determine.
- C. **DEFERRED COMPENSATION.** In addition to the Base Salary provided for in Paragraph IV-A above, Southwest shall continue to set aside on its books, as provided in Paragraph IV-C of each of the Old Contracts, a special ledger Deferred Compensation Account (the "Account") for the Employee, and shall credit thereto Deferred Compensation determined as hereinafter provided. (Southwest at its election may fund the payment of Deferred Compensation by setting aside and investing such funds as Southwest may from time to time determine. Neither the establishment of the Account, the crediting of Deferred Compensation thereto, nor the setting aside of any funds shall be deemed to create a trust. Legal and equitable title to any funds set aside shall remain in Southwest, and the Employee shall have no security or other interest in such funds. Any funds so set aside or invested shall remain subject to the claims of the creditors of Southwest, present and future.) For each full or partial calendar year as the Employee shall remain in the employment of Southwest under this Agreement, Deferred Compensation shall accumulate in an amount equal to any contributions (including forfeitures but excluding any elective deferrals actually returned to the Employee) which would otherwise have been made by Southwest on behalf of the Employee to the Southwest Airlines Co. Profitsharing Plan and Southwest Airlines Co. 401(k) Plan but which exceed the amount permitted to be so contributed due to the limitations under Sections 415(c) (the "415(c) Excess Amount") and 401(a)(17) of the Internal Revenue Code.. If such employment shall terminate prior to December 31 in any calendar year, then Deferred Compensation shall accumulate and be calculated as provided under the terms of Southwest's Profitsharing Plan. Employee hereby elects not to invest the 415(c) Excess Amount in Southwest's 2005 Excess Benefit Plan (or any successor plan).

The Deferred Compensation credited to the Account (including the Interest hereinafter provided) shall be paid to the Employee (or to the executors or administrators of her estate) at the rate of \$200,000 per calendar year (subject to such payroll and withholding deductions as may be required by law), commencing with the calendar year following the year in which (i) the Employee shall attain the age of sixty-eight (68) or (ii) the Employee's employment with Southwest shall terminate (whether such termination is under this Agreement or otherwise and whether it is before, on or after the expiration of the initial term set forth in Paragraph III-A above, and irrespective of the cause thereof), whichever shall occur later, and continuing until the entire amount of Deferred Compensation and Interest credited to the Account shall have been paid. Although the total amount of Deferred Compensation ultimately payable to the Employee hereunder shall be computed in accordance with the provisions set forth above, there shall be accrued and credited to the Account, beginning on January 1, 2007 (if not so accrued and credited pursuant to the Old Contracts, and if so accrued and credited, then beginning on January 1, 2008) and continuing annually thereafter until the entire balance of the account has been distributed (whether such distribution takes place during the term of this Agreement or thereafter), amounts equal to simple interest at the rate of ten percent (10%) per annum, compounded annually ("Interest"), on the accrued and unpaid balance of the Deferred Compensation credited to the Account as of the preceding December 31. The Deferred Compensation and Interest to be paid in any one calendar year shall be paid on the first business day of such calendar year; provided, however, that if the event triggering commencement of payment of Deferred Compensation and Interest is Employee's termination of employment with Southwest, payment of the first of such annual Deferred Compensation and Interest payments shall be deferred to the extent necessary to cause such payment to comply with the six month deferral rule described in Section 409A(a)(2)(B) of the Internal Revenue Code if Employee at her termination of employment with Southwest is a "specified employee" within the meaning of such section. No right, title, interest or benefit under this Paragraph IV-C shall ever be liable for or charged with any of the torts or obligations of the Employee or any person claiming under her, or be subject to seizure by any creditor of the Employee or any person claiming under her. Neither the Employee nor any person claiming under her shall have the power to anticipate or dispose of any right, title, interest or benefit under this Paragraph IV-C in any manner until the same shall have been actually distributed by Southwest.

Except with respect to the 415(c) Excess Amount elections, Paragraph IV-C of each of the Old Contracts is hereby amended and restated to conform to the provisions set forth herein.

- D. **DISABILITY INSURANCE.** During the term of this Agreement, Southwest shall provide long term disability insurance providing for payment, in the event of disability of the Employee, of \$10,000 per month to age seventy (70). Except as to amounts payable, the terms and conditions of such policy shall be identical, or substantially similar, to the disability insurance provided by Southwest for its other officers as of the date of this Agreement.
- E. **MEDICAL AND DENTAL EXPENSES.** During the term of this Agreement, the Employee shall remain eligible to participate in any medical benefit plan or program that Southwest makes available to its employees generally. Upon termination of her employment with Southwest, the Employee shall be eligible to participate in any non-contract retiree medical benefit plan or program that Southwest may then make available to its retirees generally. Southwest shall reimburse the Employee for all her out-of-pocket expenses (including specifically all premiums and deductibles) that the Employee may incur under any such Southwest plan or program during the term of this Agreement.
- F. **STOCK OPTION GRANT.** In connection with its approval of the terms of this Agreement on July 19, 2007, the Compensation Committee of the Board of Directors granted to the Employee ten-year options to purchase 75,000 shares of its common stock. Such options were granted pursuant to the Company's 2007 Equity Incentive Plan and became exercisable with respect to 100% of the shares of Common Stock covered thereby on the date of grant. Such options shall be incentive stock options to the maximum extent permissible under the terms of the 2007 Equity Incentive Plan. The exercise price of such options shall be the fair market value of Southwest's common stock on July 19, 2007 or the date of approval of the form of this Agreement by the Compensation Committee, whichever is higher.
- G. **OTHER BENEFITS.** The Employee shall be eligible to continue to participate in all employee pension, profit-sharing, stock purchase, group insurance and other benefit plans or programs in effect for Southwest managerial employees generally to the extent of and in accordance with the rules and agreements governing such plans or programs, so long as same shall be in effect, with full service credit where relevant for the Employee's prior employment by Southwest. Southwest shall reimburse the Employee for reasonable expenses incurred by her in the performance of her duties and responsibilities hereunder. The Employee shall be entitled to vacation of three (3) weeks per year or such longer period as may be established from time to time by Southwest for its managerial employees generally.

V. TERMINATION PROVISIONS

- A. **EXPIRATION OR DEATH.** The Employee's employment hereunder shall terminate on July 15, 2013 (or such later date to which the term of this Agreement may be extended by consent of the parties hereto, in either case without prejudice to the Employee's privilege to remain an employee of Southwest thereafter), or upon the Employee's death, whichever shall first occur, without further obligation or liability of either party hereunder, except for Southwest's obligation to pay Deferred Compensation as provided in Paragraph IV-C of this Agreement.
- B. **TERMINATION FOR CAUSE.** Southwest may terminate the Employee's employment hereunder upon the determination by a majority of its whole Board of Directors that the Employee has willfully failed and refused to perform her duties and to discharge her responsibilities hereunder. Such determination shall be final and conclusive. If the Board of Directors of Southwest makes such determination, Southwest may (a) terminate the Employee's employment, effective immediately or at a subsequent date, or (b) condition her continued employment upon the circumstances and place a reasonable limitation upon the time within which the Employee shall comply with such considerations or requirements. If termination is so effected, Southwest shall have no further liability to the Employee hereunder except for the obligation to pay Deferred Compensation as provided in Paragraph IV-C hereof.
- C. **TERMINATION FOR DISABILITY.** Southwest may terminate the Employee's employment hereunder on account of any disabling illness, hereby defined to include any emotional or mental disorders, physical diseases or injuries as a result of which the Employee is, for a continuous period of ninety (90) days, unable to perform her duties hereunder. Southwest shall give to the Employee ninety (90) days' notice of its intention to effect such termination pursuant to this Paragraph V-C. If, within such notice period, the Employee shall have recovered from her disability sufficiently well to resume performance of her duties (although still undergoing treatment or rehabilitation), Southwest shall not have the right to effect such termination. If such disabling illness occurs as a result of a job-related cause, Southwest shall continue to pay the Employee regular installments of her Base Salary in effect at the time of such termination for the remainder of the term of this Agreement in accordance with Southwest's regular payroll practices; provided that, payment shall be deferred to the extent necessary to cause such payment to comply with the six month deferral rule described in Section 409A(a)(2)(B) of the Internal Revenue Code if Employee at her termination of employment with Southwest is a "specified employee" as defined in such section. It is expressly understood and agreed, however, that any obligation of Southwest to continue to pay the Employee her Base Salary pursuant to this Paragraph V-C shall be reduced by the amount of any proceeds of long-term disability insurance provided for the Employee pursuant to Paragraph IV-D above, and shall also be reduced by the amount of the proceeds of any worker's compensation or other benefits which the Employee receives as a result of or growing out of her disabling illness.
- D. **CHANGE OF CONTROL TERMINATION.** In the event of any change of control of Southwest, the Employee may, at her option, terminate her employment hereunder by giving to Southwest notice thereof no later than sixty (60) days after the Employee shall have determined or ascertained that such change has occurred, irrespective whether Southwest shall have purported to terminate this Agreement after such event but prior to receipt of such notice. If termination is so effected, no later than the date of such termination Southwest shall pay the Employee as "severance pay" a lump sum equal to (i) \$750,000 plus (ii) an amount equal to the unpaid installments of her Base Salary in effect at the time of such termination for the remaining term of this Agreement; provided, however, that if Employee is, at her termination of employment with Southwest, a "specified employee" within the meaning of Section 409A(a)(2)(B) of the Internal Revenue Code, payment of the "severance pay" shall be deferred to the extent necessary to cause such payment to comply with the six month deferral rule described in such section. If termination is so effected, Southwest shall have no other further liability to the Employee hereunder except for its obligation to pay Deferred Compensation as provided in Paragraph IV-C above. For purposes of this Paragraph V-D, a "change of control of Southwest" shall be deemed to occur if (i) a third person, including a "group" as determined in accordance with Section 13(d)(3) of the Securities Exchange Act of 1934, becomes the beneficial owner of shares of Southwest having twenty percent (20%) or more of the total number of votes that may be cast for the election of directors of Southwest, or (ii) as a result of, or in connection with, any cash tender or exchange offer, merger or other business combination, sale of assets or contested election, or any combination of the foregoing transactions (herein called a "Transaction"), the persons who were directors of Southwest before the Transaction shall cease to constitute a majority of the Board of Directors of Southwest or any successor to Southwest.
- E. **VOLUNTARY TERMINATION.** The Employee's employment hereunder shall terminate forthwith upon her resignation and its acceptance by Southwest, without further obligation or liability of either party hereunder, except for Southwest's obligation to pay Deferred Compensation as provided in Paragraph IV-C above.

VI. MISCELLANEOUS

- A. ASSIGNABILITY, ETC.** The rights and obligations of Southwest hereunder shall inure to the benefit of and shall be binding upon the successors and assigns of Southwest; provided, however, Southwest's obligations hereunder may not be assigned without the prior approval of the Employee. This Agreement is personal to the Employee and may not be assigned by her.
- B. NO WAIVERS.** Failure to insist upon strict compliance with any provision hereof shall not be deemed a waiver of such provision or any other provision hereof.
- C. AMENDMENTS.** This Agreement may not be modified except by an agreement in writing executed by the parties hereto.
- D. NOTICES.** Any notice required or permitted to be given under this Agreement shall be in writing and shall be deemed to have been given to the person affected by such notice when personally delivered or when deposited in the United States mail, certified mail, return receipt requested and postage prepaid, and addressed to the party affected by such notice at the address indicated on the signature page hereof.
- E. SEVERABILITY.** The invalidity or unenforceability of any provision hereof shall not affect the validity or enforceability of any other provision hereof.
- F. COUNTERPARTS.** This Agreement may be executed in multiple counterparts, each of which shall be deemed an original but all of which taken together shall constitute a single instrument.
- G. ENTIRE AGREEMENT.** This Agreement contains all of the terms and conditions agreed upon by the parties hereto respecting the subject matter hereof, and all other prior agreements, oral or otherwise, regarding the subject matter of this Agreement shall be deemed to be superseded as of the date of this Agreement and not to bind either of the parties hereto.
- H. GOVERNING LAW.** This Agreement shall be subject to and governed by the laws of the State of Texas.

IN WITNESS WHEREOF, the Employee has set her hand hereto and Southwest has caused this Agreement to be signed in its corporate name and behalf by the Chairman of the Compensation Committee of the Board of Directors who is thereunto duly authorized all as of the day and year first above written.

SOUTHWEST AIRLINES CO.

By /s/ David Biegler
David Biegler
Chairman, Compensation Committee of the
Board of Directors

THE EMPLOYEE

By /s/ Colleen C. Barrett
Colleen C. Barrett

Address: P.O. Box 36611
Dallas, Texas 75235-1611

CERTIFICATION

I, Gary C. Kelly, Chief Executive Officer and Vice Chairman of the Board of Directors of Southwest Airlines Co., certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended September 30, 2007 of Southwest Airlines Co.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 19, 2007

By: /s/ Gary C. Kelly
Gary C. Kelly
Chief Executive Officer and
Vice Chairman of the Board
of Directors

CERTIFICATION

I, Laura Wright, Chief Financial Officer of Southwest Airlines Co., certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended September 30, 2007 of Southwest Airlines Co.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 19, 2007

By: /s/ Laura Wright
Laura Wright
Chief Financial Officer

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

In connection with the Quarterly Report on Form 10-Q of Southwest Airlines Co. (the "Company") for the period ended September 30, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Gary C. Kelly, Chief Executive Officer and Vice Chairman of the Board of Directors of the Company, and Laura Wright, Chief Financial Officer of the Company, each certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

Date: October 19, 2007

By: /s/ Gary C. Kelly
Gary C. Kelly
Chief Executive Officer and
Vice Chairman of the Board
of Directors

By: /s/ Laura Wright
Laura Wright
Chief Financial Officer
