
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 March 31, 2006 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 x No o

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 in Rule 12b-2 of the Exchange Act.

Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

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 April 18, 2006:

802,567,873

TABLE OF CONTENTS

[SOUTHWEST AIRLINES CO.](#)

[FORM 10-Q](#)

[Part I — FINANCIAL INFORMATION](#)

[Item 1. Financial Statements](#)

[Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations](#)

[Item 3. Quantitative and Qualitative Disclosures About Market Risk](#)

[Item 4. Controls and Procedures](#)

[PART II. OTHER INFORMATION](#)

[Item 1. Legal Proceedings](#)

[Item 1A. Risk Factors](#)

[Item 2. Unregistered Sales of Equity Securities and Use of Proceeds](#)

[Item 3. Defaults upon Senior Securities](#)

[Item 4. Submission of Matters to a Vote of Security Holders](#)

[Item 5. Other Information](#)

[Item 6. Exhibits](#)

[SIGNATURES](#)

[EXHIBIT INDEX](#)

[Supplemental Agreement to Purchase Agreement](#)

[Severance Agreement](#)

[Letter from Ernst & Young LLP](#)

[Rule 13a-14\(a\) Certification of CEO](#)

[Rule 13a-14\(a\) Certification of CFO](#)

[Section 1350 Certification of CEO & CFO](#)

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>March 31, 2006</u>	<u>December 31, 2005</u> (As Adjusted-Note 2)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 2,600	\$ 2,280
Short-term investments	320	251
Accounts and other receivables	250	258
Inventories of parts and supplies, at cost	158	150
Fuel hedge contracts	705	641
Prepaid expenses and other current assets	59	40
Total current assets	<u>4,092</u>	<u>3,620</u>
Property and equipment, at cost:		
Flight equipment	10,789	10,592
Ground property and equipment	1,274	1,256
Deposits on flight equipment purchase contracts	691	660
	<u>12,754</u>	<u>12,508</u>
Less allowance for depreciation and amortization	3,403	3,296
	<u>9,351</u>	<u>9,212</u>
Other assets	1,280	1,171
	<u>\$ 14,723</u>	<u>\$ 14,003</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 585	\$ 524
Accrued liabilities	2,361	2,074
Air traffic liability	929	649
Current maturities of long-term debt	574	601
Total current liabilities	<u>4,449</u>	<u>3,848</u>
Long-term debt less current maturities	1,368	1,394
Deferred income taxes	1,752	1,681
Deferred gains from sale and leaseback of aircraft	132	136
Other deferred liabilities	257	269
Stockholders' equity:		
Common stock	808	802
Capital in excess of par value	1,024	963
Retained earnings	4,016	4,018
Accumulated other comprehensive income	1,009	892
Treasury stock, at cost	(92)	—
Total stockholders' equity	<u>6,765</u>	<u>6,675</u>
	<u>\$ 14,723</u>	<u>\$ 14,003</u>

See accompanying notes.

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

	Three months ended March 31,	
	<u>2006</u>	<u>2005</u> (As Adjusted- Note 2)
OPERATING REVENUES:		
Passenger	\$ 1,938	\$ 1,592
Freight	35	34
Other	46	37
Total operating revenues	2,019	1,663
OPERATING EXPENSES:		
Salaries, wages, and benefits	716	660
Fuel and oil	501	279
Maintenance materials and repairs	104	106
Aircraft rentals	40	43
Landing fees and other rentals	120	113
Depreciation and amortization	124	112
Other operating expenses	316	269
Total operating expenses	1,921	1,582
OPERATING INCOME	98	81
OTHER EXPENSES (INCOME):		
Interest expense	34	27
Capitalized interest	(12)	(9)
Interest income	(18)	(7)
Other (gains) losses, net	(2)	(19)
Total other expenses (income)	2	(8)
INCOME BEFORE INCOME TAXES	96	89
PROVISION FOR INCOME TAXES	35	30
NET INCOME	\$ 61	\$ 59
NET INCOME PER SHARE, BASIC	\$.08	\$.08
NET INCOME PER SHARE, DILUTED	\$.07	\$.07
WEIGHTED AVERAGE SHARES OUTSTANDING:		
Basic	803	784
Diluted	836	802

See accompanying notes.

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

	Three months ended March 31,	
	<u>2006</u>	<u>2005</u> (As Adjusted- Note 2)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 61	\$ 59
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	124	112
Deferred income taxes	35	30
Amortization of deferred gains on sale and leaseback of aircraft	(4)	(4)
Share-based compensation expense	22	20
Excess tax benefits from share-based compensation expense	(28)	(6)
Changes in certain assets and liabilities:		
Accounts and other receivables	(13)	(85)
Other current assets	14	(12)
Accounts payable and accrued liabilities	317	593
Air traffic liability	280	195
Other	(57)	(38)
Net cash provided by operating activities	<u>751</u>	<u>864</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment, net	(262)	(407)
Change in short-term investments, net	(68)	257
Payment for assets from ATA Airlines, Inc.	—	(6)
Proceeds from ATA Airlines, Inc. debtor in possession loan	20	—
Other	1	—
Net cash used in investing activities	<u>(309)</u>	<u>(156)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Issuance of long-term debt	—	300
Proceeds from Employee stock plans	107	19
Payments of long-term debt and capital lease obligations	(37)	(108)
Payments of cash dividends	(7)	(7)
Repurchase of common stock	(214)	(55)
Excess tax benefits from share-based compensation expense	28	6
Other, net	1	(3)
Net cash provided by financing activities	<u>(122)</u>	<u>152</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	320	860
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	<u>2,280</u>	<u>1,048</u>
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<u>\$ 2,600</u>	<u>\$ 1,908</u>
CASH PAYMENTS FOR:		
Interest, net of amount capitalized	\$ 20	\$ 16
Income taxes	\$ —	\$ —

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 March 31, 2006 and 2005, 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, and other accounting entries as described herein. The unaudited Condensed Consolidated Statements of Income and Cash Flows for the three months ended March 31, 2005, have been retrospectively adjusted for the accounting changes described in Note 2. The unaudited Condensed Consolidated Balance Sheet as of December 31, 2005, has been derived from the Company's audited financial statements as of that date, as retrospectively adjusted for the accounting changes described in Note 2. However, they do 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. Operating results for the three months ended March 31, 2006, are not necessarily indicative of the results that may be expected for the year ended December 31, 2006. 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, 2005.

2. ACCOUNTING CHANGES

Aircraft and engine maintenance

In first quarter 2006, the Company began transitioning the maintenance program for performing planned airframe maintenance on its fleet of 737-300 and 737-500 aircraft. The previous program utilized was a periodic "hard time" program (the "MSG-2" program) which required specific activities, including replacement of specified components, and D checks that were capitalized and amortized over the estimated period benefited. This estimated period was the least of ten years, the next D check, or the remaining life of the aircraft. The Company's new "MSG-3" program does not include D checks. In many cases, more frequent inspections are required with repairs and replacements performed based on the condition of components, rather than at stipulated intervals. The Company's 737-700 aircraft are already maintained under the MSG-3 program.

Due to the change in the nature of the maintenance activities performed, the Company has changed its method of accounting for scheduled airframe and inspection repairs for 737-300 and 737-500 aircraft from the deferral method to the direct expense method, effective January 1, 2006. Under the direct expense method, the cost of scheduled airframe and inspection repairs is expensed as

[Table of Contents](#)

incurred. The Company believes the direct expense method is preferable to its former method because it more closely aligns with the nature of activities performed under the MSG-3 program, it eliminates any judgment in determining which costs should be deferred versus expensed, it matches the method currently utilized on the Company's 737-700 fleet, and it is the predominant method utilized for airframe maintenance in the airline industry, particularly among the largest airlines.

The Company recorded the change in accounting in accordance with Statement of Financial Accounting Standards No. 154, *Accounting Changes and Error Corrections* (SFAS 154), which is effective for calendar year companies on January 1, 2006. SFAS 154 requires that all elective accounting changes be made on a retrospective basis. As such, the accompanying unaudited Condensed Consolidated Statement of Income for the period ended March 31, 2005, and the Condensed Consolidated Balance Sheet as of December 31, 2005, have been adjusted to apply the direct expense method retrospectively to all prior periods.

As a result, for the three months ended March 31, 2005, Maintenance materials and repairs expense was increased by \$5 million resulting in a reduction in net income of \$3 million. Net income per share, basic and diluted, were each unchanged. The net unamortized balance of previously capitalized D checks, which was a net asset of \$216 million at December 31, 2005, is now reflected in the accompanying unaudited adjusted Condensed Consolidated Balance Sheet as a reduction of Retained earnings in the amount of \$130 million, and a reduction in Deferred income taxes of \$86 million.

The impact of adopting the direct expense method on net income for the period ended March 31, 2006 was not material.

Share-based Compensation

The Company has share-based compensation plans covering the majority of its Employee groups, including plans adopted via collective bargaining, a plan covering the Company's Board of Directors, and plans related to employment contracts with one Executive Officer of the Company. Prior to January 1, 2006, the Company accounted for stock-based compensation utilizing the intrinsic value method in accordance with the provisions of Accounting Principles Board Opinion No. 25 (APB 25), "Accounting for Stock Issued to Employees" and related Interpretations. Accordingly, no compensation expense was recognized for fixed option plans because the exercise prices of Employee stock options equaled or exceeded the market prices of the underlying stock on the dates of grant. However, share-based compensation has been included in pro forma disclosures in the financial statement footnotes in prior periods.

Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123R, "Share-Based Payment" using the modified retrospective transition method. Among other items, SFAS 123R eliminates the use of APB 25 and the intrinsic value method of accounting, and

[Table of Contents](#)

requires companies to recognize the cost of Employee services received in exchange for awards of equity instruments, based on the grant date fair value of those awards, in the financial statements.

Under the modified retrospective method, compensation cost is recognized in the financial statements beginning with the effective date, based on the requirements of SFAS 123R for all share-based payments granted after that date, and based on the requirements of SFAS 123 for all unvested awards granted prior to the effective date of SFAS 123R. In addition, results for prior periods have been retrospectively adjusted utilizing the pro forma disclosures in those prior financial statements, except as noted. As part of the adoption of SFAS 123R, the Company recorded cumulative share-based compensation expense, net of taxes, of \$409 million for the period 1995-2005, resulting in a reduction to Retained earnings in the accompanying unaudited Condensed Consolidated Balance Sheet as of December 31, 2005. This adjustment, along with the creation of a net Deferred income tax asset in the amount of \$130 million, resulted in an offsetting increase to Capital in excess of par value in the amount of \$539 million in the accompanying unaudited Condensed Consolidated Balance Sheet as of December 31, 2005. The Deferred tax asset represents the portion of the cumulative expense related to stock options expected to result in a future tax deduction.

The unaudited Condensed Consolidated Statement of Income for the three months ended March 31, 2006 and 2005 reflects share-based compensation cost of \$22 million and \$20 million, respectively. The total tax benefit recognized from share-based compensation arrangements for the three months ended March 31, 2006 and 2005, was \$6 million and \$5 million, respectively. The Company's earnings before income taxes and net earnings for first quarter 2006, were reduced by \$19 million (net of profitsharing) and \$12 million, respectively, compared to the previous accounting method under APB 25. Net income per share, basic and diluted, were each reduced by \$.01 in first quarter 2006 compared to the previous accounting under APB 25. As a result of the SFAS 123R retroactive application, for the three months ended March 31, 2005, net income was reduced by \$14 million, and net income per share, basic and diluted, were each reduced by \$.02. The Company currently estimates that share-based compensation expense will be approximately \$80 million for the full year 2006, before income taxes and profitsharing.

Prior to the adoption of SFAS 123R, the Company was required to record benefits associated with the tax deductions in excess of recognized compensation cost as an operating cash flow. However, SFAS 123R requires that such benefits be recorded as a financing cash inflow and corresponding operating cash outflow. In the accompanying unaudited Condensed Consolidated Statement of Cash Flows for first quarter 2006, the \$28 million tax benefit classified as a financing cash flow (and corresponding operating cash outflow) would have been classified as an operating cash inflow prior to the adoption of SFAS 123R. In addition, the cash flow presentation for the three months ended March 31, 2005, has been adjusted to conform to the current year presentation.

Stock Plans

The Company has stock 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.

[Table of Contents](#)

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 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 under the heading of "Other Employee Plans" have been approved by shareholders, except the plan covering non-management, non-contract Employees, which had options outstanding to purchase 6.0 million shares of the Company's common stock as of March 31, 2006. 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.

Vesting terms for the collective bargaining plans differ based on the grant made, and have ranged in length from immediate vesting to vesting periods in accordance with the period covered by the respective collective bargaining agreement. For "Other Employee Plans", options vest and become fully exercisable over three, five, or ten years of continued employment, depending upon the grant type. 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 grants include 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 following weighted-average assumptions were used for grants made under the fixed option plans for the current and prior year:

	Three months ended March 31, 2006	Year ended December 31, 2005
Expected stock volatility	25.9%	26.2%
Expected life of option (years)	5.3	4.7
Wtd-average risk-free interest rate	4.6%	4.1%
Expected dividend yield	0.07%	0.09%

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. For 2006 and 2005, the Company has relied on observations of both historical volatility trends as well as implied future volatility observations as determined by independent third parties. For both 2006 and 2005 stock option grants, the Company utilized expected volatility based on the expected life of the option, but within a range of 25% to 27%. In determining the expected life of the option grants, the Company has observed the actual terms of prior grants with similar characteristics, the actual vesting schedule of the grant, and assessed the expected risk tolerance of different optionee groups. The risk-free interest rates used, which were actual U.S. Treasury zero-coupon rates for bonds matching the expected term of the option as of the option grant date, ranged from 4.26% to 4.78% for first quarter 2006, versus 3.37% to 4.47% for all of 2005.

[Table of Contents](#)

The fair value of options granted under the fixed option plans during the three months ended March 31, 2006, ranged from \$4.26 to \$6.99, with a weighted-average fair value of \$5.73. The fair value of options granted under the fixed option plans during 2005 ranged from \$2.90 to \$6.79, with a weighted-average fair value of \$3.84.

Aggregated information regarding the Company's fixed stock option plans is summarized below:

COLLECTIVE BARGAINING PLANS				
	Options (000)	Wtd. average exercise price	Wtd. average remaining contractual term	Aggregate intrinsic value (millions)
Outstanding December 31, 2005	105,244	\$ 11.65		
Granted	249	16.71		
Exercised	(10,246)	7.64		
Surrendered	(348)	14.42		
Outstanding March 31, 2006	94,899	\$ 12.09	4.5	\$ 564
Vested or expected to vest at March 31, 2006	87,924	\$ 11.93	4.5	\$ 539
Exercisable at March 31, 2006	69,986	\$ 11.31	4.0	\$ 470
OTHER EMPLOYEE PLANS				
	Options (000)	Wtd. average exercise price	Wtd. average remaining contractual term	Aggregate intrinsic value (millions)
Outstanding December 31, 2005	35,820	\$ 13.96		
Granted	2,824	17.52		
Exercised	(2,805)	8.90		
Surrendered	(326)	15.66		
Outstanding March 31, 2006	35,513	\$ 14.63	6.2	\$ 124
Vested or expected to vest at March 31, 2006	34,081	\$ 14.61	6.2	\$ 121
Exercisable at March 31, 2006	20,206	\$ 14.01	5.1	\$ 84

The total aggregate intrinsic value of options exercised during the three months ended March 31, 2006 and 2005, was \$120 million and \$25 million, respectively. The total fair value of shares vesting during the three months ended March 31, 2006 and 2005, was \$28 million for each period. As of March 31, 2006, there was \$127 million of total unrecognized compensation cost related to share-based compensation arrangements, which is expected to be recognized over a weighted-average period of 1.9 years. The total recognition period for the remaining unrecognized compensation cost is approximately ten years; however, the majority of this cost will be recognized over the next two years, in accordance with vesting provisions.

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 1.7 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

[Table of Contents](#)

are paid for through periodic payroll deductions. For the three months ended March 31, 2006, and for the full year 2005, participants under the plan purchased .3 million shares and 1.5 million shares at average prices of \$14.86 and \$13.19, respectively. The weighted-average fair value of each purchase right under the ESPP granted for the three months ended March 31, 2006 and full year 2005, 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 \$1.65 and \$1.47, respectively. Subject to shareholder approval at the Company's 2006 Annual Meeting of Shareholders, the Board of Directors has approved an amendment to the ESPP which authorizes an additional 7 million shares for issuance under the plan.

Non-Employee Director grants and Incentive Plan

Upon initial election to the Board, non-Employee Directors receive a one-time option grant to purchase 10,000 shares of Southwest Common Stock at the fair market value of such stock on the date of the grant. These awards are made under the 1996 Non-Qualified Stock Option Plan (1996 Plan), which is administered by the Compensation Committee of the Board of Directors. The 1996 Plan has expired during 2006 and, thus, no additional options may be granted from the plan. Outstanding stock options to the Board become exercisable over a period of five years from the grant date and have a term of 10 years.

In 2001, the Board adopted the Southwest Airlines Co. Outside Director Incentive Plan. The purpose of the plan is to align more closely the interests of the non-Employee Directors with those of the Company's Shareholders and to provide the non-Employee Directors with retirement income. To accomplish this purpose, the plan compensates each non-Employee Director based on the performance of the Company's Common Stock and defers the receipt of such compensation until after the non-Employee Director ceases to be a Director of the Company. Pursuant to the plan, on the date of the 2002 Annual Meeting of Shareholders, the Company granted 750 non-transferable Performance Shares to each non-Employee Director who had served as a Director since at least May 2001. Thereafter, on the date of each Annual Meeting of Shareholders, the Company will grant 750 Performance Shares to each non-Employee Director who has served since the previous Annual Meeting. A Performance Share is a unit of value equal to the Fair Market Value of a share of Southwest Common Stock, based on the average closing sale price of the Common Stock as reported on the New York Stock Exchange during a specified period. On the 30th calendar day following the date a non-Employee Director ceases to serve as a Director of the Company for any reason, Southwest will pay to such non-Employee Director an amount equal to the Fair Market Value of the Common Stock during the 30 days preceding such last date of service multiplied by the number of Performance Shares then held by such Director. The plan contains provisions contemplating adjustments on changes in capitalization of the Company. The Company accounts for grants made under this plan as liability awards, as defined, and since the awards are not stock options, they are not reflected in the above tables. The fair value of the awards as of March 31, 2006, which is not material to the Company, is included in Accrued liabilities in the accompanying Condensed Consolidated Balance Sheet.

Taxes

A portion of the Company's granted options qualify as incentive stock options (ISO) for income tax purposes. As such, a tax benefit is not recorded at the time the compensation cost related to the options is recorded for book purposes due to the fact that an ISO does not ordinarily result in a tax

[Table of Contents](#)

benefit unless there is a disqualifying disposition. Stock option grants of non-qualified options result in the creation of a deferred tax asset, which is a temporary difference, until the time that the option is exercised. Due to the treatment of incentive stock options for tax purposes, the Company's effective tax rate will likely be subject to more variability in 2006 and in future periods.

Retrospective Application

The following unaudited tables present the differences between the Company's previously reported financial results for 2005, 2004, and 2003 and amounts adjusted for both of the described accounting changes.

(in millions, except per share amounts)	2005 Three months ended				Year ended Dec 31 2005
	March 31	June 30	Sept 30	Dec 31	
Net income, as previously reported	\$ 76	\$ 159	\$ 227	\$ 86	\$ 548
Less: impact of SFAS 123R (Salaries, wages and benefits)	(20)	(18)	(19)	(23)	(80)
Less: impact of change in maintenance accounting (Maintenance, materials and repairs)	(5)	(4)	(6)	—	(15)
Add: Income tax benefit from accounting changes	8	7	8	7	31
Net income — As retrospectively adjusted	<u>\$ 59</u>	<u>\$ 144</u>	<u>\$ 210</u>	<u>\$ 70</u>	<u>\$ 484</u>
Weighted-average shares outstanding, diluted, as previously reported	812	811	810	823	814
Less: impact of SFAS 123R	(10)	(9)	(8)	(7)	(8)
Weighted-average shares outstanding, diluted — As retrospectively adjusted	<u>802</u>	<u>802</u>	<u>802</u>	<u>816</u>	<u>806</u>
Net income per share, basic, as previously reported	\$.10	\$.20	\$.29	\$.11	\$.70
Less: impact of SFAS 123R, net of tax	(.02)	(.02)	(.01)	(.02)	(.08)
Less: impact of maintenance accounting change, net of tax	—	—	(.01)	—	(.01)
Net income per share, basic — As retrospectively adjusted	<u>\$.08</u>	<u>\$.18</u>	<u>\$.27</u>	<u>\$.09</u>	<u>\$.61</u>
Net income per share, diluted, as previously reported	\$.09	\$.20	\$.28	\$.10	\$.67
Less: impact of SFAS 123R, net of tax	(.02)	(.02)	(.02)	(.01)	(.06)
Less: impact of maintenance accounting change, net of tax	—	—	—	—	(.01)
Net income per share, diluted — As retrospectively adjusted	<u>\$.07</u>	<u>\$.18</u>	<u>\$.26</u>	<u>\$.09</u>	<u>\$.60</u>

[Table of Contents](#)

(in millions, except per share amounts)	2004 Three months ended				Year ended Dec 31 2004
	March 31	June 30	Sept 30	Dec 31	
Net income, as previously reported	\$ 26	\$ 113	\$ 119	\$ 56	\$ 313
Less: impact of SFAS 123R (Salaries, wages and benefits)	(21)	(19)	(74)	(21)	(135)
Less: impact of change in maintenance accounting (Maintenance, materials and repairs)	(3)	(4)	(6)	(2)	(15)
Add: Income tax benefit from accounting changes	8	8	28	8	52
Net income — As retrospectively adjusted	<u>\$ 10</u>	<u>\$ 98</u>	<u>\$ 67</u>	<u>\$ 41</u>	<u>\$ 215</u>
Weighted-average shares outstanding, diluted, as previously reported	817	817	812	813	815
Less: impact of SFAS 123R	(12)	(10)	(11)	(10)	(11)
Weighted-average shares outstanding, diluted — As retrospectively adjusted	<u>805</u>	<u>807</u>	<u>801</u>	<u>803</u>	<u>804</u>
Net income per share, basic, as previously reported	\$.03	\$.14	\$.15	\$.07	\$.40
Less: impact of SFAS 123R, net of tax	(.02)	(.02)	(.06)	(.02)	(.12)
Less: impact of maintenance accounting change, net of tax	—	—	—	—	(.01)
Net income per share, basic — As retrospectively adjusted	<u>\$.01</u>	<u>\$.12</u>	<u>\$.09</u>	<u>\$.05</u>	<u>\$.27</u>
Net income per share, diluted, as previously reported	\$.03	\$.14	\$.15	\$.07	\$.38
Less: impact of SFAS 123R, net of tax	(.02)	(.02)	(.06)	(.02)	(.10)
Less: impact of maintenance accounting change, net of tax	—	—	(.01)	—	(.01)
Net income per share, diluted — As retrospectively adjusted	<u>\$.01</u>	<u>\$.12</u>	<u>\$.08</u>	<u>\$.05</u>	<u>\$.27</u>

[Table of Contents](#)

(in millions, except per share amounts)		Year ended Dec 31 2003
Net income, as previously reported	\$	442
Less: impact of SFAS 123R (Salaries, wages and benefits)		(107)
Less: impact of change in maintenance accounting (Maintenance, materials and repairs)		3
Add: Income tax benefit from accounting changes		34
Net income — As retrospectively adjusted	\$	372
Weighted-average shares outstanding, diluted, as previously reported		822
Less: impact of SFAS 123R		(12)
Weighted-average shares outstanding, diluted — As retrospectively adjusted		810
Net income per share, basic, as previously reported	\$	.56
Less: impact of SFAS 123R, net of tax		(.09)
Less: impact of maintenance accounting change, net of tax		.01
Net income per share, basic — As retrospectively adjusted	\$	.48
Net income per share, diluted, as previously reported	\$	.54
Less: impact of SFAS 123R, net of tax		(.08)
Less: impact of maintenance accounting change, net of tax		—
Net income per share, diluted — As retrospectively adjusted	\$	.46

Share-based compensation expense reported under SFAS 123R does not exactly match the pro forma results disclosed in the footnotes to previous years' financial statements. We have adjusted the amounts reported in prior period pro forma results to exclude a previous assumption that if share-based compensation expense were recorded in the financial statements in prior periods, the Company's profitsharing contributions would be impacted by that expense. The amount of this adjustment related to 2005 was \$12 million, or \$3 million per quarter, the amount related to 2004 was \$20 million, and the amount related to 2003 was \$16 million. On a per share basis for 2005, the \$12 million profitsharing amount resulted in a difference of \$.02, both basic and diluted, compared to previously disclosed pro forma amounts. These adjustments had no impact on our balance sheets, statements of operations, cash flows, or stockholders' equity as reported in prior periods.

[Table of Contents](#)

3. DIVIDENDS

During the three month periods ended March 31, 2006, and 2005, dividends of \$.0045 per share were declared on the 803 million shares and 783 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 March 31,	
	2006	2005
NUMERATOR:		
Net income available to common stockholders	<u>\$ 61</u>	<u>\$ 59</u>
DENOMINATOR:		
Weighted-average shares outstanding, basic	803	784
Dilutive effect of Employee stock options	<u>33</u>	<u>18</u>
Adjusted weighted-average shares outstanding, diluted	<u>836</u>	<u>802</u>
NET INCOME PER SHARE:		
Basic	\$.08	\$.08
Diluted	\$.07	\$.07

5. FINANCIAL DERIVATIVE INSTRUMENTS

Fuel Contracts

Airline operators are inherently dependent upon energy to operate and, therefore, are impacted by changes in jet fuel prices. Jet fuel and oil consumed for the three months ended March 31, 2006 and 2005 represented approximately 26.1 percent and 17.6 percent of Southwest's operating expenses, respectively. The Company endeavors 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 effective hedging of jet fuel costs, primarily crude oil, and refined products such as heating oil and unleaded gasoline. The Company utilizes financial derivative instruments as hedges to decrease its exposure to jet fuel price increases. 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 hedging positions the Company had in place during first

quarter 2006, the Company also has significant future hedging positions. The Company currently has a mixture of purchased call options, collar structures, and fixed price swap agreements in place to hedge over 70 percent of its remaining 2006 total anticipated jet fuel requirements at average crude oil equivalent prices of approximately \$36 per barrel, and has also hedged the refinery margins on most of those positions. The Company is also approximately 60 percent hedged for 2007 at approximately \$39 per barrel, over 35 percent hedged for 2008 at approximately \$38 per barrel, and approximately 30 percent hedged for 2009 at approximately \$39 per barrel.

The Company accounts for its fuel hedge 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 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 effective, as defined, or that the derivatives will no longer qualify for special hedge accounting. Ineffectiveness, as defined, results when the change in the total fair value of the derivative instrument does not exactly equal 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 are not effective, that ineffectiveness is recorded to Other gains and losses in the income statement. Likewise, if a hedge ceases to qualify for hedge accounting, those periodic changes in the fair value of derivative instruments are recorded to Other gains and losses in the income statement in the period of the change.

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 hedge derivatives and the recent volatility in the prices of refined products. Due to the volatility in markets for crude oil and related products, 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. 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 on derivative contracts settling in future periods recorded during recent quarters 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 in hedging. 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. When this happens, any changes in fair value of the derivative instruments are marked to market through earnings in the period of change. 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 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.

[Table of Contents](#)

The Company continually looks for better and more accurate methodologies in forecasting future cash flows relating to its jet fuel hedging program. These estimates are used in the measurement of effectiveness for the Company's fuel hedges, as required by SFAS 133. During first quarter 2006, the Company did revise its method for forecasting future cash flows. Previously, the Company had estimated future cash flows using actual market forward prices of like commodities and adjusting for historical differences from the Company's actual jet fuel purchase prices. The Company's new methodology utilizes a statistical-based regression equation with data from market forward prices of like commodities. This equation is then adjusted for certain items, such as transportation costs, that are stated in the Company's fuel purchasing contracts with its vendors. This change to the Company's methodology for estimating future cash flows (i.e., jet fuel prices) was applied prospectively, in accordance with the Company's interpretation of SFAS 133. While the Company expects that this change for estimating future cash flows will result in more effective hedges over the long-term, the change could result in more ineffectiveness, as defined, in the short-term, due to the prospective nature of enacting the change.

During the three months ended March 31, 2006, the Company recognized approximately \$13 million of additional net gains in Other (gains) losses, net, related to the ineffectiveness of its hedges and the loss of hedge accounting for certain hedges. Of this net total, approximately \$40 million of the additional income was unrealized, mark-to-market changes in the fair value of derivatives due to the discontinuation of hedge accounting for certain contracts that will settle in future periods, and \$10 million was ineffectiveness expense and mark-to-market losses related to contracts that settled during first quarter 2006. These were partially offset by \$17 million in losses related to unrealized ineffectiveness from hedges designated for future periods. During the three months ended March 31, 2005, the Company recognized approximately \$27 million of additional gains in Other (gains) losses, net, related to the ineffectiveness of its hedges and the loss of hedge accounting for certain hedges. Of this amount, approximately \$10 million was gains from unrealized, mark-to-market changes in the fair value of derivatives due to the discontinuation of hedge accounting for certain contracts that will settle in future periods, approximately \$13 million was gains from ineffectiveness associated with hedges designated for future periods, and \$4 million was ineffectiveness and mark-to-market gains related to hedges that settled during first quarter 2005. During the three months ended March 31, 2006 and 2005, the Company recognized approximately \$11 million and \$9 million of net expense, respectively, related to amounts excluded from the Company's measurements of hedge effectiveness, in Other (gains) losses, net.

During the three months ended March 31, 2006 and 2005, the Company recognized gains in Fuel and oil expense of \$116 million and \$155 million, respectively, from hedging activities. At March 31, 2006, approximately \$48 million due from third parties from settled derivative contracts is included in Accounts and other receivables in the accompanying unaudited Condensed Consolidated Balance Sheet. The fair value of the Company's financial derivative instruments at March 31, 2006, was a net asset of approximately \$1.8 billion. The current portion of these financial derivative instruments, \$705 million, is classified as Fuel hedge contracts and the long-term portion, \$1.1 billion, is classified as Other assets in the unaudited Condensed Consolidated Balance Sheet. The fair value of the derivative instruments, depending on the type of instrument, was determined by the use of present value methods or standard option value models with assumptions about commodity prices based on those observed in underlying markets.

[Table of Contents](#)

As of March 31, 2006, the Company had approximately \$1.0 billion in unrealized gains, net of tax, in Accumulated other comprehensive income related to fuel hedges. Included in this total are approximately \$385 million in net unrealized gains that are expected to be realized in earnings during the twelve months following March 31, 2006.

Interest Rate Swaps

In previous periods, the Company entered into interest rate swap agreements relating to its \$350 million 5.25% senior unsecured notes due October 1, 2014, its \$385 million 6.5% senior unsecured notes due March 1, 2012 and its \$375 million 5.496% Class A-2 pass-through certificates due November 1, 2006. Under 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 March 31, 2006, was a liability of approximately \$47 million. Of this amount \$42 million is recorded in Other deferred liabilities, and \$5 million is recorded in Accrued 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.

6. COMPREHENSIVE INCOME

Comprehensive income 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 \$178 million and \$614 million for the three months ended March 31, 2006 and 2005, respectively. The differences between net income and comprehensive income for each of these periods were as follows (in millions):

	Three months ended March 31,	
	2006	2005
Net income	\$ 61	\$ 59
Unrealized gain on derivative instruments, net of deferred taxes of \$72 and \$352	116	555
Other, net of deferred taxes of \$1 and \$0	1	—
Total other comprehensive income	117	555
Comprehensive income	\$ 178	\$ 614

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

[Table of Contents](#)

	Fuel hedge derivatives	Other	Accumulated other comprehensive income (loss)
Balance at December 31, 2005	\$ 890	\$ 2	\$ 892
2006 changes in value	178	1	179
Reclassification to earnings	(62)	—	(62)
Balance at March 31, 2006	\$ 1,006	\$ 3	\$ 1,009

7. LONG-TERM DEBT

During first quarter 2006, the Company redeemed a \$29 million non-interest bearing note on its maturity date of February 24, 2006.

8. OTHER ASSETS AND ACCRUED LIABILITIES (in millions)

	March 31, 2006	December 31, 2005
Noncurrent fuel hedge contracts, at fair value	\$ 1,145	\$ 1,037
Other	135	134
Other assets	\$ 1,280	\$ 1,171
	March 31, 2006	December 31, 2005
Retirement Plans	\$ 160	\$ 142
Aircraft Rentals	122	116
Vacation Pay	139	135
Advances and deposits	1,155	955
Deferred income taxes	524	489
Other	261	237
Accrued liabilities	\$ 2,361	\$ 2,074

9. POSTRETIREMENT BENEFITS

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

	Three months ended March 31,	
(In millions)	2006	2005
Service cost	\$ 4	\$ 3
Interest cost	1	1
Amortization of prior service cost	—	—
Recognized actuarial loss	—	—
Net periodic postretirement benefit cost	\$ 5	\$ 4

10. ACQUISITION OF CERTAIN ASSETS

In fourth quarter 2004, Southwest was selected as the winning bidder at a bankruptcy-court approved auction for certain ATA Airlines, Inc. (ATA) assets. As part of the transaction, which was approved in December 2004, Southwest agreed to pay \$40 million for certain ATA assets, consisting of the leasehold rights to six of ATA's leased Chicago Midway Airport gates and the rights to a leased aircraft maintenance hangar at Chicago Midway Airport. In addition, Southwest provided ATA with \$40 million in debtor-in-possession financing while ATA remained in bankruptcy, and also guaranteed the repayment of an ATA construction loan to the City of Chicago for \$7 million. As part of this original transaction, Southwest committed, upon ATA's emergence from bankruptcy, to convert the debtor-in-possession financing to a term loan, payable over five years, and to invest \$30 million cash in ATA convertible preferred stock.

During fourth quarter 2005, ATA entered into an agreement in which an investor, MatlinPatterson Global Opportunities Partners II, would provide financing to enable ATA to emerge from bankruptcy. As part of this transaction, Southwest entered into an agreement with ATA to acquire the leasehold rights to four additional leased gates at Chicago Midway Airport in exchange for a \$20 million reduction in the Company's debtor-in-possession loan. Upon ATA's emergence from bankruptcy, which took place on February 28, 2006, ATA repaid the remaining \$20 million balance of the debtor-in-possession financing to the Company, and provided a letter of credit to support Southwest's obligation under the construction loan to the City of Chicago. In addition, Southwest was relieved of its commitment to purchase ATA convertible preferred stock.

Southwest and ATA agreed on a code share arrangement, which was approved by the Department of Transportation in January 2005. Under the agreement, which has since been expanded, each carrier can exchange passengers on certain designated flights. Sales of the code share flights began in January 2005, with travel dates beginning in February 2005. As part of the December 2005 agreement with ATA, Southwest has enhanced its codeshare arrangement with ATA to include additional flights and destinations, among other items. In addition, the Company and ATA have announced future enhancements to our Rapid Rewards frequent flyer program to provide new award destinations via ATA.

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 have a material adverse effect on the Company's financial condition, results of operations or cash flow.

[Table of Contents](#)

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 months ended March 31, 2006 and 2005 are as follows:

	Three months ended March 31,		Change
	2006	2005	
Revenue passengers carried	19,199,483	17,474,557	9.9%
Enplaned passengers	22,015,484	19,780,746	11.3%
Revenue passenger miles (RPMs) (000s)	15,280,497	13,238,009	15.4%
Available seat miles (ASMs) (000s)	22,079,458	20,231,599	9.1%
Load factor	69.2%	65.4%	3.8 pts
Average length of passenger haul (miles)	796	758	5.0%
Average aircraft stage length (miles)	617	596	3.5%
Trips flown	262,449	249,119	5.4%
Average passenger fare	\$ 100.94	\$ 91.15	10.7%
Passenger revenue yield per RPM (cents)	12.68	12.03	5.4%
Operating revenue yield per ASM (cents)	9.15	8.22	11.3%
Operating expenses per ASM (cents)	8.70	7.82	11.3%
Operating expenses per ASM, excluding fuel (cents)	6.43	6.44	(0.2)%
Fuel costs per gallon, excluding fuel tax	\$ 1.514	\$.903	67.7%
Fuel consumed, in gallons (millions)	329	307	7.2%
Number of Employees at period-end	31,396	30,974	1.4%
Size of fleet at period-end	451	424	6.4%

Material Changes in Results of Operations

Summary

As disclosed in Note 2 to the unaudited condensed consolidated financial statements, the Company had two separate accounting changes in 2006. The Company elected to change its method of accounting for scheduled airframe repairs for its 737-300 and 737-500 aircraft, and the Company also adopted SFAS 123R, "Share-Based Payment" (SFAS 123R), both effective January 1, 2006. As part of the Company's change in accounting for maintenance, the Company was required to retroactively apply the change to prior period financial statements to conform to the new method of accounting. Under the adoption of SFAS 123R, which requires that all stock-based compensation, including grants of Employee stock options, be accounted for using a fair-value based method, the Company elected to use the modified retrospective method under which prior years' results have been adjusted to give effect to the value of stock-based compensation beginning on or after January 1, 1995. All discussions below are based on the Company's adjusted financial statements. See Note 2 for additional information.

The Company's first quarter 2006 net income was \$61 million (\$.07 per share, diluted), 3.4 percent higher than first quarter 2005. First quarter 2006 represented the Company's 60th

[Table of Contents](#)

consecutive quarterly profit. Due to the strong demand for the Company's low fares and excellent Customer Service, and a reduction in competitive capacity, the Company was able to grow revenues enough to entirely offset the significant increase in the Company's fuel costs compared to first quarter 2005. The Company's fuel hedging program again mitigated some of the increase in energy prices; however, our hedge position was not as strong as the position we held in 2005. The Company's fuel hedge resulted in a reduction to Fuel and oil expense of \$116 million in first quarter 2006. See Note 5 to the unaudited condensed consolidated financial statements. However, even with the Company's hedge position, fuel cost per gallon increased 67.7 percent versus first quarter 2005 as the Company was hedged at a lower percentage of its fuel needs, and at higher crude-oil equivalent prices, in addition to higher market jet fuel prices.

First quarter 2006 operating income increased \$17 million, or 21.0 percent, compared to first quarter 2005, primarily due to an exceptional revenue performance. Operating revenues grew 21.4 percent, led by a 21.7 percent increase in Passenger revenues. The Company grew capacity (available seat miles) by 9.1 percent, and has also been able to implement several modest fare increases over the past twelve months due to strong demand. Competitive capacity decreases and strong demand combined to result in a 15.4 percent increase in revenue passenger miles (RPMs). This resulted in a first quarter 2006 load factor of 69.2 percent, which was the highest for any first quarter in the Company's history. The first quarter 2005 load factor was 65.4 percent. RPM yields improved 5.4 percent as a result of the modest fare increases. The Company's codeshare with ATA Airlines (ATA) generated \$10 million in revenues in first quarter 2006. ATA emerged from bankruptcy on February 28, 2006, and Southwest and ATA have again expanded our codeshare agreement to now include flights from Houston and Oakland.

First quarter 2006 CASM (cost per available seat mile) was basically flat compared to first quarter 2005, excluding fuel. Including fuel expense, first quarter 2006 CASM increased 11.3 percent compared to the same prior year period. The largest increases in unit costs were in fuel expense, as previously mentioned, and in other operating expenses, primarily as a result of higher airport security fees assessed by the Transportation Security Administration. The Company continued its focus on controlling non-fuel costs. As a result of increased workforce productivity and automation with the use of technology, the Company's headcount per aircraft was 70 versus a year-ago level of 73. These productivity enhancements have helped the Company absorb cost pressures from wage and benefit increases. Based on recent trends, however, the Company currently expects second quarter 2006 unit costs, excluding fuel, to exceed first quarter's 6.43 cents per ASM.

The Company began service to Denver, Colorado, on January 3, 2006, representing the 62nd city the Company now serves. The Company also announced that it has applied for two gates at Washington Dulles International Airport in northern Virginia, with plans to begin service in the fall of 2006. Based on our current forecast, the Company expects second quarter 2006 capacity to grow approximately seven percent versus second quarter 2005.

Comparison of three months ended March 31, 2006, to three months ended March 31, 2005

Revenues

Consolidated operating revenues increased by \$356 million, or 21.4 percent, primarily due to a \$346 million, or 21.7 percent, increase in Passenger revenues. Approximately 70 percent of the increase in Passenger revenues was primarily due to a 15.4 percent increase in revenue passenger miles (RPMs) flown. The majority of the remaining increase was due to moderate fare increases and less fare discounting, as reflected in the increases in yields and average fares.

First quarter 2006 capacity, as measured by available seat miles (ASMs), increased 9.1 percent compared to first quarter 2005. The capacity increase resulted from the addition of 27 aircraft since the end of first quarter 2005 (and no aircraft retirements). The first quarter 2006 load factor was 69.2 percent, an increase of 3.8 points compared to the same period of 2005. The Company also experienced a 9.9 percent increase in revenue passengers carried compared to first quarter 2005.

The first quarter 2006 passenger yield per RPM increased 5.4 percent to 12.68 cents from 12.03 cents in first quarter 2005. The higher RPM yield was primarily due to competitor capacity reductions, modest fare increases, and an overall improvement in industry demand, especially for the Company's low fares. Unit revenue (operating revenue per ASM) increased 11.3 percent, due to the combination of higher RPM yields and the higher load factor. Thus far, strong load factor and revenue trends have continued in April, and customer bookings for the remainder of second quarter 2006 are strong.

Consolidated freight revenues increased by \$1 million, or 2.9 percent. Higher freight and cargo revenues, primarily as a result of higher rates charged, were partially offset by lower mail revenues versus first quarter 2005. The U.S. Postal Service has recently shifted more mail shipments to freight air carriers. The Company expects these trends for both cargo and mail revenues to continue in second quarter 2006. Other revenues increased by \$9 million, or 24.3 percent, compared to first quarter 2005. Approximately half of the increase was in commissions earned from programs the Company sponsors with certain business partners, such as the Company sponsored Chase Visa card. The remaining half was primarily in excess baggage charges, as the Company modified its fee policy related to the weight of checked baggage during second quarter 2005. The Company expects another year-over-year Other revenue increase in second quarter 2006; however, at a lower rate than in first quarter 2006.

Operating expenses

To a large extent, except for large swings in market prices for fuel from time to time, 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 March 31, 2006 and 2005 (as adjusted), followed by explanations of changes on a per-ASM basis:

Table of Contents

	Three months ended March 31, 2006	2005	Per ASM Change	Percent Change
Salaries, wages, and benefits	3.24	3.26	(.02)	(.6)
Fuel and oil	2.27	1.38	.89	64.5
Maintenance materials and repairs	.47	.53	(.06)	(11.3)
Aircraft rentals	.18	.21	(.03)	(14.3)
Landing fees and other rentals	.55	.56	(.01)	(1.8)
Depreciation	.56	.55	.01	1.8
Other operating expenses	1.43	1.33	.10	7.5
Total	8.70	7.82	.88	11.3

Operating expenses per ASM were 8.70 cents, an 11.3 percent increase compared to 7.82 cents for first quarter 2005. The majority of the year-over-year CASM increase was due to higher fuel costs, as the Company's average cost per gallon of fuel increased 67.7 percent versus the prior year. Excluding fuel, year-over-year CASM was basically flat, as higher Other operating expenses were offset by lower maintenance costs and Aircraft rentals expense.

Salaries, wages, and benefits expense per ASM decreased slightly compared to first quarter 2005. Slightly higher salaries and wages per ASM were offset by a slight decrease in benefits expense per ASM. As explained in Note 2 to the unaudited condensed consolidated financial statements, the Company adopted SFAS 123R, using the modified retrospective method, effective January 1, 2006. As a result, prior year results have been retrospectively adjusted to include \$20 million in share-based compensation expense, primarily associated with Employee stock options. For the three months ended March 31, 2006, Salaries, wages and benefits includes share-based compensation expense of \$22 million, also primarily associated with Employee stock options. As the amounts of share-based compensation expense in each period were similar, the inclusion of these amounts did not materially change the year-over-year comparisons of salaries, wages and benefits on a per-ASM basis. The Company currently estimates that share-based compensation expense will be approximately \$80 million for the full year 2006. The Company currently expects Salaries, wages, and benefits per ASM in second quarter 2006 to increase from first quarter 2006.

Fuel and oil expense per ASM increased 64.5 percent primarily due to a weaker hedge position held by the Company in first quarter 2006 versus first quarter 2005, and higher market jet fuel prices. In first quarter 2006, the Company was hedged at a lower percentage of anticipated fuel consumption versus the prior year, and at higher average crude oil-equivalent prices. The Company's average fuel cost per gallon in first quarter 2006 was \$1.51, 67.7 percent higher than first quarter 2005, including the effects of hedging activities. Prior to first quarter 2006, the Company had hedged over 75 percent of its anticipated fuel needs, resulting in gains recorded in Fuel and oil expense of \$116 million. First quarter 2005 hedging gains recorded in Fuel and oil expense were \$155 million.

For second quarter 2006, the Company has fuel hedges in place for over 75 percent of its expected fuel consumption with a combination of derivative instruments that effectively cap prices at approximately \$36 per barrel of crude oil and has hedged the refinery margins on the majority of those positions. The majority of the Company's near term hedge

[Table of Contents](#)

positions are also in the form of option contracts. At March 31, 2006, the estimated net fair value of the Company's fuel hedge contracts was \$1.8 billion. See Note 5 to the unaudited condensed consolidated financial statements for further discussion of the Company's hedging activities.

Maintenance materials and repairs per ASM decreased 11.3 percent primarily due to a decrease in repair costs for airframes. Also, as discussed in Note 2 to the unaudited condensed consolidated financial statements, the Company changed its method of accounting for planned airframe maintenance on its 737-300 and 737-500 aircraft. As a result of this change, the prior year now reflects an additional \$5 million in Maintenance materials and repairs expense for the three months ended March 31, 2005. The Company currently expects Maintenance materials and repairs per ASM for second quarter 2006 to be higher than the second quarter 2005's 52 cents per ASM, as adjusted, due to more scheduled repair events.

Aircraft rentals per ASM decreased 14.3 percent compared to first quarter 2005. The majority of the decrease per ASM was due to the renegotiation of several aircraft leases over the past twelve months that resulted in both lower lease rates and the reclassification of four aircraft from operating leases to capital leases. Expense associated with capital lease aircraft is recorded as depreciation. In addition, all of the aircraft acquired in 2005 and 2006 are owned by the Company. The Company currently expects another year-over-year decline in Aircraft rentals per ASM for second quarter 2006, at approximately the same level as the first quarter 2006 decrease.

Landing fees and other rentals per ASM decreased 1.8 percent compared to first quarter 2005. An increase in other rentals per ASM from higher rates for airport space was more than offset by a decrease in landing fees per ASM. The decrease in landing fees per ASM was primarily due to a large number of credits from airports' audits of prior periods received in first quarter 2006, versus charges incurred from airports' audit of prior periods in first quarter 2005. The Company expects an increase in Landing fees and other rentals per ASM in second quarter 2006 compared to second quarter 2005, primarily due to continued higher rates paid for airport space.

Depreciation expense per ASM was up slightly compared to first quarter 2006, primarily due to the reclassification of four aircraft from operating leases to capital leases over the past twelve months. For second quarter 2006, the Company currently expects Depreciation expense per ASM to be in line with first quarter 2006.

Other operating expenses per ASM increased 7.5 percent compared to first quarter 2005. Approximately thirty percent of the increase was due to higher security fees assessed by the Transportation Security Administration, and another thirty percent was due to higher credit card fees associated with the increase in revenues. Approximately twenty-five percent of the increase was due to higher fuel sales taxes due to the substantial increase in jet fuel prices. The Company currently expects Other operating expenses per ASM for second quarter 2006 to be higher than second quarter 2005 due to the same reasons noted for first quarter 2006.

Through the 2003 Emergency Wartime Supplemental Appropriations Act, the federal government has continued to provide supplemental third-party war-risk insurance coverage to commercial carriers for renewable 60-day periods, 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

[Table of Contents](#)

December 31, 2006. 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 in future periods.

Other

Interest expense increased \$7 million, or 25.9 percent compared to first quarter 2005. The majority of the increase was due to an increase in interest rates, due to the fact that most of the Company's long-term debt is at floating rates. See Notes 5 and 7 to the unaudited condensed consolidated financial statements for more information.

Capitalized interest increased \$3 million, or 33.3 percent compared to the prior year, also primarily due to an increase in interest rates.

Interest income increased by \$11 million, or 157.1 percent, primarily due to an increase in rates earned on cash and investments.

Other (gains) losses, net primarily includes amounts recorded in accordance with the Company's hedging activities and SFAS 133. During first quarter 2006, the Company recognized approximately \$11 million of expense related to amounts excluded from the Company's measurements of hedge effectiveness. Also in first quarter 2006, the Company recognized approximately \$13 million of net additional income in Other (gains) losses, net, related to the ineffectiveness of its hedges and the loss of hedge accounting for certain hedges. Of this net total, approximately \$40 million of the additional income was unrealized, mark-to-market changes in the fair value of derivatives due to the discontinuation of hedge accounting for certain contracts that will settle in future periods. This was partially offset by \$10 million in ineffectiveness expense and mark-to-market losses related to contracts that settled during first quarter 2006, and \$17 million in losses related to unrealized ineffectiveness from hedges designated for future periods. See Note 5 to the unaudited condensed consolidated financial statements for more information on the Company's hedging activities. In first quarter 2005, the Company recognized approximately \$9 million of expense related to amounts excluded from the Company's measurements of hedge effectiveness and \$27 million in income related to the ineffectiveness of its hedges and the loss of hedge accounting for certain hedges. Of this \$27 million, approximately \$10 million of the additional income was unrealized, mark-to-market changes in the fair value of derivatives due to the discontinuation of hedge accounting for certain contracts that will settle in future periods, \$13 million was gains related to unrealized ineffectiveness from hedges designated for future periods, and \$4 million was ineffectiveness and mark-to-market gains related to contracts that settled during first quarter 2005.

The Company's effective tax rate increased to 36.3 percent in first quarter 2006 from 33.2 percent in first quarter 2005. The prior year rate was favorably impacted by an adjustment related to the ultimate resolution of an airline industry-wide issue regarding the tax treatment of certain aircraft engine maintenance costs. The Company currently expects its full year 2006 effective rate to be in the 38 to 39 percent range; however, future effective rates are more difficult to forecast due to the Company's January 1, 2006, adoption of SFAS 123R. See Note 2 to the unaudited condensed consolidated financial statements for further information.

Liquidity and Capital Resources

Net cash provided by operating activities was \$751 million for the three months ended March 31, 2006, compared to \$864 million in the same prior year period. The operating cash flows in both years was largely impacted by increases in counterparty deposits associated with the Company's fuel hedging program. The increase in counterparty deposits was higher in first quarter 2005 primarily due to a larger increase in the fair value of the Company's hedge instruments, as a result of a large increase in energy prices during first quarter 2005. The largest portion of the first quarter 2006 cash flows from operating activities was the increase in Air traffic liability, as a result of seasonal bookings for future travel. See Item 3, and Notes 5 and 8 to the unaudited condensed consolidated financial statements. Net cash provided by operating activities is primarily used to finance capital expenditures.

Net cash flows used in investing activities during the three months ended March 31, 2006, totaled \$309 million compared to \$156 million in 2005. 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 was impacted by changes in the balance of the Company's short-term investments, namely auction rate securities. During the three months ended March 31, 2006 and 2005, the Company's short-term investments increased by \$68 million and decreased by \$257 million, respectively. During the first quarter 2006, the Company also received \$20 million from ATA's repayment of their remaining balance of the Company's debtor in possession loan made to ATA in 2004. See Note 10 to the unaudited condensed consolidated financial statements for more information.

Net cash used in financing activities during the three months ended March 31, 2006, was \$122 million compared to \$152 million generated from financing activities for the same period in 2005. In first quarter 2006, the Company repurchased \$214 million of its common stock and redeemed \$37 million of its debt on scheduled maturity dates. These outflows were partially offset by \$107 million received from the exercise of Employee stock options. In the prior year, the Company generated \$300 million from the February 2005 issuance of senior unsecured Notes due 2017. This was partially offset by cash used to redeem the \$100 million senior unsecured 8% Notes due March 1, 2005, and to repurchase \$55 million of the Company's common stock.

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 three months of 2006, the Company purchased six new 737-700 aircraft from Boeing. In addition, one new 737-700 was received from Boeing during the first half of April 2006. On April 20, 2006, Southwest and Boeing entered into an agreement providing for the exercise by Southwest of options to purchase seventy-nine (79) Boeing 737-700 Aircraft for delivery in 2007 through 2012. In addition, Southwest has 116 options with delivery positions in 2008 through 2012, and 54 purchase rights for delivery through December 31, 2014, if Southwest elects to purchase such aircraft. As a result of this transaction, Southwest has firm orders and options to purchase Boeing 737-700 aircraft as follows:

[Table of Contents](#)

	Current Schedule	
	Firm	Options
2006*	33	—
2007	36	—
2008	30	6
2009	18	18
2010	10	32
2011	10	30
2012	10	30
2008-2014	—	54**
Total	147	170

* Includes seven aircraft delivered through April 20, 2006

** Purchase rights

The following table details information on the 451 aircraft in the Company's fleet as of March 31, 2006:

737 Type	Seats	Average Age (Yrs)	Number of Aircraft	Number Owned	Number Leased
-300	137	14.9	194	112	82
-500	122	14.9	25	16	9
-700	137	3.8	232	230	2
TOTALS		9.2	451	358	93

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 \$3.9 billion, subject to adjustments for inflation, due as follows: \$795 million remaining in 2006, \$994 million in 2007, \$765 million in 2008, \$467 million in 2009, \$341 million in 2010, and \$499 million thereafter.

The Company has various options available to meet its capital and operating commitments, including cash on hand and short term investments at March 31, 2006, of \$2.9 billion, internally generated funds, and the Company's fully available \$600 million revolving credit facility. The Company will also consider various borrowing or leasing options to maximize earnings and supplement cash requirements.

In January 2006, the Company's Board of Directors authorized the repurchase of up to \$300 million of the Company's common stock. Repurchases are made in accordance with applicable securities laws in the open market or in private transactions from time to time, depending on market conditions. During first quarter 2006, the Company repurchased 12.7 million shares at a total cost of \$214 million. See Item 2 of Part II of this filing for further information.

[Table of Contents](#)

During first quarter 2006, the Company redeemed a \$29 million two-year note on the maturity date of February 24, 2006. See Note 7 to the unaudited condensed consolidated financial statements.

The Company currently has outstanding shelf registrations for the issuance of up to \$1.3 billion in public debt securities and pass-through certificates, which it may utilize for aircraft financings or other purposes in the future.

Critical accounting policies

The Company's unaudited condensed consolidated financial statements have been prepared in accordance with United States GAAP. The preparation of financial statements in accordance with GAAP requires the Company's management to make estimates and assumptions that affect the amounts reported in the unaudited condensed consolidated financial statements and accompanying footnotes. The Company's estimates and assumptions are based on historical experience and changes in the business environment. However, actual results may differ from estimates under different conditions, sometimes materially. Critical accounting policies and estimates are defined as those that are both most important to the portrayal of the Company's financial condition and results and require management's most subjective judgments. The Company's most critical accounting policies and estimates are described in Item 7 of the Company's Annual Report on Form 10-K for the year ended December 31, 2005. In addition, following the adoption of SFAS 123R, the Company considers its policies related to share-based compensation to be a critical accounting policy.

Share-Based Compensation

The Company has share-based compensation plans covering the majority of its Employee groups, including plans adopted via collective bargaining, a plan covering the Company's Board of Directors, and plans related to employment contracts with one Executive Officer of the Company. Prior to January 1, 2006, the Company accounted for stock-based compensation utilizing the intrinsic value method in accordance with the provisions of Accounting Principles Board Opinion No. 25 (APB 25), "Accounting for Stock Issued to Employees" and related Interpretations. Accordingly, no compensation expense was recognized for fixed option plans because the exercise prices of Employee stock options equaled or exceeded the market prices of the underlying stock on the dates of grant. However, prior to adoption of SFAS 123R, share-based compensation had been included in pro forma disclosures in the financial statement footnotes for periods prior to 2006.

Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123R, "Share-Based Payment" using the modified retrospective transition method. Among other items, SFAS 123R eliminates the use of APB 25 and the intrinsic value method of accounting, and requires companies to recognize the cost of Employee services received in exchange for awards of equity instruments, based on the grant date fair value of those awards, in the financial statements.

Under the modified retrospective method, compensation cost is recognized in the financial statements beginning with the effective date, based on the requirements of SFAS 123R for all share-based payments granted after that date, and based on the requirements of SFAS 123 for all unvested awards granted prior to the effective date of SFAS 123R. In addition, results for prior

[Table of Contents](#)

periods have been retroactively adjusted utilizing the pro forma disclosures in those prior financial statements, except as noted. As part of this revision, the Company recorded cumulative share-based compensation expense of \$409 million for the period 1995-2005, resulting in a reduction to Retained earnings in the accompanying unaudited Condensed Consolidated Balance Sheet as of December 31, 2005. This adjustment, along with the creation of a net Deferred income tax asset in the amount of \$130 million, resulted in an offsetting increase to Capital in excess of par value in the amount of \$539 million in the accompanying unaudited Condensed Consolidated Balance Sheet as of December 31, 2005. The Deferred tax asset represents the portion of the cumulative expense related to stock options that will result in a future tax deduction.

The unaudited Condensed Consolidated Statement of Income for the three months ended March 31, 2006 and 2005 reflect share-based compensation cost of \$22 million and \$20 million, respectively. The total tax benefit recognized from share-based compensation arrangements for the three months ended March 31, 2006 and 2005, was \$6 million and \$5 million, respectively. The Company's earnings before income taxes and net earnings for first quarter 2006 were reduced by \$19 million and \$12 million, respectively, compared to the previous accounting method under APB 25. Net income per share, basic and diluted, were each reduced by \$.01 in first quarter 2006, compared to the previous accounting under APB 25. As a result of the SFAS 123R retroactive application, for the three months ended March 31, 2005, net income was reduced by \$14 million, and net income per share, basic and diluted, were each reduced by \$.02.

The Company estimates the fair value of stock option awards on the date of grant utilizing 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. However, certain assumptions used in the Black-Scholes model, such as expected term, can be adjusted to incorporate the unique characteristics of the Company's stock option awards. Option valuation models require the input of somewhat subjective assumptions including expected stock price volatility and expected term. For 2005 and 2006, the Company has relied on observations of both historical volatility trends, implied future volatility observations as determined by independent third parties, and implied volatility from traded options on the Company's stock. For both 2006 and 2005 stock option grants, the Company utilized expected volatility based on the expected life of the option, but within a range of 25% to 27%. In determining the expected term of the option grants, the Company has observed the actual terms of prior grants with similar characteristics, the actual vesting schedule of the grant, and assessed the expected risk tolerance of different optionee groups.

Other assumptions required for estimating fair value with the Black-Scholes model are the expected risk-free interest rate and expected dividend yield of the Company's stock. The risk-free interest rates used, which were actual U.S. Treasury zero-coupon rates for bonds matching the expected term of the option on the date of grant, ranged from 4.26% to 4.78% for first quarter 2006, versus 3.37% to 4.47% for 2005. The expected dividend yield of the Company's common stock over the expected term of the option on the date of grant was estimated based on the Company's current dividend yield, and adjusted for anticipated future changes.

The fair value of options granted under the fixed option plans during the three months ended March 31, 2006, ranged from \$4.26 to \$6.99, with a weighted-average fair value of \$5.73. The fair

[Table of Contents](#)

value of options granted under the fixed option plans during 2005 ranged from \$2.90 to \$6.79, with a weighted-average fair value of \$3.84.

Vesting terms for the Company's stock option plans differ based on the type of grant made and the group to which the options are granted. For grants made to Employees under collective bargaining plans, vesting has ranged in length from immediate vesting to vesting periods in accordance with the period covered by the respective collective bargaining agreement. For "Other Employee Plans", options vest and become fully exercisable over three, five, or ten years of continued employment, depending upon the grant type. 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 grants include performance-based or market-based vesting conditions, as defined.

As of March 31, 2006, the Company has \$127 million in remaining unrecognized compensation cost related to past grants of stock options, which is expected to be recognized over a weighted-average period of 1.9 years. The total recognition period for the remaining unrecognized compensation cost is approximately ten years; however, the majority of this cost will be recognized over the next two years, in accordance with vesting provisions. Approximately 87 percent of net unrecognized amount at March 31, 2006, related to options granted prior to the adoption of SFAS 123R on January 1, 2006. In addition, the vast majority of the \$22 million in share-based compensation expense reflected in the unaudited Condensed Consolidated Statement of Income for the three months ended March 31, 2006, was related to options granted prior to the adoption of SFAS 123R. Based on Employee stock options expected to vest over the remainder of 2006, the number of options eligible to be granted in future periods and the Company's expectation of future grants, we expect the expense related to share-based compensation to decrease significantly during the second half of 2006 compared to the first half of 2006.

The Company believes it is unlikely that materially different estimates for the assumptions used in estimating the fair value of stock options granted would be made based on the conditions suggested by actual historical experience and other data available at the time estimates were made.

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 21E of the Securities Exchange Act of 1934 and the Private Securities Litigation Reform Act of 1995. Forward-looking statements include statements about Southwest's estimates, expectations, beliefs, intentions, or strategies for the future, and the assumptions underlying these forward-looking statements. Southwest uses the words "anticipates," "believes," "estimates," "expects," "intends," "forecasts," "may," "will," "should," and similar expressions to identify these forward-looking statements.

Forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from historical experience or the Company's present expectations. Factors that could cause these differences include, but are not limited to those set forth under Item 1A. — Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2005.

[Table of Contents](#)

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.

[Table of Contents](#)

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 three months of 2006, the fair values of the Company's fuel hedge contracts have increased. At March 31, 2006, the estimated gross fair value of outstanding contracts was \$1.8 billion, compared to \$1.7 billion at December 31, 2005.

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 March 31, 2006, the Company had agreements with seven 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 March 31, 2006, the Company held \$1.2 billion in fuel hedge 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 8 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, 2005 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 process, summarize and disclose this information within the time periods specified in the rules of the SEC. 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.

[Table of Contents](#)

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 March 31, 2006, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

[Table of Contents](#)

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, 2005.

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

(c)

Issuer Purchases of Equity Securities (1)

Period	(a) Total number of shares purchased	(b) Average price paid per share	(c) Total number of shares purchased as part of publicly announced plans or programs	(d) Maximum dollar value that may yet be purchased under the plans or programs
January 1, 2006 through January 31, 2006			—	\$ 300,000,000
February 1, 2006 through February 28, 2006	5,965,000	\$ 16.53	5,965,000	\$ 201,424,755
March 1, 2006 through March 31, 2006	6,715,000	\$ 17.08	6,715,000	\$ 86,732,472
Total (2)	12,680,000		12,680,000	

(1) In January 2006, the Company announced a program for the repurchase of up to \$300 million of the Company's common stock. Repurchases are made in accordance with applicable securities laws in the open market or in private transactions from time to time, depending on market conditions.

(2) All shares were purchased pursuant to the publicly announced program.

[Table of Contents](#)

Item 3. Defaults upon Senior Securities

None

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

None

Item 5. Other Information

On April 20, 2006, the Company entered into a Severance Contract with Jim Wimberly, its former Executive Vice President — Aircraft Operations.

Item 6. Exhibits

- | | |
|------|--|
| a) | Exhibits |
| 10.1 | Supplemental Agreement Nos. 46 and 47 to Purchase Agreement No. 1810, dated January 19, 1994 between The Boeing Company and Southwest. 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. |
| 10.2 | Severance Contract between Jim Wimberly and Southwest Airlines Co., dated as of April 20, 2006. |
| 18 | Letter from Ernst & Young LLP regarding change in accounting principle |
| 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 |

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.

April 21, 2006

By: /s/ Laura Wright
Laura Wright
Chief Financial Officer
(Principal Financial and
Accounting Officer)

EXHIBIT INDEX

<u>Exhibit No.</u>		<u>Description</u>
Exhibit 10.1	-	Supplemental Agreement Nos. 46 and 47 to Purchase Agreement No. 1810, dated January 19, 1994 between The Boeing Company and Southwest. 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.
Exhibit 10.2	-	Severance Contract between Jim Wimberly and Southwest Airlines Co., dated as of April 20, 2006.
Exhibit 18	-	Letter from Ernst & Young LLP regarding change in accounting principle
Exhibit 31.1	-	Rule 13a-14(a) Certification of Chief Executive Officer
Exhibit 31.2	-	Rule 13a-14(a) Certification of Chief Financial Officer
Exhibit 32.1	-	Section 1350 Certifications of Chief Executive Officer and Chief Financial Officer

Supplemental Agreement No. 46

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 January 27, 2006, 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 exercise one (1) April 2007 Block U-W Option Aircraft (April 2007 Aircraft) and exercise one (1) May 2007 Block U-W Option Aircraft (May 2007 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.
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.

*****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-46-1

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.

NOTE — Buyer now has fifty-five (55) ‘banked’ Rollover Option Aircraft as a result of the option exercises covered by Supplemental Agreement No. 21, 23, 24, 26, 27, 28, 29, 30, 31, 32, 33, 34, 35, 36, 37, 38, 39, 40, 41, 42, 43, 44, 45 and 46 that may be converted to Option Aircraft at a future date subject to the terms of Letter Agreement No. 6-1162-RLL-933R19.

4. Attachment A to Letter Agreement No. 6-1162-JMG-669R6 entitled “Special Matters” is deleted in its entirety and replaced with new Attachment A to Agreement No. 6-1162-JMG-669R6 entitled “Special Matters” attached hereto and is hereby incorporated into the Agreement by this reference.

5. Letter Agreement No. 6-1162-NIW-1369 entitled *** previously executed on December 7, 2005 has been administratively incorporated into the Agreement by this reference.

6. All references in the Letter Agreements associated with Purchase Agreement No. 1810 shall be deemed to refer to the purchase by Buyer of two hundred ninety-one (291) Model 737-7H4 Aircraft, thirty-two (32) Model 737-7H4 Option Aircraft and two hundred seventeen (217) Model 737-7H4 Rollover Option Aircraft, to the extent such reference is not specifically addressed herein.

7. The Advance Payments due upon signing assuming execution of this Supplemental Agreement on or before January 31, 2006 are:

*** for one (1) April 2007 aircraft

*** for one (1) May 2007 aircraft

Buyer will pay the *** directly to Boeing on or before Tuesday, January 31, 2006.

8. As Boeing informed Buyer previously, the International Association of Machinists and Aerospace Workers began a labor stoppage on September 2, 2005 and it concluded on September 29, 2005 (The Strike). Due to the Strike impact, Boeing currently forecasts April 2007 Aircraft to be tendered for delivery in May 2007. Boeing will continue to evaluate the possibility of delivering April 2007 Aircraft in its Contract Delivery Month. If Boeing delays delivery of April 2007 Aircraft, such delay is

P.A. No. 1810
K/SWA

SA-46-2

considered to be Excusable Delay in accordance with Article 6 of the Agreement. Further, the Advance Payment schedule for April 2007 Aircraft has been adjusted to reflect the current forecast delivery month of May 2007.

P.A. No. 1810
K/SWA

SA-46-3

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

SA-46-4

TABLE OF CONTENTS

		Page Number	SA Number
<u>ARTICLES</u>			
1.	Subject Matter of Sale	1-1	SA-13
2.	Delivery, Title and Risk of Loss	2-1	SA-28
3.	Price of Aircraft	3-1	SA-28
4.	Taxes	4-1	
5.	Payment	5-1	
6.	Excusable Delay	6-1	
7.	Changes to the Detail Specification	7-1	SA-1
8.	Federal Aviation Requirements and Certificates and Export License	8-1	
9.	Representatives, Inspection, Flights and Test Data	9-1	
10.	Assignment, Resale or Lease	10-1	
11.	Termination for Certain Events	11-1	
12.	Product Assurance; Disclaimer and Release; Exclusion of Liabilities; Customer Support; Indemnification and Insurance	12-1	
13.	Buyer Furnished Equipment and Spare Parts	13-1	
14.	Contractual Notices and Requests	14-1	
15.	Miscellaneous	15-1	
P.A. No. 1810			
K/SWA	i		SA-46

TABLE OF CONTENTS CON'T

		<u>SA Number</u>
 <u>TABLE</u>		
1.	Aircraft Information Table	SA-46
2.	Option Aircraft Information Table	SA-46
 <u>EXHIBITS</u>		
A	Aircraft Configuration	SA-36
B	Product Assurance Document	SA-1
C	Customer Support Document	
D	Price Adjustments Due to Economic Fluctuations - Aircraft	SA-13
E	Buyer Furnished Equipment Provisions Document	
F	Defined Terms Document	
 <u>LETTER AGREEMENTS</u>		
1810-1	Waiver of Aircraft Demonstration Flight	
P.A. No. 1810		
K/SWA	ii	SA-46

TABLE OF CONTENTS CON'T

		<u>SA Number</u>
<u>RESTRICTED LETTER AGREEMENTS</u>		
6-1162-RLL-932R2	Promotional Support	SA-13
6-1162-RLL-933R19	Option Aircraft	SA-28
6-1162-RLL-934R3	Disclosure of Confidential Information	SA-14
6-1162-RLL-935R1	Performance Guarantees	SA-1
6-1162-NIW-890	***	SA-39
6-1162-RLL-936R4	Certain Contractual Matters	SA-4
6-1162-RLL-937	Alternate Advance Payment Schedule	
6-1162-RLL-938	***	
6-1162-RLL-939R1	Certification Flight Test Aircraft	SA-1
6-1162-RLL-940R1	Training Matters	SA-1
6-1162-RLL-941R2	Other Matters	SA-13
6-1162-RLL-942	Open Configuration Matters	
6-1162-RLL-943R1	Substitution Rights	SA-6
6-1162-RLL-944	Airframe Maintenance Material Cost Protection Program	
6-1162-RLL-945	Comparison of 737-7H4 and 737-3H4 Block Fuel Burn	
6-1162-RLL-1855R3	Additional Contractual Matters	SA-4
6-1162-RLL-1856	***	SA-1
6-1162-RLL-1857	Service Ready Validation Program Field Test	SA-1
6-1162-RLL-1858R1	Escalation Matters	SA-4
P.A. No. 1810	iii	
K/SWA		SA-46

TABLE OF CONTENTS CON'T

		<u>SA Number</u>
<u>RESTRICTED LETTER AGREEMENTS</u>		
6-1162-RLL-2036	Amortization of Costs for Customer Unique Changes	SA-1
6-1162-RLL-2037	Reconciliation of the Aircraft Basic Price	SA-1
6-1162-RLL-2073	Maintenance Training Matters	SA-1
6-1162-KJJ-054	Business Matters	SA-13
6-1162-KJJ-055R1	Structural Matters	SA-25
6-1162-KJJ-056	Noise and Emission Matters	SA-13
6-1162-KJJ-057	Product Development Matters	SA-13
6-1162-KJJ-058	Additional Substitution Rights	SA-13
6-1162-KJJ-150	Flight Control Computer & Mode Control Panel Spares Matter	SA-14
6-1162-MSA-185R3	Delivery Change Contractual Matters	SA-21
6-1162-JMG-669R6	Special Matters	SA-45
New Attachment A		SA-46
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
P.A. No. 1810 K/SWA	iv	SA-46

6-1162-NIW-1142	***		SA-43
6-1162-NIW-1369	***		SA-46
P.A. No. 1810		v	
K/SWA			SA-46

Table 1 to
Purchase Agreement No. 1810
Aircraft Information Table

	Base Aircraft Price	Special Features
Block A, B, C, D & E Aircraft	***	***
Block F & G Aircraft	***	***
Block H Aircraft	***	***
Block I Aircraft	***	***
Block J Aircraft	***	***
Block K Aircraft	***	***
Block K-W Aircraft	***	***
Block L Aircraft	***	***
Block T Aircraft	***	***
Block T-W Aircraft	***	***

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

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



**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
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	***

**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
Jun-2004	2	K	***
Jul-2004	2	K	***
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	***

**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
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	***
Jun-2006	5	T-W	***
Jul-2006	3	T-W	***
Aug-2006	3	T-W	***
Sep-2006	3	T-W	***
Oct-2006	1	T-W	***
Nov-2006	2	T-W	***
Dec-2006	2	T-W	***
Jan-2007	2	T-W	***
Feb-2007	3	T-W	***
Mar-2007	2	T-W	***
Apr-2007	3	T-W	***
May-2007	3	T-W	***
Jun-2007	2	T-W	***
Jul-2007	2	T-W	***
Aug-2007	2	T-W	***
Sep-2007	2	T-W	***
Oct-2007	2	T-W	***
Nov-2007	2	T-W	***
Dec-2007	2	T-W	***
Jan-2008	1	T-W	***
Feb-2008	1	T-W	***
Mar-2008	1	T-W	***
Apr-2008	1	T-W	***
May-2008	1	T-W	***
Jun-2008	1	T-W	***

**Table 2 to Purchase Agreement No. 1810
(Letter Agreement No. 6-1162-RLL-933R19)
Option Aircraft Information Table**

Price Description of Option Aircraft:

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

Delivery of Rollover Option Aircraft:

<u>Year of Delivery</u>	<u>Number of Option Aircraft</u>	<u>Option Aircraft Block</u>
2007	Twenty (20)	Q
2008	Twenty (20)	R
2009	Six (6)	S
2009-2012	One Hundred Seventy-One (171)	V

Remaining Option Aircraft: 32

Aircraft Delivery Mo. & Yr.	Number of Option Aircraft	Option Aircraft Block	Adv Payment Base Price Per Option Aircraft	Option Exercise
Jun-2007	1	U-W	***	February 1, 2006
Jul-2007	1	U-W	***	March 1, 2006
Aug-2007	1	U-W	***	April 1, 2006
Sep-2007	1	U-W	***	May 1, 2006
Oct-2007	1	U-W	***	June 1, 2006
Nov-2007	1	U-W	***	July 1, 2006
Dec-2007	1	U-W	***	August 1, 2006
Jan-2008	2	U-W	***	September 1, 2006
Feb-2008	3	U-W	***	October 1, 2006
Mar-2008	2	U-W	***	November 1, 2006
Apr-2008	2	U-W	***	December 1, 2006
May-2008	2	U-W	***	January 1, 2007
Jun-2008	2	U-W	***	February 1, 2007
Jul-2008	2	U-W	***	March 1, 2007
Aug-2008	2	U-W	***	April 1, 2007
Sep-2008	2	U-W	***	May 1, 2007
Oct-2008	2	U-W	***	June 1, 2007
Nov-2008	2	U-W	***	July 1, 2007
Dec-2008	2	U-W	***	August 1, 2007

Southwest Airlines Co.
Attachment A to 6-1162-JMG-669R6

P.A. No. 1810
K/SWA

SA-46

The Boeing Company
3855 Lakewood Blvd
Long Beach, CA 90846-0001
(562) 593-5511

6-1162-NIW-1369

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 737-7H4 aircraft. All terms used and not defined herein will have the same meaning as in the Agreement.

1. ***

In consideration of Buyer's continued exercise of Block U Option Aircraft into firm aircraft, ***

2. Confidential Treatment

Buyer understands that certain commercial and financial information contained in this Agreement is considered by Boeing as confidential. Buyer agrees that it will treat this Letter 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 may be required by applicable law or government regulators.

Very truly yours,

THE BOEING COMPANY

By /s/ Nobuko Wiles

Its Attorney-In-Fact

P.A. No. 1810

SA-46

Southwest Airlines Co.
6-1162-NIW-1369

ACCEPTED AND AGREED TO this

Date: January 27, 2006

SOUTHWEST AIRLINES CO.

By /s/ Laura Wright

Its SVP Finance and CFO

P.A. No. 1810



SA-46

Supplemental Agreement No. 47

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 April 20, 2006, 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 exercise the following Option Aircraft:

Year 2007 — June, July, August, September, October, November and December

Year 2008 — January (2), February (3), March (2), April (2), May (2), June (2), July (2), August (2), September (2), October (2), November (2) and December

If there are more than one Aircraft in the Contract Delivery Month, quantities are indicated in parenthesis above and;

*****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-47-1

WHEREAS, Buyer has agreed to convert Rollover Option Aircraft to firm Aircraft scheduled to deliver as follows:

Year 2009 — January, February (2), March (2), April (2), May (2), June (2), July (2), August, September, October, November and December

Year 2010 — January, February, March, April, May, June, July, August, September and October

Year 2011 — January, February, March, April, May, June, July, August, September and October

Year 2012 — January, February, March, April, May, June, July, August, September and October

If there are more than one Aircraft in the Contract Delivery Month, quantities are indicated in parenthesis above and;

WHEREAS, Buyer has agreed to convert Rollover Option Aircraft to Option Aircraft scheduled to deliver as follows:

Year 2008 — January, March, July (2) and August

Year 2009 — January (3), March (3), April (2), May, June, July (2), August (2), September, October, November and December

Year 2010 — January (3), February (3), March (2), April (3), May (3), June (3), July (2), August (2), September (2), October (3), November (3) and December (3)

Year 2011 — January (3), February (3), March (2), April (3), May (3), June (3), July (2), August (2), September (2), October (2), November (3) and December (2)

Year 2012 — January (3), February (3), March (2), April (3), May (3), June (3), July (2), August (2), September (2), October (2), November (3) and December (2)

If there are more than one Aircraft in the Contract Delivery Month, quantities are indicated in parenthesis above and;

WHEREAS, Buyer and Boeing agreed to replace the term “Rollover Option” with “Purchase Right” Aircraft and;

WHEREAS, ***

WHEREAS, Buyer and Boeing agreed to update Article 3, entitled “Price of Aircraft” to incorporate pricing information of newly added Airplane Blocks 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. Article 3, entitled “Price of Aircraft”, paragraph 3.2 entitled “Aircraft Basic Price,” and paragraph 3.3 entitled “Aircraft Price” are revised by adding references to Block T-W Aircraft, Block T-W-1 Aircraft, Block T-W-1a Aircraft, Block T-W-2 Aircraft and Block T-W-2a Aircraft. Such new pages 3-1 and 3-2 are attached hereto and incorporated into the Agreement by this reference.
3. 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.
4. 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.

NOTE — Buyer had fifty-five (55) ‘banked’ Rollover Option Aircraft as a result of the option exercises covered by Supplemental Agreement No. 21, 23, 24, 26, 27, 28, 29, 30, 31, 32, 33, 34, 35, 36, 37, 38, 39, 40, 41, 42, 43, 44, 45 and 46. In accordance with the terms of Letter Agreement No. 6-1162-RLL-933R20, Buyer has converted such ‘banked’ Rollover Option Aircraft to Firm Aircraft / Option Aircraft as part of this Supplemental Agreement.

5. ***

6. Letter Agreement No. 6-1162-RLL-933R19 entitled “Option Aircraft” is deleted in its entirety and replaced with Letter Agreement No. 6-1162-RLL-933R20 entitled “Option Aircraft” attached hereto and is hereby incorporated into the Agreement by this reference.

P.A. No. 1810
K/SWA

SA-47-3

6. All references in the Letter Agreements associated with Purchase Agreement No. 1810 shall be deemed to refer to the purchase by Buyer of three hundred seventy (370) Model 737-7H4 Aircraft, one hundred sixteen (116) 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.

7. The Advance Payments for Firm Aircraft due upon signing assuming execution of this Supplemental Agreement on or before April 28, 2006 are:

***for 79 Firm Aircraft

The Deposit for Option Aircraft due upon signing assuming execution of this Supplemental Agreement on or before April 28, 2006 is:

*** for 115 Option Aircraft ***

Buyer will pay the *** directly to Boeing on or before Friday, April 28, 2006.

8. As Boeing informed Buyer previously, the International Association of Machinists and Aerospace Workers began a labor stoppage on September 2, 2005 and it concluded on September 29, 2005 (The Strike). Due to the Strike impact, Boeing currently forecasts one December 2007 Aircraft bearing Manufactures Serial Number 36615 (December 2007 Aircraft) to be tendered for delivery in January 2008. Boeing will continue to evaluate the possibility of delivering December 2007 Aircraft in its Contract Delivery Month. If Boeing delays delivery of December 2007 Aircraft, such delay is considered to be Excusable Delay in accordance with Article 6 of the Agreement. Further, the Advance Payment schedule for December 2007 Aircraft has been adjusted to reflect the current forecast delivery month of January 2008.

P.A. No. 1810

SA-47-4

K/SWA

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

By: /s/ Nobuku Wiles
Its: Attorney-In-Fact

P.A. No. 1810
K/SWA

SA-47-5

SOUTHWEST AIRLINES CO.

By: Laura Wright
Its: SVP Finance & CFO

TABLE OF CONTENTS

ARTICLES		<u>Page Number</u>	<u>SA Number</u>
1.	Subject Matter of Sale	1-1	SA-13
2.	Delivery, Title and Risk of Loss	2-1	SA-28
3.	Price of Aircraft	3-1	SA-47
4.	Taxes	4-1	
5.	Payment	5-1	
6.	Excusable Delay	6-1	
7.	Changes to the Detail Specification	7-1	SA-1
8.	Federal Aviation Requirements and Certificates and Export License	8-1	
9.	Representatives, Inspection, Flights and Test Data	9-1	
10.	Assignment, Resale or Lease	10-1	
11.	Termination for Certain Events	11-1	
12.	Product Assurance; Disclaimer and Release; Exclusion of Liabilities; Customer Support; Indemnification and Insurance	12-1	
13.	Buyer Furnished Equipment and Spare Parts	13-1	
14.	Contractual Notices and Requests	14-1	
15.	Miscellaneous	15-1	

TABLE OF CONTENTS CON'T

		<u>SA Number</u>
TABLE		
1.	Aircraft Information Table	SA-47
2.	Option Aircraft Information Table	SA-47
EXHIBITS		
A	Aircraft Configuration	SA-47
B	Product Assurance Document	SA-1
C	Customer Support Document	
D	Price Adjustments Due to Economic Fluctuations — Aircraft	
E	Buyer Furnished Equipment Provisions Document	
F	Defined Terms Document	
LETTER AGREEMENTS		
1810-1	Waiver of Aircraft Demonstration Flight	
P.A. No. 1810		
	ii	
		SA-47

TABLE OF CONTENTS CON'T

		<u>SA Number</u>
RESTRICTED LETTER AGREEMENTS		
6-1162-RLL-932R2	Promotional Support	SA-13
6-1162-RLL-933R20	***	SA-47
6-1162-RLL-934R3	Disclosure of Confidential Information	SA-14
6-1162-RLL-935R1	Performance Guarantees	SA-1
6-1162-NIW-890	***	SA-39
6-1162-RLL-936R4	Certain Contractual Matters	SA-4
6-1162-RLL-937	Alternate Advance Payment Schedule	
6-1162-RLL-938	***	
6-1162-RLL-939R1	Certification Flight Test Aircraft	SA-1
6-1162-RLL-940R1	Training Matters	SA-1
6-1162-RLL-941R2	Other Matters	SA-13
6-1162-RLL-942	Open Configuration Matters	
6-1162-RLL-943R1	Substitution Rights	SA-6
6-1162-RLL-944	Airframe Maintenance Material Cost Protection Program	
6-1162-RLL-945	Comparison of 737-7H4 and 737-3H4 Block Fuel Burn	
6-1162-RLL-1855R3	Additional Contractual Matters	SA-4
6-1162-RLL-1856	***	SA-1
6-1162-RLL-1857	Service Ready Validation Program Field Test	SA-1
6-1162-RLL-1858R1	Escalation Matters	SA-4
P.A. No. 1810	iii	
		SA-47

TABLE OF CONTENTS CON'T

	<u>SA Number</u>
RESTRICTED LETTER AGREEMENTS	
6-1162-RLL-2036	Amortization of Costs for Customer Unique Changes SA-1
6-1162-RLL-2037	Reconciliation of the Aircraft Basic Price SA-1
6-1162-RLL-2073	Maintenance Training Matters SA-1
6-1162-KJJ-054R1	Business Matters
6-1162-KJJ-055R1	Structural Matters SA-25
6-1162-KJJ-056	Noise and Emission Matters SA-13
6-1162-KJJ-057	Product Development Matters SA-13
6-1162-KJJ-058	Additional Substitution Rights SA-13
6-1162-KJJ-150	Flight Control Computer & Mode Control Panel Spares Matter SA-14
6-1162-MSA-185R3	Delivery Change Contractual Matters SA-21
New Attachment A	SA-46
6-1162-JMG-669R7	*** SA-47
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
P.A. No. 1810	iv SA-47

**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	***	

**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
May-2004	1	K	***	
Jun-2004	2	K	***	
Jul-2004	2	K	***	
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	***	

**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
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	***	
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	***	***
Jul-2007	2	T-W-1	***	
Jul-2007	1	T-W-1a	***	***
Aug-2007	2	T-W-1	***	
Aug-2007	1	T-W-1a	***	***
Sep-2007	2	T-W-1	***	
Sep-2007	1	T-W-1a	***	***
Oct-2007	2	T-W-1	***	
Oct-2007	1	T-W-1a	***	***
Nov-2007	2	T-W-1	***	
Nov-2007	1	T-W-1a	***	***
Dec-2007	2	T-W-1	***	
Dec-2007	1	T-W-1a	***	***
Jan-2008	1	T-W-1	***	
Jan-2008	2	T-W-1a	***	***
Feb-2008	1	T-W-1	***	
Feb-2008	3	T-W-1a	***	***
Mar-2008	1	T-W-1	***	
Mar-2008	2	T-W-1a	***	***
Apr-2008	1	T-W-1	***	
Apr-2008	2	T-W-1a	***	***
May-2008	1	T-W-1	***	
May-2008	2	T-W-1a	***	***

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
Jun-2008	1	T-W-1	***	
Jun-2008	2	T-W-1a	***	***
Jul-2008	2	T-W-2a	***	
Aug-2008	2	T-W-2a	***	
Sep-2008	2	T-W-2a	***	
Oct-2008	2	T-W-2a	***	
Nov-2008	2	T-W-2a	***	
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	***	

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
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	***	

**Table 2 to Purchase Agreement No. 1810
(Letter Agreement No. 6-1162-RLL-933R19)
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
<i>Delivery of <u>Purchase Right</u> Aircraft:</i>	Quantity			54
<i>Delivery Period of <u>Purchase Right</u> Aircraft:</i>	Complete delivery not later than Dec. 31, 2014			
<i>Condition of Offer for <u>Purchase Right</u> Aircraft:</i>	Subject to Available Position			
Remaining Option Aircraft:	116			

**Table 2 to Purchase Agreement No. 1810
(Letter Agreement No. 6-1162-RLL-933R19)
Option Aircraft Information Table**

Aircraft Delivery Mo. & Yr.	Number of Option Aircraft	Option Aircraft Block	Adv Payment Base Price Per Option Aircraft	Option Exercise
Jan-2008	1	U-W-1	***	September 1, 2006
Mar-2008	1	U-W-1	***	November 1, 2006
Jul-2008	2	U-W-1	***	March 1, 2007
Aug-2008	1	U-W-1	***	April 2, 2007
Dec-2008	1	U-W-1	***	August 1, 2007
Jan-2009	3	U-W-1	***	September 3, 2007
Mar-2009	3	U-W-1	***	November 1, 2007
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	2	U-W-1	***	April 1, 2008
Sep-2009	1	U-W-1	***	May 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	3	U-W-1	***	September 1, 2008
Feb-2010	3	U-W-1	***	October 1, 2008
Mar-2010	2	U-W-1	***	November 3, 2008
Apr-2010	3	U-W-1	***	December 1, 2008
May-2010	3	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	3	U-W-1	***	September 1, 2009
Feb-2011	3	U-W-1	***	October 1, 2009
Mar-2011	2	U-W-1	***	November 2, 2009
Apr-2011	3	U-W-1	***	December 1, 2009
May-2011	3	U-W-1	***	January 1, 2010
Jun-2011	3	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

Table 2 to Purchase Agreement No. 1810
(Letter Agreement No. 6-1162-RLL-933R19)
Option Aircraft Information Table

Aircraft Delivery Mo. & Yr.	Number of Option Aircraft	Option Aircraft Block	Adv Payment Base Price Per Option Aircraft	Option Exercise
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

6-1162-JMG-669R7

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. ***

Consistent with the spirit of the Letter dated May 4,

8. ***

P.A. No. 1810
K/SWA

SA-47

Southwest Airlines Co.
6-1162-JMG-669R7

9. ***

10. ***

11. ***

12. ***

13. ***.

14. 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-RLL-934, as amended.

P.A. No. 1810
K/SWA

SA-47

Southwest Airlines Co.
6-1162-JMG-669R7

Very truly yours,

THE BOEING COMPANY

By /s/ Nobuko Wiles

Its Attorney-In-Fact

ACCEPTED AND AGREED TO this

date: April 20, 2006

SOUTHWEST AIRLINES CO.

By: Laura Wright

Its SVP Finance and CFO

P.A. No. 1810
K/SWA

SA-47

SA-47

P.A. No. 1810
K/SWA

6-1162-RLL-933R20

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

Subject: Letter Agreement No. 6-1162-RLL-933R20 to Purchase Agreement No. 1810 — ***

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 737-7H4 aircraft (Aircraft).

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

In consideration of the purchase by Buyer of the Aircraft, Boeing hereby agrees to manufacture and sell to Buyer and Buyer shall have the option to purchase (Option or Options) the additional Model 737-7H4 aircraft as described in paragraph 1 of Attachment A hereto and listed in Table 2 of the Agreement (Option Aircraft) and Model 737-7H4 Purchase Right Aircraft summarized in Table 2 of the Agreement (Purchase Right Aircraft), subject to the terms and conditions set forth below. For the avoidance of doubt, Buyer and Boeing hereby agree to replace the term “Rollover Option Aircraft” with “Purchase Right Aircraft” at the execution of Supplemental Agreement No. 47 to the Agreement.

1. Delivery of Option Aircraft.

The Option Aircraft will be delivered to Buyer during or before the months set forth in Table 2 of the Agreement.

2. Delivery of Purchase Right Aircraft.

2.1 The Purchase Right Aircraft are offered subject to available position during the period set forth in Table 2 of the Agreement. For the avoidance of any doubt, Buyer and Boeing hereby agree that the delivery of Purchase Right Aircraft shall be completed by not later than December 31, 2014.

2.2 ***

SA-47

P.A. No. 1810
K/SWA

2.3 Base Price Adjustments for Purchase Right Aircraft which are converted to Option Aircraft or firm Aircraft shall be in accordance with Article 2.2.5 of Attachment A to this Letter Agreement.

2.4 Upon conversion of a Purchase Right Aircraft into an Option Aircraft, Buyer shall wire transfer the Deposit of *** to Boeing and Boeing and Buyer shall agree on a delivery position for that aircraft. Table 2 of the Agreement will be amended accordingly. In the event Buyer thereafter exercises its right to purchase such Option Aircraft, application of the Deposit will be in accordance with Article 4.1 herein. If the conversion is a Purchase Right Aircraft to a firm Aircraft, Buyer shall wire transfer any advance payments due under the Agreement.

2.5 Buyer and Boeing will consult on a frequent basis to keep each other informed as to Buyer's fleet plans and Boeing's production plans in order to accommodate to the greatest extent reasonably possible each party's needs in managing the delivery schedule for Purchase Right Aircraft and will use its best reasonable efforts to meet Buyer's needs.

3. Price.

3.1 The advance payment base prices of the Option Aircraft are set forth in Table 2 of the Agreement. The Option Aircraft pricing elements and associated pricing terms and conditions are given in Attachment A.

3.2 The Advance Payment Base Prices of the Option Aircraft indicated in Table 2 do include an amount for special features in addition to those specifically described in Attachment A but do not include any amount for items of Buyer Furnished Equipment (BFE). An estimate for typical special features is *** per Aircraft (expressed in 1992 STE dollars) or *** per Aircraft (expressed in 1999 STE dollars). Table 2 in the Agreement lists the Advance Payment Base Price per Option Aircraft.

3.3 The Option Aircraft purchase price will be the applicable basic price thereof at the time of Option Aircraft delivery adjusted in accordance with Boeing's Aircraft escalation provisions contained in the definitive agreement to purchase the Option Aircraft. The purchase price will include the price for Seller Purchased Equipment (SPE) if Buyer has elected to change Buyer Furnished Equipment (BFE) to SPE.

SA-47

4. Option Aircraft Payment.

4.1 In consideration of the granting of the Options as set forth herein, on or before the date Boeing and Buyer enter into a definitive agreement to purchase the Aircraft, Buyer will pay a deposit to Boeing of for each Option Aircraft (Deposit). In the event Buyer exercises its Options herein, the amount of the Deposit will be credited against the first advance payment due for such Option Aircraft pursuant to the advance payment schedule set forth in paragraph 3 of Attachment A. The Deposits for the Option Aircraft will be refunded to Buyer, without interest, if the parties do not enter into a definitive Agreement for the Aircraft.

In the event that, after the parties enter into a definitive agreement to purchase the Aircraft, Buyer does not exercise its Options to purchase the Option Aircraft pursuant to the terms and conditions set forth herein, Boeing will be entitled to retain the Deposits for the Option Aircraft except as provided in paragraph 6 herein.

4.2 Advance payments in the amount of 30% of the advance payment base price will be payable on the Option Aircraft in accordance with paragraph 3 of Attachment A. The remainder of the Option Aircraft purchase price is due at the time of delivery of the Option Aircraft.

5. Option Exercise.

5.1 To exercise its Option, Buyer will give written or telegraphic notice thereof to Boeing on or before sixteen (16) months prior to the first day of the delivery month of each Option Aircraft.

In such notice Buyer will select the Option Model type, and the applicable delivery positions. Table 2 of the Agreement lists the Option Exercise dates.

5.2 It is understood and agreed that Boeing may accelerate the Option exercise dates specified above if Boeing must make production decisions which are dependent on Buyer's decision to buy the Option Aircraft. If Boeing elects to accelerate the Option exercise dates, Boeing will do so by giving written or telegraphic notice thereof to Buyer. Such notice will specify the revised Option exercise dates, which will not be earlier than 30 days after the date of transmittal of such notice, and the Option Aircraft

SA-47

delivery positions affected by such revision. If Buyer fails to exercise its Option for any Option Aircraft affected by such revised dates, the Deposit applicable to such Option Aircraft will be promptly refunded, with interest, to Buyer. The interest rate for calculation of the interest associated with such refund is the rate of two percent (2%) below the Citibank base rate in effect from time to time during the period the Option deposit is held by Boeing.

6. Contract Terms.

It is understood that Boeing and Buyer will use their best efforts to enter into a definitive agreement for the Option Aircraft within thirty (30) days after Buyer exercises an Option to purchase Option Aircraft pursuant to paragraph 5 covering the detailed terms and conditions for the sale of such Option Aircraft.

Such definitive agreement will include the terms and conditions contained herein together with the terms and conditions, not inconsistent herewith, contained in Boeing's then-current standard form of purchase agreement for the sale of Model 737-700 aircraft in effect as of the date of Option exercise and such additional terms and conditions as may be mutually agreed upon. In the event the parties have not entered into such an agreement within the time period contemplated herein, either party may, exercisable by written or telegraphic notice given to the other within thirty (30) days after such period, terminate the purchase of such Option Aircraft.

7. Termination of Option to Purchase.

Either Boeing or Buyer may terminate the Options to purchase an Option Aircraft if any of the following events are not accomplished by the respective dates contemplated in this letter agreement, or in the Agreement, as the case may be:

- (i) termination of the purchase of the Aircraft under the Agreement for any reason;
- (ii) payment by Buyer of the Deposit with respect to an Option Aircraft pursuant to paragraph 4.1 herein;
- (iii) exercise of an Option to purchase an Option Aircraft pursuant to the terms hereof.

Any termination of an Option to purchase by Boeing which is based on the termination of the purchase of

SA-47

Aircraft under the Agreement will be on a one-for-one basis, for each Aircraft so terminated.

Any cancellation of an Option to purchase which is based on failure to make the required Deposit or to exercise the Option to purchase shall only apply to the Option Aircraft so canceled.

Termination of an Option to purchase provided by this letter agreement will be caused by either party giving written notice to the other within 10 days after the applicable date. Upon receipt of such notice, all rights and obligations of the parties with respect to an Option Aircraft for which the Option to purchase has been terminate will thereupon terminate.

If termination is result of a revision of an Option exercise date by Boeing pursuant to paragraph 5.2, Boeing will promptly refund to Buyer, with interest, any payments received from Buyer, including the Deposit, with respect to the Option Aircraft for which the Option is terminated. If termination is for any other reason, Boeing will promptly refund to Buyer, without interest, any payments received from Buyer with respect to the affected Option Aircraft, except the Deposit, which Buyer may apply to any model Boeing aircraft purchased by Buyer from Boeing at a future date.

SA-47

P.A. No. 1810
K/SWA

Southwest Airlines Co.
6-1162-RLL-933R20 Page 6

8. 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-RLL-934, as amended.

Very truly yours,

THE BOEING COMPANY

By /s/ Nobuko Wiles
Its Attorney-In-Fact

ACCEPTED AND AGREED TO this
date: April 20, 2006
SOUTHWEST AIRLINES CO.

By /s/ Laura Wright
Its SVP Finance & CFO

Attachments

SA-47

P.A. No. 1810
K/SWA

Model 737-7H4 Aircraft

1. Option Aircraft Description and Changes.

1.1 Aircraft Description. The Option Aircraft is described by Boeing Detail Specification D6-38808-1, Dated October 30 ,1996, for Block “U” Option Aircraft by Boeing Detail Specification D6-38808-1, Rev. A, Dated February 24, 1998, and **for Block “U-W-1” Option Aircraft by Boeing Detail Specification D6-38808-1, Rev. G, Dated July 26, 2005.**

1.2 Changes. The Detail Specification will be revised to include:

(1) Changes applicable to the basic Model 737-700 aircraft which are developed by Boeing between the date of the Detail Specification and the signing of a definitive agreement to purchase the Option Aircraft.

(2) Changes mutually agreed upon.

(3) Changes required to obtain a Standard Certificate of Airworthiness.

(4) To provide sufficient Option Aircraft manufacturing and procurement lead time it is necessary for Boeing and Buyer to reach final agreement on the Option Aircraft configuration, including BFE/SPE vendor selection fifteen (15) months prior to delivery of each Option Aircraft. If such items are not resolved by the indicated dates, Boeing reserves the right to amend this letter agreement:

(i) to adjust the scheduled delivery of the Option Aircraft to a later time period and,

(ii) to make such other changes as are appropriate and consistent with the revised Option Aircraft deliveries.

1.3 Effect of Changes. Changes to the Detail Specification incorporated pursuant to the provisions of the clauses above will include the effects of such changes upon Option Aircraft weight, balance, design and performance. Performance guarantees for the Option Aircraft which are mutually acceptable to the parties will be included in the definitive agreement for the Option Aircraft.

SA-47

2. Price Description

2.1 Price Elements Per Aircraft. The Aircraft Basic Price detailed in Table 2 of the Agreement is added to the Estimated Escalation and Estimated Escalation Sharing to determine the Advance Payment Base Price of the Option Aircraft (also listed in Table 2 of the Agreement). At the signing of this Letter Agreement, the Estimated Escalation Sharing is zero for all Option Aircraft.

2.2 Price Adjustments For Option Aircraft Delivering From January 2008 through December 2014.

2.2.1 Escalation Adjustments. The Advance Payment Base Price per Option Aircraft in Table 2 is based on 4th Quarter 2005 forecast at the execution of Letter Agreement No. 6-1162-RLL-933R20. Buyer and Boeing agree to review and update Advance Payment Base Price of Option Aircraft as such Option Aircraft is added to Table 2 or if Boeing and Buyer agree to incorporate a new escalation provision into the Agreement.

2.2.2 Base Price Adjustments for FAA Changes. The Aircraft Basic Price of the Option Aircraft will be adjusted for any FAA mandated changes incorporated into the Aircraft.

2.2.3 Price Adjustments for Changes. Boeing may adjust the Aircraft Basic Price and the Advance Payment Base Price for any changes mutually agreed upon subsequent to the date that Buyer and Boeing enter into a definitive agreement for the Option Aircraft.

2.2.4 Base Price Adjustments. The Aircraft Basic Price of the Option Aircraft will be adjusted to Boeing's then-current prices as of the date of execution of the definitive agreement for the Option Aircraft in accordance with the agreement reached below. The Aircraft Basic Price starting point for Option Aircraft delivering in 2003 is *** (July 1992 STE), for Option Aircraft delivering in 2004 is *** (July 1992 STE), for Options delivering in 2005 through **February 2006** is *** (July 1992 STE), for Block "U" Option Aircraft is *** (July 1999 STE), **for Block "U-W" Option Aircraft is *** (July 1999 STE) and for Block "U-W-1" Option Aircraft is *** July 1999 STE**. Such Aircraft Basic Price may increase in accordance with paragraphs 2.2.1, 2.2.2, and 2.2.3. For any other changes to the Aircraft Basic Price, Boeing may increase the Aircraft Basic Price by a maximum of *** (July 1992 STE) for Aircraft delivering in 2005; by a maximum of *** (July 1992 STE) per year or portion thereof starting in January 2006 through 2009. For Block "U" Option Aircraft Boeing may increase the Aircraft

SA-47

Basic Price by a maximum of *** (July 1999 STE) per year or portion thereof starting in January 2008.

2.2.6 BFE to SPE. An estimate of the total price for items of Buyer Furnished Equipment (BFE) changed to Seller Purchased Equipment (SPE) pursuant to the Configuration Specification is included in the Option Aircraft price build-up. The purchase price of the Option Aircraft will be adjusted by the price charged to Boeing for such items plus 10% of such price. If all BFE except developmental avionics is converted to SPE, Boeing will waive the 10% fee.

SA-47

P.A. No. 1810
K/SWA

3. Advance Payment Schedules, Prices and Adjustments.

3.1 Buyer will pay to Boeing advance payments for the Option Aircraft on the dates and in the amounts determined below.

Due Date of Payment		Amount Due per Aircraft (Percentage times Advance Payment Base Price)
Deposit		*** (if applicable)
18 months prior to the first day of the scheduled delivery month of the Aircraft		15% (less the Deposit if any)
12 months prior to the first day of the scheduled delivery month of the Aircraft		5%
9 months prior to the first day of the scheduled delivery month of the Aircraft		5%
6 months prior to the first day of the scheduled delivery month of the Aircraft		5%
Total		30%

Any advance payments that would be past due as of the date of signing the definitive purchase agreement for the Option Aircraft in accordance with the above schedule are due and payable on such date.

3.2 Option Aircraft advance payment base prices will be increased or decreased, as appropriate, at the time of signing of the definitive purchase agreement for the Option Aircraft, using the then-current forecasted aircraft escalation factors used by Boeing, to determine the amount of the advance payments to be made by Buyer on the Option Aircraft.

SEVERANCE CONTRACT

THIS SEVERANCE CONTRACT (hereinafter referred to as this "Agreement"), dated as of April 20, 2006, by and between **JAMES C. WIMBERLY** (hereinafter referred to as the "Executive"), 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 Executive has served as an employee and an officer of Southwest since November 18, 1985; and

WHEREAS the Executive desires to resign his office but to continue his employment with Southwest, and Southwest is agreeable, subject to the terms and conditions of this Agreement, to continuing his employment and to paying him severance compensation in consideration of the Executive's agreements contained herein;

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

I. RESIGNATION AND CONTINUED EMPLOYMENT

RESIGNATION AND CONTINUED EMPLOYMENT. The Executive will resign as an officer of Southwest effective as of January 1, 2006, and he irrevocably waives any claim that he may have against Southwest, its directors or officers based on or related to such resignation. Notwithstanding such resignation, the Executive shall remain an employee of Southwest through February 15, 2008, and during the period of such employment the Executive shall discharge the consulting obligations set forth in Paragraph II-B of this Agreement. The Executive may elect to terminate his employment at any time prior to February 16, 2008, upon prior notice to Southwest; provided, however, that in such event Southwest shall be relieved of any obligation to make further payments to the Executive under Paragraphs III-B and III-C hereof and, if the Executive shall do work prior to February 16, 2008 for any airline that then competes with Southwest, then Southwest shall be entitled to recover all past payments that Southwest shall have made pursuant to Paragraphs III-B and III-C hereof, all as more particularly provided in Paragraph III-G hereof.

II. EXECUTIVE'S OBLIGATIONS

A. NON-DEROGATION, ETC. The Executive agrees that he shall not do or say anything, whether personally or through his attorney, agent or other representative, to, directly or impliedly, derogate Southwest, its business operations or prospects, its properties or any of its officers, directors or employees, whether by way of media interviews, radio or television appearances, letters to editors or others, articles published in the airline trade press or in the general press, Internet chat rooms or otherwise. In addition, the Executive shall provide no assistance or advice to, or discuss any of Southwest's business matters or affairs with, any current or prospective employee of Southwest,

whether for a fee or otherwise, unless specifically requested to do so by the Chief Executive Officer or the Chairman of the Board of Directors of Southwest.

B. CONSULTANCY. The Executive agrees that, from time to time during the term of his employment under this Agreement, the Executive shall make himself available at the offices of Southwest, when specifically requested to do so by Southwest, in order to consult with either the Chief Executive Officer of Southwest, or the Chairman of its Board of Directors, as to aircraft and airport operations and as to the business, properties or operations of Southwest, in each case for such reasonable periods of time as either such officer may request; it being understood that Executive will take vacation from the period January 1, 2006 through February 15, 2006. At all times during his employment the Executive shall generally conform to all policies of Southwest as they may apply to an employee of his level of duties and obligations.

C. UNION WORK. The Executive agrees that, at all times prior to February 16, 2008, he shall not personally, or through any representative, intermediary or agent, directly or indirectly provide any advice, assistance or counsel to any union or collective bargaining unit in connection with its representation (or efforts to seek representation) of any group of Employees at Southwest.

III. EXECUTIVE SEVERANCE COMPENSATION

A. SEVERANCE COMPENSATION. In consideration of his agreements set forth in Articles I and II hereof, Southwest shall pay to the Executive the severance compensation set forth in this Article III. All such severance compensation shall be subject to such payroll and withholding deductions as may be required by law.

B. SEMI-MONTHLY INSTALLMENTS. The Executive shall receive severance compensation consisting of the following:

Beginning with payroll date January 5, 2006, and continuing through the payroll date April 20, 2006, the sum of \$11,260.04 on each regular semi-monthly payroll date.

Beginning with the payroll date May 5, 2006, and continuing through the payroll date December 20, 2006, the sum of \$8,760.04 on each regular semi-monthly payroll date.

On January 5, 2007, the sum of 9,696.69.

Beginning with the payroll date January 20, 2007, and continuing through the payroll date December 20, 2007, the sum of \$7,296.69 on each regular semi-monthly payroll date.

Beginning with the payroll date January 5, 2008, and continuing through the payroll date February 20, 2008, the sum of \$5,630.02 on each regular semi-monthly payroll date.

In the event that Southwest shall change its payroll practices while payments are owing to the Executive pursuant to this Paragraph III-B, then Southwest shall adjust the timing of its such payments to the Executive so as to insure that he receives equal installment payments no less frequently than monthly.

C. LUMP-SUM PAYMENT. The Executive shall receive a lump-sum severance payment payable on such dates in January 2006 and 2007 as Southwest shall pay its officers their annual performance bonuses (or, in the absence of any such bonus payments in January, on the last business day of January 2006 and 2007), in an amount determined by the Compensation Committee of the Southwest Board of Directors. The amount payable in January 2006 shall be not less than \$190,000, and the amount payable in January 2007 shall be not less than the amount paid in January 2006. The Executive shall receive an additional lump sum severance payments on such date in January 2008 as Southwest shall pay its officers their annual performance bonuses (or, in the absence of any such bonus payments in January 2008 on the last business day of January 2008), in an amount determined by the Compensation Committee of the Southwest Board of Directors, not less than one half of the lump sum payment made in January 2007.

D. AIRLINE PASSES. The Executive and his wife, Margie, shall receive lifetime, positive-space passes for travel on Southwest's scheduled flights, and the Executive shall be eligible for all pass privileges that other airlines make available to Southwest's retirees generally.

E. MEDICAL AND DENTAL EXPENSES. During his term of employment with Southwest, the Executive 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 Executive may elect to participate in any non-contract retiree medical benefit plan or program that Southwest may then make available to its retirees generally and for which Employee may then be eligible. Southwest shall reimburse the Executive for all actuarial age-banded rate premiums that the Executive may incur for himself and his spouse under any such Southwest plan or program from February 15, 2008 until February 16, 2013; provided, however that the right to reimbursement provided in this sentence shall terminate in the event Executive is employed by another entity providing comparable medical benefits.

F. PRIOR BENEFITS. Nothing contained in this Agreement is intended to diminish or enlarge any compensation or other benefits that may have accrued to the benefit of the Executive in his capacity as an employee or officer of Southwest at any time prior to the date of this Agreement, it being understood that the Executive shall have no claim on any further Base Salary or Performance Bonus or stock options. The Executive shall be eligible to receive such benefits as he may be entitled to under all profit-sharing, stock purchase, stock option, group insurance and other benefit plans or programs in which he may have participated while employed by Southwest, either prior to or after the date of this Agreement, in each case to the extent of and in accordance with the rules and agreements governing such plans or programs; provided however, that no stock options granted to Executive by Southwest shall vest after December 31, 2005.

G. PAYMENTS UNFUNDED; CONDITION PRECEDENT; CLAWBACK, ETC. The severance compensation provided for in this Article III is provided on an unsecured, unfunded basis and shall be payable solely from the general assets of Southwest. All amounts payable by Southwest pursuant to this Article III shall be paid without notice or demand, and irrespective of the Executive's death or disability; provided, however, that notwithstanding any other provision of this Agreement it shall be a condition precedent to the obligation of Southwest to make any payment under Paragraphs III-B and III-C hereof that each of the following shall be true and accurate at the time of such payment: (i) the Executive's agreements contained in Paragraphs II-A and II-C of this Agreement shall not have been declared to be unenforceable or non-binding on the Executive, in

whole or in part, by any court of competent jurisdiction; (ii) the Executive shall not have engaged in any conduct in breach of his agreements contained in Paragraphs II-A and II-C hereof, irrespective of the enforceability of any such agreements at law or in equity; and (iii) at no time prior to February 16, 2008, shall the Executive do work for any airline that then competes with Southwest, whether as an employee or as a consultant, nor shall he provide advice to, nor representation of, any person or entity whose interests are adverse to Southwest in any legal or administrative proceeding. Upon the occurrence at any time of either event described in the preceding clauses (i) and (ii) or, if prior to February 16, 2008, (but not thereafter) the Executive shall do work for any airline that then competes with Southwest, in addition to relieving Southwest of any obligation to make any further payments owing under Paragraphs III-B and III-C hereof, Southwest shall be entitled to recover the full amount of all past payments that Southwest shall have made pursuant to Paragraph III-B hereof and Paragraph III-C hereof, with interest thereon at a rate of six percent (6%) per annum from the time Southwest shall have made any such payment to the Executive until its recovery thereof. The Executive shall have no obligation to seek other employment in mitigation of any amount payable to him under this Article III, and he shall have the right, without incurring any penalty hereunder, to accept any other employment that does not (i) violate the provisions of Paragraph II-C hereof or (ii) involve doing work for any airline that then competes with Southwest. After February 15, 2008, the Executive may accept employment that involves doing work for an airline that then competes with Southwest.

IV. 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 Executive. This Agreement is personal to the Executive and may not be assigned by him; provided, however, the rights of the Executive to receive payments of severance compensation pursuant to Paragraphs III-B and III-C hereof shall inure to the benefit of his heirs and legal representatives.

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; FORUM SELECTION. This Agreement shall be subject to and governed by the laws of the State of Texas. The parties hereto agree that any action or proceeding arising out of this Agreement shall be subject to the exclusive jurisdiction of the competent courts of the State of Texas sitting in Dallas County, Texas, and of the United States District Court for the Northern District of Texas, irrespective of whether or not at any time after the date hereof the Executive shall relocate his residence to a jurisdiction outside the State of Texas.

IN WITNESS WHEREOF, the Executive has set his hand hereto and Southwest has caused this Agreement to be signed in its corporate name and behalf by one of its officers thereunto duly authorized, all as of the day and year first above written.

SOUTHWEST AIRLINES CO.

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

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

EXECUTIVE

By: /s/ James C. Wimberly
James C. Wimberly

Address: 6118 Glendora Ave.
Dallas, Texas 75230

April 21, 2006

Laura Wright, Chief Financial Officer
Southwest Airlines Co.
P.O. Box 36611
Dallas, TX 75235-1611

Dear Ms. Wright:

Note 2 of the Notes to the Condensed Consolidated Financial Statements of Southwest Airlines Co. (the Company) included in its Form 10-Q for the three months ended March 31, 2006 describes a change in the method of accounting for scheduled airframe inspections and repairs of 737-300 and 737-500 aircraft from the deferral method to the direct expense method. Under the new method, costs associated with scheduled airframe inspections and repairs are expensed as maintenance services are performed. There are no authoritative criteria for determining a 'preferable' method for accounting for scheduled airframe inspections and repairs based on the particular circumstances; however, we conclude that such change in the method of accounting is to an acceptable alternative method which, based on your business judgment to make this change and for the stated reasons, is preferable in your circumstances. We have not conducted an audit in accordance with U.S. generally accepted auditing standards of any financial statements of the Company as of any date or for any period subsequent to December 31, 2005, and therefore we do not express any opinion on any financial statements of Southwest Airlines Co. subsequent to that date.

Very truly yours,

/s/ Ernst & Young LLP

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 March 31, 2006 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
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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: April 21, 2006

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

CERTIFICATION

I, Laura H. 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 March 31, 2006 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
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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: April 21, 2006

By: /s/ Laura H. Wright

Laura H. 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 March 31, 2006 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 H. 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: April 21, 2006

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

/s/ Laura H. Wright
Laura H. Wright
Chief Financial Officer