

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

Form 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2007

or  
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from to

Commission File No. 1-7259

**Southwest Airlines Co.**

*(Exact name of registrant as specified in its charter)*

**Texas**  
*(State or other jurisdiction of  
incorporation or organization)*  
**P.O. Box 36611**  
**Dallas, Texas**  
*(Address of principal executive offices)*

**74-1563240**  
*(I.R.S. Employer  
Identification No.)*  
**75235-1611**  
*(Zip Code)*

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

**Securities registered pursuant to Section 12(b) of the Act:**

**Title of Each Class**  
Common Stock (\$1.00 par value)

**Name of Each Exchange on Which Registered**  
New York Stock Exchange, Inc.

**Securities registered pursuant to Section 12(g) of the Act:**  
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

The aggregate market value of the common stock held by non-affiliates of the registrant was approximately \$11,172,660,474, computed by reference to the closing sale price of the common stock on the New York Stock Exchange on June 29, 2007, the last trading day of the registrant's most recently completed second fiscal quarter.

Number of shares of common stock outstanding as of the close of business on January 30, 2008: 735,665,898 shares

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the Company's Annual Meeting of Shareholders to be held May 21, 2008 are incorporated into Part III of this Annual Report on Form 10-K.

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**PART I****Item 1. Business****Overview**

Southwest Airlines Co. is a major passenger airline that provides scheduled air transportation in the United States. Based on the most recent data available from the U.S. Department of Transportation ("DOT"), Southwest is the largest air carrier in the United States, as measured by the number of originating passengers boarded and the number of scheduled domestic departures. Southwest commenced Customer Service on June 18, 1971, with three Boeing 737 aircraft serving three Texas cities — Dallas, Houston, and San Antonio. As of December 31, 2007, Southwest operated 520 Boeing 737 aircraft and provided service to 64 cities in 32 states throughout the United States. In 2007, Southwest recommenced service to San Francisco International Airport.

Southwest focuses principally on point-to-point, rather than hub-and-spoke, service, providing its markets with frequent, conveniently timed flights and low fares. As of December 31, 2007, Southwest served 411 nonstop city pairs. Historically, Southwest has served predominantly short-haul routes, with high frequencies. In recent years, Southwest has complemented this service with more medium to long-haul routes, including transcontinental service.

Southwest has a low cost structure, enabling it to charge low fares. Adjusted for stage length, Southwest has lower unit costs, on average, than most major network carriers. Southwest's low cost advantage is facilitated by reliance upon a single aircraft type, an operationally efficient route structure, and highly productive Employees.

**Fuel Cost Impact and Related Growth Plans and Initiatives**

Fuel prices can have a significant impact on Southwest's profitability. From October 1, 2007 through December 31, 2007, the average cost per gallon for jet fuel was \$1.87. Southwest's average cost of jet fuel, net of hedging gains and excluding fuel taxes, over the past five years was as follows:

Year	Cost (Millions)	Average Cost Per Gallon	Percent of Operating Expenses
2003	\$ 830	\$ .72	14.9%
2004	\$ 1,000	\$ .83	16.3%
2005	\$ 1,341	\$ 1.03	19.6%
2006	\$ 2,138	\$ 1.53	26.2%
2007	\$ 2,536	\$ 1.70	28.0%

Fuel costs, coupled with evidence of slowing economic growth and the impact of labor costs, led to the Company's decision in 2007 to slow capacity growth through a combination of schedule adjustments and fleet changes. The Company has been working on optimizing its flight schedule by reducing frequency on less profitable routes and reallocating capacity to potentially more rewarding markets. This in turn has allowed the Company to reduce the number of aircraft it will add to its fleet in 2008. As discussed further below under "Properties," the Company has also adjusted its aircraft deliveries from Boeing.

In addition to schedule adjustments, the Company has developed several initiatives designed to enhance Customer Service and to help offset increasing costs through improving future revenues. These initiatives include, among others:

- Implementation of a new Customer boarding method for flights;
- Commencement of a significant gate re-design to enhance the airport experience for Customers;
- Introduction of a new fare structure, including a "Business Select" product;
- Introduction of enhancements to the Company's Rapid Rewards frequent flyer program;
- Launch of a new advertising campaign;
- Announcement of an expansion of the Company's GDS (Global Distribution System) and corporate travel account efforts; and
- Exploration of international codeshare alliances.

The Company's initiatives are discussed in more detail below under "Operating Strategies and Marketing." Fuel costs and Southwest's fuel hedging activities are discussed in more detail below under "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations."

**Regulation**

The airline industry is regulated heavily, especially by the federal government. Examples of such regulation include:

*Economic and Operational Regulation*

- *Aviation Taxes.* The statutory authority for the federal government to collect aviation taxes, which are used, in part, to finance the nation's airport and air traffic control systems, and the authority of the

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Federal Aviation Administration (“FAA”) to expend those funds must be periodically reauthorized by the U.S. Congress. This authority was scheduled to expire on September 30, 2007. However, Congress has approved a temporary extension of this authority through February 29, 2008. Similar temporary extensions or a reauthorization for a fixed term are expected to occur in 2009. Other proposals being considered by Congress in connection with the FAA reauthorization legislation include: (i) the imposition of new user fees on jet-powered aircraft, (ii) an increase in the amount of airport passenger facility charges, and (iii) the adoption of new unfunded mandates on commercial airlines such as passenger-rights standards and labor protection provisions, any of which could have an impact on the Company’s operations.

- *U.S. Department of Transportation.* The DOT has significant regulatory jurisdiction over passenger airlines. To provide passenger transportation in the United States, a domestic airline is required to hold a Certificate of Public Convenience and Necessity issued by the DOT. A certificate is unlimited in duration and generally permits the Company to operate among any points within the United States and its territories and possessions. The DOT may revoke a certificate, in whole or in part, for intentional failure to comply with federal aviation statutes, regulations, orders, or the terms of the certificate itself. The DOT also has jurisdiction over certain economic and consumer protection matters such as advertising, denied boarding compensation, baggage liability, and access for persons with disabilities. The DOT may impose civil penalties on air carriers for violations of its regulations in these areas.
- *Wright Amendment.* The International Air Transportation Competition Act of 1979, as amended (the “Act”), imposed restrictions on the provision of air transportation to and from Dallas Love Field. The applicable portion of the Act, commonly known as the “Wright Amendment,” impacted Southwest’s scheduled service by prohibiting the carrying of nonstop and through passengers on commercial flights between Dallas Love Field and all states outside of Texas, with the exception of the following states (the “Wright Amendment States”): Alabama, Arkansas, Kansas, Louisiana, Mississippi, Missouri, New Mexico, and Oklahoma. In addition, the Wright Amendment only permitted an airline to offer flights between Dallas Love Field and the Wright Amendment States to the extent the airline did not offer or provide any through service or ticketing with another air carrier at Dallas Love Field and did not market service to or from Dallas Love Field and any point outside of a Wright Amendment State. In other words, a Customer could not purchase a single ticket between Dallas Love Field and any destination other than a Wright Amendment State. The Wright Amendment did not restrict flights operated with aircraft having 56 or fewer passenger seats, nor did it restrict Southwest’s intrastate Texas flights or its air service to or from points other than Dallas Love Field.  
  
In 2006, Southwest entered into an agreement with the City of Dallas, the City of Fort Worth, American Airlines, Inc., and the DFW International Airport Board. Pursuant to this agreement, the five parties sought enactment of legislation to amend the Act. Congress responded by passing the Wright Amendment Reform Act of 2006 (the “Reform Act”). The Reform Act immediately repealed through service and ticketing restrictions, thereby allowing the purchase of a single ticket between Dallas Love Field and any U.S. destination (while still requiring the Customer to make a stop in a Wright Amendment State), and reduced the maximum number of gates available for commercial air service at Dallas Love Field from 32 to 20. Southwest currently uses 15 gates at Dallas Love Field. Pursuant to the Reform Act and local agreements with the City of Dallas with respect to gates, Southwest can expand scheduled service from Dallas Love Field and intends to do so. The Reform Act also provides for substantial repeal of the remainder of the Wright Amendment in 2014.

### *Safety and Health Regulation*

The Company and its third-party maintenance providers are subject to the jurisdiction of the FAA with respect to the Company’s aircraft maintenance and operations, including equipment, ground facilities, dispatch, communications, flight training personnel, and other matters affecting air safety. To ensure compliance with its regulations, the FAA requires airlines to obtain, and Southwest has obtained, operating, airworthiness, and other certificates. These certificates are subject to suspension or revocation for cause. In addition, pursuant to FAA regulations, the Company has established, and the FAA has approved, the Company’s operations specifications and a maintenance program for the Company’s

aircraft, ranging from frequent routine inspections to major overhauls. The FAA, acting through its own powers or through the appropriate U.S. Attorney, also has the power to bring proceedings for the imposition and collection of fines for violation of the Federal Aviation Regulations.

The Company is subject to various other federal, state, and local laws and regulations relating to occupational safety and health, including Occupational Safety and Health Administration and Food and Drug Administration regulations.

*Security Regulation*

Following the terrorist attacks on September 11, 2001, Congress enacted the Aviation and Transportation Security Act (the "Aviation Security Act"). The Aviation Security Act established the Transportation Security Administration (the "TSA"), a division of the U.S. Department of Homeland Security that is responsible for certain civil aviation security matters. The Aviation Security Act also mandated, among other things, improved flight deck security, deployment of federal air marshals onboard flights, improved airport perimeter access security, airline crew security training, enhanced security screening of passengers, baggage, cargo, mail, employees, and vendors, enhanced training and qualifications of security screening personnel, additional provision of passenger data to U.S. Customs and Border Protection, and enhanced background checks. Under the Aviation Security Act, substantially all security screeners at airports are federal employees, and significant other elements of airline and airport security are overseen and performed by federal employees, including federal security managers, federal law enforcement officers, and federal air marshals.

Enhanced security measures have impacted the Company's business. In particular, they have had a significant impact on the airport experience for passengers. For example, in the third quarter of 2006, the TSA mandated new security measures in response to a terrorist plot uncovered by authorities in London. These rules, which primarily regulate the types of liquid items that can be carried onboard aircraft, have had a negative impact on air travel, especially on shorthaul routes and with business travelers. Although the TSA has relaxed some of its requirements, the Company is not able to predict the ongoing impact, if any, that these security changes will have on passenger revenues, both in the shortterm and the longterm. The Company has made significant investments to address the impact of these types of regulations, including investments in facilities, equipment, and technology to process Customers efficiently and restore the airport experience. The Company's Automated Boarding Passes and self service kiosks have reduced the number of lines in which a Customer must wait. In addition, the Company's gate readers at all of its airports have improved the boarding reconciliation process. The Company also offers baggage checkin through self service kiosks at certain airport locations, as well as Internet checkin and transfer boarding passes at the time of checkin.

Enhanced security measures have also impacted the Company's business through the imposition of security fees on the Company's Customers and on the Company. Under the Aviation Security Act, funding for passenger security is provided in part by a \$2.50 per enplanement security fee, subject to a maximum of \$5.00 per one-way trip. The Aviation Security Act also allows the TSA to assess an Aviation Security Infrastructure Fee ("ASIF") on each airline. Southwest's ASIF liability was originally set at \$24 million per year. Effective in 2005, the TSA unilaterally increased the amount to \$50 million. Southwest and 22 other airlines are joined in litigation presently pending in the U.S. Court of Appeals against the TSA to challenge that increase.

*Environmental Regulation*

The Airport Noise and Capacity Act of 1990 gives airport operators the right, under certain circumstances, to implement local noise abatement programs, so long as they do not unreasonably interfere with interstate or foreign commerce or the national air transportation system. Some airports have established airport restrictions to limit noise, including restrictions on aircraft types to be used, and limits on the number of hourly or daily operations or the time of operations. These types of restrictions can cause curtailments in service or increases in operating costs and could limit the ability of Southwest to expand its operations at the affected airports.

The Company is subject to various other federal, state, and local laws and regulations relating to the protection of the environment, including the discharge or disposal of materials such as chemicals, hazardous waste, and aircraft deicing fluid. Regulatory developments pertaining to such things as control of engine exhaust emissions from ground support equipment and prevention of leaks from underground aircraft fueling systems could increase operating costs in the airline industry. The Company does not believe, however, that presently pending environmental regulatory developments will have a material impact on the Company's capital expenditures or otherwise adversely affect its operations, operating costs,

or competitive position. However, legislation has been introduced in the U.S. Congress to regulate so-called “green house gas emissions.” The legislation could impose unknown costs or restrictions on all transportation-related activities, the impact of which is presently unpredictable. Additionally, in conjunction with airport authorities, other airlines, and state and local environmental regulatory agencies, the Company is undertaking voluntary investigation or remediation of soil or groundwater contamination at several airport sites. The Company does not believe that any environmental liability associated with such sites will have a material adverse effect on the Company’s operations, costs, or profitability.

The Company has appointed a “Green Team” to target areas of environmental improvement in all aspects of the Company’s business, while at the same time remaining true to the Company’s low cost philosophy. As part of this initiative, during 2008, the Company will be publishing an Environmental Report describing the Company’s strategies to reduce greenhouse gas emissions and addressing other environmental matters such as waste management and recycling.

#### *Regulation of Customer Service Practices*

From time to time, the airline industry has been faced with possible legislation dealing with certain Customer Service practices. As a compromise with Congress, the industry, working with the Air Transport Association, has responded by adopting and filing with the DOT written plans disclosing commitments to improve performance. Southwest Airlines’ Customer Service Commitment is a comprehensive plan that embodies the Mission Statement of Southwest Airlines: dedication to the highest quality of Customer Service delivered with a sense of warmth, friendliness, individual pride, and Company Spirit. The Customer Service Commitment can be reviewed by clicking on “About Southwest” at [www.southwest.com](http://www.southwest.com). The DOT and Congress monitor the industry’s plans, and there can be no assurance that legislation or regulations will not be proposed in the future to regulate airline Customer Service practices.

### **Operating Strategies and Marketing**

#### *General Operating Strategies*

Southwest focuses principally on point-to-point service, rather than the hub-and-spoke service provided by most major U.S. airlines. The “hub-and-spoke” system concentrates most of an airline’s operations at a limited number of hub cities and serves most other destinations in the system by providing one-stop or connecting service through the hub. Point-to-point service allows for more direct nonstop routing than the hub and spoke system, minimizing connections, delays, and total trip time. As a result, approximately 78 percent of Southwest’s Customers fly nonstop. Southwest’s average aircraft trip stage length in 2007 was 629 miles with an average duration of approximately 1.8 hours, as compared to an average aircraft trip stage length of 622 miles and an average duration of approximately 1.7 hours in 2006. Point-to-point service also enables Southwest to provide its markets with frequent, conveniently timed flights and low fares. Examples of markets offering frequent daily flights are: Dallas Love Field to Houston Hobby, 30 weekday roundtrips; Phoenix to Las Vegas, 18 weekday roundtrips; and Los Angeles International to Oakland, 20 weekday roundtrips. Southwest complements these high-frequency shorthaul routes with longhaul nonstop service between markets such as Phoenix and Tampa Bay, Las Vegas and Orlando, and Nashville and Oakland.

Southwest serves many conveniently located secondary or downtown airports such as Dallas Love Field, Houston Hobby, Chicago Midway, Baltimore-Washington International, Burbank, Manchester, Oakland, San Jose, Providence, Ft. Lauderdale/Hollywood, and Long Island Islip airports, which are typically less congested than other airlines’ hub airports. This operating strategy enables the Company to achieve high asset utilization because aircraft can be scheduled to minimize the amount of time they are on the ground. This in turn reduces the number of aircraft and gate facilities that would otherwise be required. The Company is also able to simplify scheduling, maintenance, flight operations, and training activities by operating only one aircraft type, the Boeing 737. All of these strategies enhance the Company’s ability to sustain high Employee productivity and reliable ontime performance.

#### *Simplified Fare Structure*

Southwest employs a relatively simple fare structure, featuring low, unrestricted, unlimited, everyday coach fares, as well as even lower fares available on a restricted basis. As of November 1, 2007, Southwest’s highest non-codeshare, one-way unrestricted walkup fare offered was \$399 for its longest flights. Substantially lower walkup fares are generally available on Southwest’s short and medium haul flights.

In November 2007, Southwest announced enhancements to its fare structure and unveiled a new fare display on its web site, [www.southwest.com](http://www.southwest.com). Instead of a large display with numerous fare categories, Southwest has streamlined the process by bundling fares into three

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major fare columns: "Business Select," "Business," and "Wanna Get Away," with the goal of making it easier for Customers to choose the fare they want. The new "Business Select" fare is part of the Company's initiative to increase offerings and improve productivity for the business traveler. Customers who purchase the Business Select fare are allowed to be among the first Customers to board the aircraft. They also receive extra Rapid Rewards credit for the flight and a free drink.

### *Enhanced Boarding Method and Updated Gate Design*

During fourth quarter 2007, the Company introduced an enhanced boarding method, which is designed to significantly reduce the time a Customer spends standing in line at the gate. The enhanced boarding process automatically reserves a place for a Customer in the Customer's boarding group at the time of check-in by assigning a specific position number within the A, B, or C boarding group. Customers then board the aircraft in that numerical order. The new boarding method also allows for future enhancements, such as product customization and additional incentives for business and leisure travelers.

The Company has also commenced modification of its gate areas with columns and signage that facilitate the new boarding process. The "extreme gate makeover" is also designed to improve the airport experience for all of the Company's Customers by including (i) a business focused area with padded seats, tables with power outlets, power stations with stools, and a flat screen television for news programming; and (ii) a family area with smaller tables and chairs, "kid friendly" programming on a flat screen television, and power stations for charging electrical devices. The updated gate design is scheduled to be completed during 2008 at virtually all airports served by the Company.

### *Rapid Rewards Frequent Flyer Program*

Southwest's frequent flyer program, Rapid Rewards, is based on trips flown rather than mileage. Rapid Rewards Customers earn a credit for each one-way trip flown or two credits for each roundtrip flown. Rapid Rewards Customers can also earn credits by using the services of non-airline partners, which include car rental agencies, hotels, and credit card partners, including the Southwest Airlines Chase® Visa card. Rapid Rewards offers two types of travel awards. The Rapid Rewards Award Ticket ("Award Ticket") offers one free roundtrip award, valid to any destination available on Southwest, after the accumulation of 16 credits within 24 months. The Rapid Rewards Companion Pass ("Companion Pass") is granted for accumulating 100 credits within a consecutive twelve-month period. The Companion Pass offers unlimited free roundtrip travel, to any destination available on Southwest, for a designated companion of the qualifying Rapid Rewards Member. For the designated companion to use this pass, the Rapid Rewards Member must purchase a ticket or use an Award Ticket. Additionally, the Rapid Rewards Member and designated companion must travel together on the same flight.

Award Tickets and Companion Passes are automatically generated when earned by the Customer rather than allowing the Customer to bank credits indefinitely. Award Tickets are valid for 12 months after issuance and are subject to seat restrictions. Companion Passes have no seat restrictions or "Black out" dates.

The Company also sells credits to business partners, including credit card companies, hotels, and car rental agencies. These credits may be redeemed for Award Tickets having the same program characteristics as those earned by flying.

During 2007, the Company enhanced its Rapid Rewards program and rolled out a new business traveler focused marketing campaign. Rapid Rewards Members who fly 32 or more qualifying one-way flights within a 12-month period receive priority boarding privileges for an entire year. In addition, if travel is purchased at least 36 hours prior to flight time, these passengers also receive the best boarding pass number available (generally, an "A" boarding pass). Customers on this "A-List" are also automatically checked in for their flight in advance of departure. During 2007, Southwest also introduced a new Freedom Award, which allows Rapid Rewards Members the opportunity to exchange two standard Award Tickets for one Freedom Award. The Freedom Award is free of seat restrictions, except for a limited number of blackout dates around major holidays.

Customers redeemed approximately 2.8 million, 2.7 million, and 2.6 million Award Tickets and flights on Companion Passes during 2007, 2006, and 2005, respectively. The amount of free travel award usage as a percentage of total Southwest revenue passengers carried was 6.2 percent in 2007, 6.4 percent in 2006, and 6.6 percent in 2005. The number of fully earned Award Tickets and partially earned awards outstanding at December 31, 2007 was approximately 11.6 million, of which approximately 81 percent were partially earned awards. The number of fully earned Award Tickets and partially earned awards outstanding at December 31, 2006 was approximately 10.1 million, of which

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approximately 81 percent were partially earned awards. However, due to the expected expiration of a portion of credits making up partial awards, not all of them will eventually turn into useable Award Tickets. In addition, not all Award Tickets will be redeemed for future travel. Since the inception of Rapid Rewards in 1987, approximately 15 percent of all fully earned Award Tickets have expired without being used. The number of Companion Passes outstanding at December 31, 2007 and 2006 was approximately 65,000 and 58,000, respectively. The Company currently estimates that an average of three to four trips will be redeemed per outstanding Companion Pass.

The Company accounts for its Rapid Rewards program obligations by recording, at the time an award is earned, a liability for the estimated incremental cost of the use of flight awards the Company expects to be redeemed. The estimated incremental cost includes direct passenger costs such as fuel, food, and other operational costs, but does not include any contribution to overhead or profit. Revenue from the sale of credits to business partners and associated with future travel is deferred and recognized when the ultimate free travel award is flown or the credits expire unused. The liability for free travel awards earned but not used at December 31, 2007 and 2006 was not material to the Company's business.

### *Southwest.com; Expansion of GDS Participation and Corporate Travel Account Efforts*

Southwest was the first major airline to introduce a Ticketless travel option, eliminating the need to print and then process a paper ticket altogether, and the first to offer Ticketless travel through the Company's web site at [www.southwest.com](http://www.southwest.com). For the year ended December 31, 2007, more than 95 percent of Southwest's Customers chose the Ticketless travel option, and nearly 74 percent of Southwest's passenger revenues came through its web site (including SWABiz revenues), which has become a vital part of the Company's distribution strategy.

In 2007, in order to better attract business travelers, Southwest began exploring selling tickets through channels in addition to its own reservation system, web site, and the Sabre System. Southwest is continuing its efforts to provide travel agent and professional travel manager partners with increased and cost effective access to its fares and inventory. In particular, during 2007, Southwest announced an expansion of its GDS (Global Distribution System) and corporate travel account efforts through a ten-year content distribution agreement with Travelport's Galileo, a leading provider of global distribution services. The agreement has recently been expanded to include Worldspan, another of Travelport's global distribution systems. Through the agreement, Southwest intends that all of its published fares and inventory, with the exception of Southwest's exclusive web fares, will eventually be available to Galileo-connected travel agencies in North America.

### *RNP*

During 2007, Southwest announced an agreement with Naverus, an aviation consulting firm in Seattle, Washington, to partner on development of a Required Navigation Performance ("RNP") program. RNP combines GPS (Global Positioning System), the capabilities of advanced aircraft avionics, and new flight procedures for the purpose of achieving safer, more efficient, and environmentally friendly flight operations. RNP procedures are designed to reduce fuel consumption, improve safety, and minimize emissions and noise, while simultaneously taking advantage of the high-performance characteristics that exist in an airline's fleet.

### *Codesharing*

Southwest implemented codesharing in 2005 with ATA Airlines. Under its codeshare arrangement with ATA, Southwest may market and sell tickets for certain flights on ATA that are identified by Southwest's designator code (for example, "WN Flight 123"). Conversely, ATA may market and sell tickets under its code designator (TZ) for certain flights on Southwest. Any flight bearing a Southwest code designator that is operated by ATA is disclosed in Southwest's reservations systems and on the Customer's flight itinerary, boarding pass, and ticket, if a paper ticket is issued. As a result of the ATA codeshare arrangement, Southwest's Customers are able to purchase single ticket service on Southwest connecting to ATA's service to Hawaii and Dallas Fort Worth International Airport. Also, members of Southwest's and ATA's respective frequent flier programs are able to earn and redeem awards in the other carrier's program. Finally, beginning in 2006, Southwest began selling ATA-only service at [www.southwest.com](http://www.southwest.com). Other than the ATA arrangement, Southwest does not interline or offer joint fares with other airlines, nor does Southwest have any marketing or commuter feeder relationships with other carriers; however Southwest is currently exploring international codeshare opportunities.

### *Management Information Systems*

Southwest is continuing to invest in technology to support the initiatives discussed above as well as Southwest's ongoing operations. Southwest is currently

developing a system to replace its current point of sale application in the stations and its refunds system in the back office. Additionally, Southwest has purchased technology that will replace its existing Ticketless system and revenue accounting system. The new systems are designed to, among other things, enhance data flow and thereby increase Southwest's operational efficiencies and Customer Service capabilities. Southwest is also working to replace its back office accounting systems, payroll system, and human resource information system, with a goal of completion sometime during 2009.

#### **Competition**

The airline industry is highly competitive. The Company believes the principal competitive factors in the industry are:

- Fares;
- Customer Service;
- Costs;
- Frequency and convenience of scheduling;
- Frequent flyer benefits; and
- Efficiency and productivity, including effective selection and use of aircraft.

Southwest currently competes with other airlines on all of its routes. Some of these airlines have larger fleets than Southwest and some may have wider name recognition in certain markets. In addition, some major U.S. airlines have established extensive marketing or codesharing alliances, including Northwest Airlines/Continental Airlines/Delta Air Lines; American Airlines/Alaska Airlines; and United Airlines/US Airways. These alliances are more extensive than Southwest's arrangement with ATA Airlines and enable these carriers to expand their destinations and marketing opportunities. In addition, some airlines are able to offset less profitable domestic fares with more profitable international fares. As discussed above, the Company is evaluating international code sharing opportunities.

The Company is also subject to varying degrees of competition from surface transportation in its shorthaul markets. This competition can be more significant during economic downturns. Although price is a competitive factor in these instances, the Company believes frequency and convenience of scheduling, facilities, transportation safety and security procedures, and Customer Service are also of great importance to many passengers.

The competitive landscape for airlines has changed significantly over the last few years. Following the terrorist attacks on September 11, 2001, the airline industry, as a whole, incurred substantial losses through 2005. The war in Iraq and significant increases in the cost of fuel have exacerbated industry challenges. As a result, a number of carriers have sought relief from financial obligations in bankruptcy, including UAL Corporation, the parent of United Airlines; ATA Airlines; US Airways; Northwest Airlines Corporation, the parent of Northwest Airlines; and Delta Air Lines. UAL Corporation and ATA Airlines emerged from bankruptcy in 2006, and Northwest Airlines Corporation and Delta Air Lines emerged from bankruptcy in 2007. US Airways' emergence from bankruptcy in 2005 culminated in its merger with America West Airlines in September of that year. Other, smaller carriers have ceased operations entirely. In addition, post-9/11, many carriers shrank capacity, grounded their most inefficient aircraft, cut back on unprofitable service, and furloughed employees. Reorganization in bankruptcy, and even the threat of bankruptcy, has allowed carriers to decrease operating costs through renegotiated labor, supply, and financing contracts. As a result, differentials in cost structures between traditional hub-and-spoke carriers and low cost carriers have significantly diminished. Nevertheless, throughout this entire time period, Southwest has continued to maintain its cost advantage, improve Employee productivity, pursue steady, controlled growth, and provide outstanding Service to its Customers. The factors discussed above have, however, led to more intense competition in the airline industry, generally. In 2006, some carriers began reporting profitable results for the first time since 9/11.

The re-emerging competitiveness of some of the larger carriers, such as United, US Airways, and American, has put pressure on smaller carriers such as AirTran Airways, JetBlue, and Frontier. Like Southwest, several other carriers, large and small, have announced scaled back growth plans, and some carriers have expressed interest in industry consolidation. The Company cannot predict the timing or extent of any such consolidation or its impact (either positive or negative) on the Company's operations or results of operations.

#### **Insurance**

The Company carries insurance of types customary in the airline industry and at amounts deemed adequate to protect the Company and its property and to comply both with federal regulations and certain of the Company's credit and lease agreements. The policies principally provide coverage for public and passenger liability, property damage, cargo and baggage liability, loss or damage

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to aircraft, engines, and spare parts, and workers' compensation.

Following the terrorist attacks, commercial aviation insurers significantly increased the premiums and reduced the amount of war-risk coverage available to commercial carriers. Through the 2003 Emergency Wartime Supplemental Appropriations Act, the federal government has continued to provide supplemental, first-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 March 30, 2008. Although another extension beyond this date is expected, if such coverage is not extended by the government, the Company could incur substantially higher insurance costs or unavailability of adequate coverage in future periods.

**Seasonality**

The business of the Company is somewhat seasonal. Quarterly operating income and, to a lesser extent, revenues have historically tended to be lower in the first quarter (January 1 - March 31) and fourth quarter (October 1 - December 31).

**Employees**

At December 31, 2007, Southwest had 34,378 active full-time equivalent Employees, consisting of 13,885 flight, 2,079 maintenance, 13,921 ground, Customer, and fleet service, and 4,493 management, accounting, marketing, and clerical personnel.

Southwest has ten collective bargaining agreements, which covered approximately 82 percent of Southwest's Employees as of December 31, 2007. Southwest's relations with labor unions are governed by the Railway Labor Act (the "RLA"), which establishes the right of airline employees to organize and bargain collectively. Under the RLA, a collective bargaining agreement between an airline and a labor union generally does not expire, but instead becomes amendable as of a stated date. If either party wants to modify the terms of the agreement, it must notify the other party in the manner required by the RLA and/or described in the agreement. After receipt of such notice, the parties must meet for direct negotiations, and, if no agreement is reached, either party may request the National Mediation Board (the "NMB") to appoint a federal mediator. If no agreement is reached in mediation, the NMB may determine that an impasse exists and offer binding arbitration to the parties. If either party rejects binding arbitration, a 30-day "cooling off" period begins. At the end of this 30-day period, the parties may engage in "self-help," unless a Presidential Emergency Board is established to investigate and report on the dispute. The appointment of a Presidential Emergency Board maintains the "status quo" for an additional 60 days. If the parties do not reach agreement during this period, the parties may then engage in "self-help." "Self-help" includes, among other things, a strike by the union or the airline's imposition of any or all of its proposed amendments and the hiring of new employees to replace any striking workers. The following table sets forth the Company's Employee groups and collective bargaining status:

<b>Employee Group</b>	<b>Represented by</b>	<b>Agreement Amendable in</b>
Pilots	Southwest Airlines Pilots' Association	Currently in negotiation
Flight Attendants	Transportation Workers of America, AFL-CIO ("TWU")	June 2008
Ramp, Operations, Provisioning, and Freight Agents	TWU	Currently in negotiation
Stock Clerks	International Brotherhood of Teamsters ("Teamsters")	August 2008
Mechanics	Aircraft Mechanics Fraternal Association ("AMFA")	August 2008
Customer Service and Reservations Agents	International Association of Machinists and Aerospace Workers, AFL-CIO	November 2008
Aircraft Appearance Technicians	AMFA	February 2009
Flight Dispatchers	Southwest Airlines Employee Association	December 2009
Flight Simulator Technicians	Teamsters	November 2011
Flight/Ground School Instructors and Flight Crew Training Instructors	Southwest Airlines Professional Instructors Association	January 2013

During 2007, as part of its efforts to improve future profitability, the Company offered an early retirement program to certain of its Employees. A total of 608 of approximately 8,500 eligible Employees elected to participate in the program.

**Additional Information About Southwest**

Southwest was incorporated in Texas in 1967. The following documents are available free of charge through the Company's website, [www.southwest.com](http://www.southwest.com): Southwest's annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports that are filed with or furnished to the SEC pursuant to Sections 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended. These materials are made available through Southwest's website as soon as reasonably practicable after they are electronically filed with, or furnished to, the SEC.

The certifications of the Company's Chief Executive Officer and Chief Financial Officer required under Section 302 of the Sarbanes-Oxley Act have been filed as Exhibits 31.1 and 31.2 to this report. Additionally, in 2007 the Company's Chief Executive Officer certified to the New York Stock Exchange ("NYSE") that he was not aware of any violation by the Company of the NYSE's corporate governance listing standards.

**DISCLOSURE REGARDING FORWARD-LOOKING INFORMATION**

Some statements in this Form 10-K (or otherwise made by the Company or on the Company's behalf from time to time in other reports, filings with the SEC, news releases, conferences, Internet postings, or otherwise) that are not historical facts may be "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995. Forward-looking statements are based on, and include statements about, Southwest's estimates, expectations, beliefs, intentions, or strategies for the future, and the assumptions underlying these forward-looking statements. Specific forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts and include, without limitation, words such as "anticipates," "believes," "estimates," "expects," "intends," "forecasts," "may," "will," "should," and similar expressions. While management believes that these forward-looking statements are reasonable as and when made, forward-looking statements are not guarantees of future performance and involve risks and uncertainties that are difficult to predict. Therefore, actual results may differ materially from what is expressed in or indicated by Southwest's forward-looking statements or from historical experience or the Company's present expectations. Factors that could cause these differences include, but are not limited to, those set forth below under "Risk Factors."

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

**Item 1A. Risk Factors**

***Southwest's business is dependent on the price and availability of aircraft fuel. Continued periods of high fuel costs and/or significant disruptions in the supply of fuel could adversely affect the Company's results of operations.***

Airlines are inherently dependent upon energy to operate and, therefore, are impacted by changes in the prices of jet fuel. The cost of fuel, which has been at historically high levels over the last three years, is largely unpredictable and has a significant impact on the Company's results of operations. Jet fuel and oil consumed for fiscal 2007 and 2006 represented approximately 28 percent and 26 percent of Southwest's operating expenses, respectively. In both years, jet fuel costs were the second largest expense incurred by the Company, following only salaries, wages, and benefits. These costs contributed to the Company's decision during 2007 to slow growth and could continue to impact growth decisions.

Fuel availability, as well as pricing, is also impacted by political and economic factors. The Company does not currently anticipate a significant reduction in fuel availability; however, it is difficult to predict the future availability of jet fuel due to the following, among other, factors: dependency on foreign imports of crude oil and the potential for hostilities or other conflicts in oil producing areas; limited refining capacity; and the possibility of changes in governmental policies on jet fuel production, transportation, and marketing. Significant disruptions in the supply of aircraft fuel could adversely affect the Company's business, financial condition, and results of operations.

The Company's profitability is impacted in part by its ability to pass fuel cost increases through to the consumer in the form of fare increases. Due to the competitive nature of the airline industry, the Company's ability to increase fares is limited, and it is not certain that future fuel cost increases can be covered by increasing fares. Fare increases are even more difficult to achieve in uncertain economic environments, as low fares are often used to stimulate demand.

From time to time the Company enters into fuel derivative contracts to protect against rising fuel costs. Changes in the Company's overall fuel hedging strategy, the ability of the commodities used in fuel hedging (principally crude oil, heating oil, and unleaded gasoline) to qualify for special hedge accounting, and the effectiveness of the Company's fuel hedges pursuant to highly complex accounting rules, are all significant factors impacting the Company's results of operations. For more information on Southwest's fuel hedging arrangements, see "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Note 10 to the Consolidated Financial Statements.

***Southwest's business is labor-intensive; Southwest could be adversely affected if it were unable to maintain satisfactory relations with any unionized or other Employee work group.***

The airline business is labor intensive, and the Company's results are subject to variations in labor-related job actions. Salaries, wages, and benefits represented 35.4 percent of the Company's operating expenses for the year ended December 31, 2007. In addition, as of December 31, 2007, approximately 82 percent of the Company's Employees were represented for collective bargaining purposes by labor unions. The Company's Ramp, Operations, Provisioning, and Freight Agents are subject to an agreement with the Transport Workers Union of America, AFL-CIO ("TWU"), which becomes amendable on June 30, 2008. The Company and TWU are in discussions on a new agreement. The Company's Pilots are subject to an agreement with the Southwest Airlines Pilots' Association ("SWAPA"), which became amendable during September 2006. The Company and SWAPA are in discussions on a new agreement. Although, historically, the Company's relationships with its Employees have been good, the following items could have a significant impact on the Company's results of operations: results of labor contract negotiations, employee hiring and retention rates, pay rates, outsourcing costs, the impact of work rules, and costs for health care.

***Southwest's business is affected by many changing economic conditions and other conditions beyond its control.***

The Company's business, and the airline industry in general, is particularly impacted by changes in economic conditions. Unfavorable general economic conditions, such as higher unemployment rates, higher interest rates, housing-related pressures (such as recent issues in the subprime mortgage market), and increased operating costs can reduce consumer spending or cause shifts in spending. A general reduction or shift in discretionary spending can result in decreased demand for leisure and business travel and can also impact the Company's ability to raise fares to counteract increased fuel and labor costs.

The Company's business, and the airline industry in general, is also impacted by other conditions that are largely outside of the Company's control, including, among others:

- Actual or threatened war, terrorist attacks, and political instability;
- Changes in consumer preferences, perceptions, spending patterns, or demographic trends;
- Actual or potential disruptions in the air traffic control system;
- Increases in costs of safety, security, and environmental measures; and
- Weather and natural disasters.

Because expenses of a flight do not vary significantly with the number of passengers carried, a relatively small change in the number of passengers can have a disproportionate effect on an airline's operating and financial results. Therefore, any general reduction in airline passenger traffic as a result of any of these factors could adversely affect the Company's business, financial condition, and results of operations.

***The Company relies on technology to operate its business and continues to implement substantial changes to its information systems; any failure or disruption in the Company's systems could adversely impact the Company's operations.***

The Company has historically been dependent on automated systems and technology to operate its business, enhance Customer Service and back office support systems, and increase Employee productivity, including the Company's computerized airline reservation system, flight operations systems, telecommunication systems, website at [www.southwest.com](http://www.southwest.com), Automated Boarding

Passes system, and its self service kiosks. The Company has become increasingly dependent on its systems and technology to maintain and support the growth of its business. Therefore, the Company's ability to expand and update its information technology infrastructure in response to its growth and changing needs is increasingly important to the operation of its business generally and the implementation of its new initiatives. Any issues with transitioning to upgraded or replacement systems, or any material failure, inadequacy, interruption, or security failure of these systems, could harm the Company's ability to effectively operate its business. In addition, the Company's growth strategies are dependent on its ability to effectively implement technology advancements.

***The Company's inability to successfully implement its revenue initiatives could adversely affect its results of operations.***

As discussed above, the Company has implemented and intends to continue to implement revenue initiatives that are designed to help offset increasing costs. The implementation of the Company's initiatives has and will involve significant investments by the Company of time and money and could be impacted by (i) the Company's ability to timely implement and maintain the necessary information technology systems and infrastructure (as discussed above), and (ii) the extent and timing of the Company's investment of incremental operating expenses and capital expenditures to develop and implement its initiatives and the Company's corresponding ability to effectively control operating expenses. Because the Company has limited experience with some of its strategic initiatives, it cannot ensure that they will be successful or profitable either over the short or long term. The Company's ability to effectively and timely prioritize and implement its initiatives will also affect when and if they will have a positive impact on the Company's profitability.

***The travel industry continues to face on-going security concerns and cost burdens; further threatened or actual terrorist attacks, or other hostilities, could significantly harm the Company's industry and its business.***

The attacks of September 11, 2001, materially impacted, and continue to impact, air travel and the results of operations for Southwest and the airline industry generally. The Department of Homeland Security and the TSA have implemented numerous security measures that affect airline operations and costs. Substantially all security screeners at airports are now federal employees, and significant other elements of airline and airport security are now overseen and performed by federal employees, including federal security managers, federal law enforcement officers, and federal air marshals. Enhanced security procedures, including enhanced security screening of passengers, baggage, cargo, mail, employees, and vendors, introduced at airports since the terrorist attacks of September 11 have increased costs to airlines and have from time to time impacted demand for air travel.

Additional terrorist attacks, even if not made directly on the airline industry, or the fear of such attacks or other hostilities (including elevated national threat warnings or selective cancellation or redirection of flights due to terror threats) could have a further significant negative impact on Southwest and the airline industry. Additional international hostilities could potentially have a material adverse impact on the Company's results of operations.

***Airport capacity constraints and air traffic control inefficiencies could limit the Company's growth; changes in or additional governmental regulation could increase the Company's operating costs or otherwise limit the Company's ability to conduct business.***

Almost all commercial service airports are owned and/or operated by units of local or state government. Airlines are largely dependent on these governmental entities to provide adequate airport facilities and capacity at an affordable cost. Similarly, the federal government singularly controls all U.S. airspace, and airlines are completely dependent on the FAA to operate that airspace in a safe, efficient, and affordable manner. As discussed above under "Business — Regulation," airlines are also subject to other extensive regulatory requirements. These requirements often impose substantial costs on airlines. The Company's results of operations may be affected by changes in law and future actions taken by governmental agencies having jurisdiction over its operations, including, but not limited to:

- Increases in airport rates and charges;
- Limitations on airport gate capacity or other use of airport facilities;
- Increases in taxes;
- Changes in the law that affect the services that can be offered by airlines in particular markets and at particular airports;
- Restrictions on competitive practices;

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- The adoption of regulations that impact customer service standards, such as security standards; and
- The adoption of more restrictive locally-imposed noise regulations.

***The airline industry is intensely competitive.***

As discussed in more detail above under “Business — Competition,” the airline industry is extremely competitive. Southwest’s competitors include other major domestic airlines, as well as regional and new entrant airlines, and other forms of transportation, including rail and private automobiles. Southwest’s revenues are sensitive to the actions of other carriers in the areas of capacity, pricing, scheduling, codesharing, and promotions.

***Southwest’s low cost structure is one of its primary competitive advantages, and many factors could affect the Company’s ability to control its costs.***

Factors affecting the Company’s ability to control its costs include the price and availability of fuel, results of Employee labor contract negotiations, Employee hiring and retention rates, costs for health care, capacity decisions by the Company and its competitors, unscheduled required aircraft airframe or engine repairs, regulatory requirements, ability to access capital or financing at competitive rates in financial markets, and future financing decisions made by the Company. In addition, a key contributor to the Company’s low cost structure is its use of a single aircraft type, the Boeing 737. Although the Company is able to purchase some of these aircraft from parties other than Boeing, most of its purchases are direct from Boeing. Therefore, if the Company were unable to acquire additional aircraft from Boeing, or Boeing were unable or unwilling to provide adequate support for its products, the Company’s operations could be adversely impacted. In addition, the Company’s dependence on a single aircraft type could result in downtime for part or all of the Company’s fleet if mechanical or regulatory issues relating to the Boeing 737 aircraft type arise. However, given the Company’s years of experience with the Boeing 737 aircraft type and its longterm relationship with Boeing, the Company believes the advantages of operating a single fleet type outweigh the risks of its single aircraft strategy.

**Item 1B. *Unresolved Staff Comments***

None.

**Item 2. *Properties***

**Aircraft**

Southwest operated a total of 520 Boeing 737 aircraft as of December 31, 2007, of which 86 and 9 were under operating and capital leases, respectively. The remaining 425 aircraft were owned.

The following table details information on the 520 aircraft in the Company’s fleet as of December 31, 2007:

737 Type	Seats	Average Age (Yrs)	Number of Aircraft	Number Owned	Number Leased
-300	137	16.7	194	112	82
-500	122	16.7	25	16	9
-700	137	4.2	301	297	4
<b>Totals</b>		9.4	520	425	95

In 2007, the Company announced a reduction in its planned growth rate for fourth quarter 2007 and for full year 2008. A portion of this growth slowdown will be achieved through changes in the Company's aircraft deliveries from Boeing. In 2008, the Company also plans to return from lease or sell a total of 22 aircraft. In total, at December 31, 2007, the Company had firm orders, options and purchase rights for the purchase of Boeing 737 aircraft as follows:

**Firm Orders, Options and Purchase Rights for Boeing 737-700 Aircraft**

Delivery Year	The Boeing Company			Total
	Firm Orders	Options	Purchase Rights	
2008	29	—	—	29
2009	20	8	—	28*
2010	10	24	—	34
2011	10	22	—	32
2012	10	30	—	40
2013	19	—	—	19
2014	10	—	—	10
2008-2014	—	—	54	54
<b>Total</b>	<b>108</b>	<b>84</b>	<b>54</b>	<b>246</b>

\* The Company exercised one option in January 2008, bring 2009 firm orders and options to 21 and 7, respectively.

**Ground Facilities and Services**

Southwest leases terminal passenger service facilities at each of the airports it serves, to which it has made various leasehold improvements. The Company leases the land and structures on a long-term basis for its maintenance centers (located at Dallas Love Field, Houston Hobby, Phoenix Sky Harbor, and Chicago Midway), its flight training center at Dallas Love Field (which houses seven 737 simulators), and its corporate headquarters, also located at Dallas Love Field. As of December 31, 2007, the Company operated six reservation centers. The reservation centers located in Chicago, Albuquerque, and Oklahoma City occupy leased space. The Company owns its Houston, Phoenix, and San Antonio reservation centers.

The Company performs substantially all line maintenance on its aircraft and provides ground support services at most of the airports it serves. However, the Company has arrangements with certain aircraft maintenance firms for major component inspections and repairs for its airframes and engines, which comprise the majority of the Company's annual aircraft maintenance costs.

**Item 3. 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 of those examinations, 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 that it deems lacking merit. The Company's management does not expect 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 flows.

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

None to be reported.

**EXECUTIVE OFFICERS OF THE REGISTRANT**

The following information regarding the Company's executive officers is as of January 1, 2008.

<u>Name</u>	<u>Position</u>	<u>Age</u>
Herbert D. Kelleher	Executive Chairman of the Board	76
Gary C. Kelly	Vice Chairman of the Board and Chief Executive Officer	52
Colleen C. Barrett	President and Secretary	63
Robert E. Jordan	Executive Vice President — Strategy and Technology	47
Ron Ricks	Executive Vice President — Law, Airports, and Public Affairs	58
Michael G. Van de Ven	Executive Vice President — Chief of Operations	46
Davis S. Ridley	Senior Vice President — Marketing	54
Laura H. Wright	Senior Vice President — Finance and Chief Financial Officer	47

Set forth below is a description of the background of each of the Company's executive officers.

*Herbert D. Kelleher* has been Executive Chairman of the Board of the Company since March 1978. Mr. Kelleher became interim President and Chief Executive Officer of the Company in September 1981, and assumed those offices on a permanent basis in February 1982, relinquishing those titles in June 2001. Mr. Kelleher serves on the Board of the Federal Reserve Bank of Dallas.

*Gary C. Kelly* has been Vice Chairman of the Board and Chief Executive Officer of the Company since July 2004. Prior to that time, Mr. Kelly was Executive Vice President — Chief Financial Officer from June 2001 to July 2004, and Vice President — Finance and Chief Financial Officer from 1989 to 2001. Mr. Kelly joined the Company in 1986 as its Controller.

*Colleen C. Barrett* has been President of the Company since June 2001, at which time she was also named to the Board of Directors. Prior to that time, Ms. Barrett was Executive Vice President — Customers from 1990 to 2001 and Vice President — Administration from 1986 to 1990. Ms. Barrett has been Secretary of the Company since March 1978. Ms. Barrett is a Director of J.C. Penney Company, Inc.

*Robert E. Jordan* has been Executive Vice President — Strategy and Technology since September 2006. Prior to that time, Mr. Jordan served as Senior Vice President — Enterprise Spend Management from August 2004 to September 2006 and as Vice President — Technology from October 2002 to August 2004.

*Ron Ricks* has been Executive Vice President — Law, Airports, and Public Affairs for the Company since September 2006. Prior to that time, Mr. Ricks was Senior Vice President — Law, Airports, and Public Affairs from August 2004 until September 2006. Prior to 2004, Mr. Ricks served as Vice President — Governmental Affairs of the Company.

*Michael G. Van de Ven* has been Executive Vice President — Chief of Operations of the Company since September 2006. Prior to that time, Mr. Van de Ven served as Executive Vice President — Aircraft Operations from November 2005 through August 2006, as Senior Vice President — Planning from August 2004 to November 2005, and as Vice President — Financial Planning & Analysis from June 2001 to August 2004.

*Davis S. Ridley* has been Senior Vice President — Marketing since November 2007. Prior to such time, Mr. Ridley served as Senior Vice President — People & Leadership Development from August 2004 to January 2006, and as Vice President — Ground Operations from May 1998 to August 2004. Mr. Ridley served as a consultant for the Company from January 2006 to November 2007.

*Laura H. Wright* has been Senior Vice President — Finance and Chief Financial Officer of the Company since July 2004. Prior to such time, Ms. Wright served as Vice President — Finance and Treasurer beginning June 2001.

## PART II

**Item 5. Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities**

Southwest's common stock is listed on the New York Stock Exchange and is traded under the symbol "LUV." The following table shows, for the periods indicated, the high and low sales prices per share of the Company's common stock, as reported on the NYSE Composite Tape, and the cash dividends per share paid on the Company's common stock.

<u>Period</u>	<u>Dividend</u>	<u>High</u>	<u>Low</u>
<b>2007</b>			
1st Quarter	\$ 0.00450	\$ 16.58	\$ 14.50
2nd Quarter	0.00450	15.90	14.03
3rd Quarter	0.00450	16.96	14.21
4th Quarter	0.00450	15.06	12.12
<b>2006</b>			
1st Quarter	\$ 0.00450	\$ 18.10	\$ 15.51
2nd Quarter	0.00450	18.20	15.10
3rd Quarter	0.00450	18.20	15.66
4th Quarter	0.00450	17.03	14.61

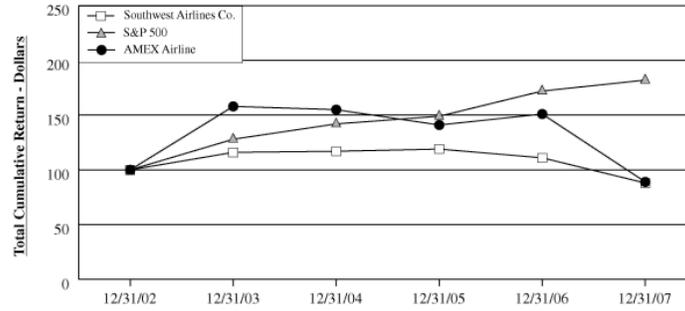
As of January 30, 2008, there were 10,708 holders of record of the Company's common stock.

**Stock Performance Graph**

The following Performance Graph and related information shall not be deemed "soliciting material" or "filed" with the Securities and Exchange Commission, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933 or Securities Exchange Act of 1934, each as amended, except to the extent that the Company specifically incorporates it by reference into such filing.

The following graph compares the cumulative total Shareholder return on the Company's common stock over the five-year period ended December 31, 2007, with the cumulative total return during such period of the Standard and Poor's 500 Stock Index and the AMEX Airline Index. The comparison assumes \$100 was invested on December 31, 2002, in the Company's common stock and in each of the foregoing indices and assumes reinvestment of dividends. The stock performance shown on the graph below represents historical stock performance and is not necessarily indicative of future stock price performance.

**COMPARISON OF FIVE YEAR CUMULATIVE TOATL RETURN  
AMONG SOUTHWEST AIRLINES CO., S&P 500 INDEX,  
AND AMEX AIRLINE INDEX**



	12/31/02	12/31/03	12/31/04	12/31/05	12/31/06	12/31/07
<b>Southwest Airlines Co.</b>	\$ 100	\$ 116	\$ 117	\$ 119	\$ 111	\$ 88
<b>S&amp;P 500</b>	\$ 100	\$ 128	\$ 142	\$ 149	\$ 172	\$ 182
<b>AMEX Airline</b>	\$ 100	\$ 158	\$ 155	\$ 141	\$ 151	\$ 89

**Item 6. Selected Financial Data**

The following financial information for the five years ended December 31, 2007, has been derived from the Company's Consolidated Financial Statements. This information should be read in conjunction with the Consolidated Financial Statements and related notes thereto included elsewhere herein.

	Year Ended December 31,				
	2007	2006	2005	2004	2003
	(in millions, except per share amounts)				
<b>Financial Data:</b>					
Operating revenues	\$ 9,861	\$ 9,086	\$ 7,584	\$ 6,530	\$ 5,937
Operating expenses	9,070	8,152	6,859	6,126	5,558
Operating income	791	934	725	404	379
Other expenses (income) net	(267)	144	(54)	65	(225)
Income before taxes	1,058	790	779	339	604
Provision for income taxes	413	291	295	124	232
Net Income	\$ 645	\$ 499	\$ 484	\$ 215	\$ 372
Net income per share, basic	\$ .85	\$ .63	\$ .61	\$ .27	\$ .48
Net income per share, diluted	\$ .84	\$ .61	\$ .60	\$ .27	\$ .46
Cash dividends per common share	\$ .0180	\$ .0180	\$ .0180	\$ .0180	\$ .0180
Total assets at period-end	\$ 16,772	\$ 13,460	\$ 14,003	\$ 11,137	\$ 9,693
Long-term obligations at period-end	\$ 2,050	\$ 1,567	\$ 1,394	\$ 1,700	\$ 1,332
Stockholders' equity at period-end	\$ 6,941	\$ 6,449	\$ 6,675	\$ 5,527	\$ 5,029
<b>Operating Data:</b>					
Revenue passengers carried	88,713,472	83,814,823	77,693,875	70,902,773	65,673,945
Enplaned passengers	101,910,809	96,276,907	88,379,900	81,066,038	74,719,340
Revenue passenger miles (RPMs) (000s)	72,318,812	67,691,289	60,223,100	53,418,353	47,943,066
Available seat miles (ASMs) (000s)	99,635,967	92,663,023	85,172,795	76,861,296	71,790,425
Load factor(1)	72.6%	73.1%	70.7%	69.5%	66.8%
Average length of passenger haul (miles)	815	808	775	753	730
Average aircraft stage length (miles)	629	622	607	576	558
Trips flown	1,160,699	1,092,331	1,028,639	981,591	949,882
Average passenger fare	\$ 106.60	\$ 104.40	\$ 93.68	\$ 88.57	\$ 87.42
Passenger revenue yield per RPM	13.08¢	12.93¢	12.09¢	11.76¢	11.97¢
Operating revenue yield per ASM	9.90¢	9.81¢	8.90¢	8.50¢	8.27¢
Operating expenses per ASM	9.10¢	8.80¢	8.05¢	7.97¢	7.74¢
Fuel costs per gallon (average)	\$ 1.70	\$ 1.53	\$ 1.03	\$ 0.83	\$ 0.72
Fuel consumed, in gallons (millions)	1,489	1,389	1,287	1,201	1,143
Fulltime equivalent Employees at period-end	34,378	32,664	31,729	31,011	32,847
Size of fleet at period-end(2)	520	481	445	417	388

(1) Revenue passenger miles divided by available seat miles.

(2) Includes leased aircraft.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**Year in Review**

Several events were significant for Southwest during 2007. For example, Southwest:

- \* Extended its string of consecutive profitable years to 35 and consecutive profitable quarters to 67. Both of these marks are unmatched in the modern era of aviation results.
- \* Implemented a new Customer boarding method for flights to significantly reduce the average time a Customer spends waiting in line at the gate, while retaining the Company's famous open seating policy once aboard the aircraft.
- \* Introduced a new fare structure including a "Business Select" product, which enables Customers to be among the first to board the aircraft. We also unveiled enhancements to our Rapid Rewards program.
- \* Began a significant gate re-design to enhance the airport experience for Customers, to be installed at virtually all airports served by the Company.
- \* Grew the Company's fleet by 39 Boeing 737-700 aircraft to a total of 520 737s as of December 31, 2007.
- \* Earned \$727 million (on a cash basis, before profitsharing and income taxes) from the expiration/settlement of fuel derivative instruments the Company had previously entered into to protect against jet fuel price increases.
- \* Incurred a one-time \$25 million charge (before profitsharing and income taxes) related to an early retirement program that was offered by the Company and accepted by more than 600 Employees during third quarter 2007, as one of many efforts underway to improve the Company's future profitability.
- \* Announced an expansion of our GDS (Global Distribution System) and corporate travel account efforts through an agreement with Travelport's Galileo and Worldspan.
- \* Recommended service to San Francisco International Airport, with the highest initial concentration of flights of any new city in the Company's history.
- \* Repurchased 66 million shares of Company common stock totaling \$1.0 billion through programs authorized by the Company's Board of Directors.

Although the Company's 2007 net income of \$645 million (\$.84 per share, diluted) exceeded its 2006 net income of \$499 million (\$.61 per share, diluted), the increase was entirely driven by certain gains and losses, recorded in accordance with Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended (SFAS 133), that relate to fuel derivatives expiring in future periods. In fact, the Company's operating income, which excludes these items, actually declined 15.3 percent from 2006 to 2007, primarily due to the significant increase in fuel costs, which the Company was not able to recover through increased revenues. The airline revenue environment was more difficult than the Company envisioned coming into 2007. This was due to a slowing economy as well as continued competitive pressures from both new airlines as well as those that have significantly reduced their cost structures through the bankruptcy process or the threat of bankruptcy. The Company did raise fares several times during 2007 in an attempt to offset fuel cost pressures; however, these increases did not keep up with the rapidly increasing fuel prices.

Looking ahead to 2008, the Company believes it has retained, and in some cases strengthened, its low-cost competitive advantages as demonstrated by its protective fuel hedging position, excellent Employees, and strong balance sheet. These enable Southwest to respond quickly to potential industry consolidation and to favorable market opportunities in the face of an uncertain economy and record energy prices. Based on current and projected energy prices for 2008 and expected growth plans, the Company believes net cash expenditures for jet fuel, which exclude certain FAS 133 gains and losses, could increase more than \$500 million compared to 2007, even including the effects of fuel derivative contracts the Company has in place as of January 2008. The Company's fuel derivative contracts in place for 2008 provide protection for over 70 percent of the Company's expected jet fuel consumption at an average price of approximately \$51 per barrel of crude oil. The Company is also currently expecting a significant increase in its aircraft engine maintenance activity in 2008. The Company will attempt to overcome the impact of higher anticipated 2008 fuel prices and other cost pressures through improved revenues and continued focus on non-fuel costs. Based on this current outlook, Southwest has reduced its previously planned growth rate for 2008. The Company currently plans to grow its fleet by a net seven aircraft. The Company will add 29 new 737-700 aircraft from Boeing, but plans to return from lease or sell a total of 22 aircraft, resulting in a net available seat mile (ASM) capacity

increase of four to five percent. For first quarter 2008, the Company's year-over-year capacity increase is expected to slightly exceed six percent. Based on current plans, the Company's fleet is scheduled to total 527 737s by the end of 2008.

**Results of Operations**

***2007 Compared With 2006***

Southwest's profit of \$645 million (\$ .84 per share, diluted) in 2007 was an increase of \$146 million, or 29.3 percent, compared to the Company's 2006 net income of \$499 million (\$ .61 per share, diluted). However, the Company's net profit results in both 2007 and 2006 include certain gains and losses, recorded in accordance with SFAS 133, that relate to fuel derivatives expiring in future periods. These adjustments, which are related to the ineffectiveness of hedges and the loss of hedge accounting for certain fuel derivatives, are included in "Other (gains) losses," which is below the operating income line, in both periods. In 2007, these adjustments totaled net gains of \$360 million. For 2006, these adjustments totaled net losses of \$101 million. Therefore, Southwest believes operating income provides a better indication of the Company's financial performance for both 2007 and 2006 than does net income. Southwest's 2007 operating income was \$791 million, a decrease of \$143 million, or 15.3 percent, compared to 2006. The decrease in operating income was driven primarily by a substantial increase in fuel expense, despite the fact that the Company once again benefited tremendously from its fuel hedging program. The Company had instruments in place to protect against over 90 percent of its fuel consumption needs at an average crude oil equivalent price of \$50 per barrel. This resulted in a \$686 million reduction to Fuel and oil expense during 2007, although, even with this protection, the Company's average jet fuel cost per gallon increased from \$1.53 in 2006 to \$1.70 in 2007. Although fuel prices began 2007 at moderately high levels, they quickly increased and stayed at record levels throughout most of the second half of the year. Market crude oil prices flirted with \$100 per barrel several times during 2007 and market (unhedged) jet fuel prices reached as high as \$2.87 per gallon during the second half of the year.

***Operating Revenues***

Consolidated operating revenues increased \$775 million, or 8.5 percent, primarily due to a \$707 million, or 8.1 percent, increase in passenger revenues. The increase in passenger revenues was primarily due to an increase in capacity, as the Company added aircraft and flights, resulting in a 7.5 percent increase in available seat miles compared to 2006. The Company purchased a total of 37 new Boeing 737-700 aircraft during 2007, and added another two leased 737-700s from a previous owner, resulting in the addition of 39 aircraft for the year. The Company attempted to combat high fuel prices through modest fare increases. However, general economic conditions as well as significant low-fare competition made it difficult to raise fares as much as the Company had done in 2006. The Company's passenger revenue yield per RPM (passenger revenues divided by revenue passenger miles) increased 1.2 percent compared to 2006. Unit revenue (total revenue divided by available seat miles) also increased 0.9 percent compared to 2006 levels, as a result of the higher RPM yield. The Company has been encouraged by more recent year-over-year unit revenue trends, which improved each month during fourth quarter 2007. The improved trends have continued thus far in first quarter 2008. Because of the uncertainty surrounding our nation's overall economy, however, it is difficult for the Company to precisely predict first quarter 2008 revenues.

Consolidated freight revenues decreased \$4 million, or 3.0 percent, versus 2006. A \$10 million, or 8.5 percent, increase in freight revenues, resulting primarily from higher rates, was more than offset by a \$14 million decline in mail revenues. The lower mail revenues were due to the Company's decision to discontinue carrying mail for the U.S. Postal Service effective as of the end of second quarter 2006. The Company expects an increase in consolidated freight revenues during first quarter 2008, primarily due to an increase in capacity and higher rates charged. "Other revenues" increased \$72 million, or 35.6 percent, compared to 2006, primarily from higher commissions earned from programs the Company sponsors with certain business partners, such as the Company sponsored Chase® Visa card. The Company currently expects another increase in first quarter 2008, also due to higher commissions earned, and at a somewhat comparable rate to the 2007 increase.

### Operating Expenses

Consolidated operating expenses for 2007 increased \$918 million, or 11.3 percent, compared to a 7.5 percent increase in capacity. Historically, changes in operating expenses for airlines are typically driven by changes in capacity, or ASMs. The following presents Southwest's operating expenses per ASM for 2007 and 2006 followed by explanations of these changes on a per-ASM basis and/or on a dollar basis (in cents, except for percentages):

	<u>2007</u>	<u>2006</u>	<u>Increase (Decrease)</u>	<u>Percent Change</u>
Salaries, wages, and benefits	3.22¢	3.29¢	(.07)¢	(2.1)%
Fuel and oil	2.55	2.31	.24	10.4
Maintenance materials and repairs	.62	.51	.11	21.6
Aircraft rentals	.16	.17	(.01)	(5.9)
Landing fees and other rentals	.56	.53	.03	5.7
Depreciation and amortization	.56	.56	—	—
Other	1.43	1.43	—	—
Total	<u>9.10¢</u>	<u>8.80¢</u>	<u>.30¢</u>	<u>3.4%</u>

The Company's 2007 CASM (cost per available seat mile) increased 3.4 percent compared to 2006. Approximately 80 percent of this increase was solely due to the increase in fuel expense, net of gains from the Company's fuel hedging program. The remainder of the increase was due to higher maintenance expense. All other operating expense categories combined to be approximately flat compared to 2006. Due to higher fuel prices, the Company has intensified its focus on controlling non-fuel costs and continues to mitigate wage rate and benefit cost pressures through productivity and efficiency improvements. The Company's headcount per aircraft at December 31, 2007, was 66, versus a year-ago level of 68. From the end of 2003 to the end of 2007, Southwest's headcount per aircraft decreased 22 percent, as the Company implemented various technology improvements, which improved efficiency and enabled the Company to grow capacity without a commensurate increase in headcount. Based on current cost trends, the Company expects first quarter 2008 unit costs to increase from first quarter 2007's 8.93 cents, due primarily to a significant increase in fuel costs and the continuation of higher maintenance costs. The higher expected fuel costs are due to the fact that the Company's protective position as to fuel derivative instruments is not as favorable as first quarter 2007, and current physical (unhedged) jet fuel prices are significantly higher than the prior year.

On an absolute dollar basis, Salaries, wages, and benefits increased \$161 million, primarily from a \$204 million increase in salaries and wages, partially offset by a \$43 million decrease in benefits. The dollar increase in salaries and wages was due primarily to a 5.2 percent headcount increase, and the dollar decrease in benefits was due primarily to a \$33 million decrease in profitsharing, attributable to lower income available for profitsharing, and a \$43 million decrease in share-based compensation, due to fewer Employee stock options becoming vested during 2007 versus 2006. These benefits decreases were partially offset by higher healthcare costs. Although the Company's net income was higher than 2006, income available for profitsharing was lower, since the Company's profitsharing plan does not consider the unrealized gains and/or losses the Company records in its fuel hedging program as a result of SFAS 133. Salaries, wages, and benefits expense per ASM decreased 2.1 percent compared to 2006, primarily due to lower profitsharing expense and lower share-based compensation expense, despite the increase in ASMs. See Note 10 to the Consolidated Financial Statements for further information on SFAS 133 and fuel hedging, and Note 13 for further information on share-based compensation. Based on current trends, the Company expects salaries, wages, and benefits per ASM in first quarter 2008 to be in line with first quarter 2007's unit cost.

The Company's Pilots are subject to an agreement with the Southwest Airlines Pilots' Association ("SWAPA"), which became amendable during September 2006. The Company and SWAPA are currently in discussions on a new agreement.

The Company's Flight Attendants are subject to an agreement with the Transport Workers Union of America, AFL-CIO ("TWU"), which becomes amendable in June 2008.

The Company's Ramp, Operations, Provisioning, and Freight Agents are subject to an agreement with the TWU, which becomes amendable in July 2008. However,

the Company and TWU began negotiations on a new agreement in January 2008.

The Company's Stock Clerks are subject to an agreement with the International Brotherhood of Teamsters, and the Company's Mechanics are subject to an agreement with the Aircraft Mechanics Fraternal Association. Both of these agreements become amendable in August 2008.

The Company's Customer Service and Reservations Agents are subject to an agreement with the International Association of Machinists and Aerospace Workers, AFL-CIO, which becomes amendable in November 2008.

Fuel and oil expense increased \$398 million, and on a per-ASM basis increased 10.4 percent versus 2006. Approximately 60 percent of the dollar increase was due to an increase in fuel prices, and the remainder was from an increase in gallons consumed to support the 7.5 percent capacity increase versus 2006. On a per-ASM basis, nearly the entire increase was due to higher fuel prices. The fuel derivative instruments the Company held for 2007 were not as favorable as those held in the prior year, as they were at higher average crude-oil equivalent prices than the instruments that settled/expired in 2006. Despite this, the Company's hedging program resulted in the realization of \$727 million in cash settlements during 2007. These settlements generated a 2007 reduction to Fuel and oil expense of \$686 million, compared to the prior year when the Company's fuel derivative instruments resulted in a \$634 million reduction to Fuel and oil expense. Even with these significant hedge positions in both years, the Company's jet fuel cost per gallon increased 11.1 percent versus 2006. The average cost per gallon of jet fuel in 2007 was \$1.70 compared to \$1.53 in 2006, excluding fuel-related taxes and net of hedging gains. See Note 10 to the Consolidated Financial Statements. The 2007 increase in fuel prices was partially offset by steps the Company has taken to improve the fuel efficiency of its aircraft, including the addition of blended winglets to all of the Company's 737-700 aircraft. The Company is also in the process of installing blended winglets on a significant number of its 737-300 aircraft.

The Company holds a significant fuel hedge position for 2008, although for a lower percentage of forecasted consumption than in 2007. As of mid-January 2008, the Company is nearly 75 percent protected with fuel derivative instruments for its first quarter 2008 jet fuel requirements, at an average crude oil equivalent price of \$51 per barrel, and the majority of these positions effectively perform like option contracts — allowing the Company to benefit in most cases from energy price decreases. During first quarter 2007, market prices (unhedged) for jet fuel averaged \$1.81 per gallon, and the Company had fuel derivatives in place to protect against nearly 100 percent of its fuel usage at a crude oil equivalent price of \$50 per barrel. January 2008 average market prices (unhedged) for jet fuel have been in the \$2.60 to \$2.65 range. Based on this difference in protection and current market conditions, the Company expects its first quarter 2008 jet fuel cost per gallon to be approximately \$2.00 per gallon, excluding the impact of any hedge ineffectiveness and derivatives that do not qualify for hedge accounting as defined in SFAS 133. In addition, the Company had fuel derivative contracts in place for over 70 percent of its expected fuel consumption for the remainder of 2008 at approximately \$51 per barrel; over 55 percent in 2009 at approximately \$51 per barrel; nearly 30 percent in 2010 at approximately \$63 per barrel; over 15 percent in 2011 at \$64 per barrel; and over 15 percent in 2012 at \$63 per barrel.

Maintenance materials and repairs per ASM increased 21.6 percent compared to 2006, while increasing \$148 million on a dollar basis. On a dollar basis, engine expense accounted for over 45 percent of the increase and airframe expense accounted for over 43 percent of the increase. With respect to airframe expense, the Company completed significantly more planned airframe inspection and repair events than in the prior year. These events, which are required based on the number of flight hours each individual aircraft has flown, were higher in number as well as cost per event, and were also due to the ongoing transition to a new airframe maintenance program for 737-300 and 737-500 aircraft which began in 2006. In engine expense, there was a significant increase in repairs for the Company's 737-700 aircraft engines primarily due to the maturation of this fleet, which was introduced in 1997, and more repair events than expected. On a per-ASM basis, approximately 48 percent of the increase in maintenance materials and repairs was a result of the higher airframe expense, and approximately 43 percent of the increase was due to the higher engine expense. In first quarter 2008, the Company expects an increase in maintenance materials and repairs per ASM compared to first quarter 2007 and fourth quarter 2007, due to higher engine expense for 737-700 aircraft as well as continued higher airframe expense from the transition of aircraft to the Company's new airframe maintenance program for 737-300 and 737-500 aircraft.

Aircraft rentals expense per ASM decreased 5.9 percent and, on a dollar basis, decreased slightly. The decrease per ASM was due primarily to the fact that the Company increased overall ASMs by 7.5 percent, but the number of aircraft on operating lease increased by only two from 2006 to 2007. The Company added 37

purchased aircraft to its fleet during 2007, and leased two additional 737-700 aircraft. The Company currently expects similar year-over-year rental expense comparisons for first quarter 2008.

Landing fees and other rentals increased \$65 million on a dollar basis and 5.7 percent on a per-ASM basis, compared to 2006. The dollar increase was due primarily to an increase in airport gate space to support the increase in capacity and trips flown versus 2006. On a per-ASM basis, the increase was due primarily to higher rates paid for airport space. The Company currently expects a year-over-year increase in landing fees and other rentals per ASM for first quarter 2008, primarily due to higher rates paid for airport space.

Depreciation and amortization expense increased \$40 million on a dollar basis compared to 2006, but was flat on a per-ASM basis. The dollar increase was due primarily to 37 new 737-700 aircraft purchased during 2007. Based on current fleet and growth plans, the Company expects a similar year-over-year comparison for first quarter 2008 on a per-ASM basis. See Note 4 to the Consolidated Financial Statements for further information on the Company's future aircraft deliveries.

Other operating expenses increased \$108 million but were flat on a per-ASM basis, compared to 2006. On a dollar basis, approximately 20 percent of the increase was due to an increase in revenue-related costs associated with the 8.1 percent increase in passenger revenues (such as credit card processing fees) and approximately 20 percent was due to higher personnel expenses (which includes items associated with flight crew travel, such as hotel and per diem costs) caused by the increase in capacity and trips flown. Excluding anticipated gains from the sale of aircraft, the Company currently expects an increase in other operating expenses on a per-ASM basis for first quarter 2008 compared to first quarter 2007, assuming increased revenues.

#### Other

"Other expenses (income)" included interest expense, capitalized interest, interest income, and other gains and losses. Interest expense decreased by \$9 million, or 7.0 percent, primarily due to the Company's repayment of \$729 million in debt during 2006 and 2007. This was partially offset by the issuance of \$800 million in new debt instruments in 2006 and 2007; however, the timing of the new debt issued compared to the debt repaid resulted in lower expense for 2007. The Company currently expects an increase in interest expense compared to 2007, primarily due to a higher average debt balance associated with recent borrowings in late 2006 and in 2007. See Note 7 to the Consolidated Financial Statements for more information on long-term debt transactions. Capitalized interest declined slightly compared to 2006 due to a reduction in progress payment balances for scheduled future aircraft deliveries. Interest income decreased \$40 million, or 47.6 percent, primarily due to a decrease in average cash and short-term investment balances on which the Company earns interest. See Note 1 to the Consolidated Financial Statements for more information.

Other (gains) losses, net, primarily includes amounts recorded in accordance with the Company's hedging activities and SFAS 133. During 2007, the Company recorded significant gains related to the ineffectiveness of its hedges as well as to the increase in market value of fuel derivative contracts that were marked to market because they didn't qualify for SFAS 133 hedge accounting. The gains resulted from the dramatic increase in the fair value of the Company's portfolio of fuel derivative instruments as commodity prices reached record levels. During 2006, the Company recorded losses related to the ineffectiveness of its hedges, as well as the increase in market value of fuel derivative contracts that were marked to market because they didn't qualify for SFAS 133 hedge accounting, as commodity prices declined during that year. The following table displays the components of Other (gains) losses, net, for the years ended December 31, 2007 and 2006:

	2007	2006
	(In millions)	
Mark-to-market impact from fuel contracts settling in future periods — included in Other (gains) losses, net	\$ (219)	\$ 42
Ineffectiveness from fuel hedges settling in future periods — included in Other (gains) losses, net	(51)	39
Realized ineffectiveness and mark-to-market (gains) or losses — included in Other (gains) losses, net	(90)	20
Premium cost of fuel contracts included in Other (gains) losses, net	58	52
Other	10	(2)
	\$ (292)	\$ 151

See Note 10 to the Consolidated Financial Statements for further information on the Company's hedging activities.

***Income Taxes***

The provision for income taxes, as a percentage of income before taxes, increased to 39.0 percent in 2007 from 36.8 percent in 2006. The higher 2007 rate included an \$11 million (\$.01 per share, diluted) net addition related to a revision in Illinois income tax laws enacted in 2007. The 2006 rate included a \$9 million net reduction related to a revision in the State of Texas franchise tax law enacted during 2006. The Company currently expects its 2008 effective tax rate to be between 36 and 37 percent. The lower expected 2008 rate is primarily due to the January 2008 reversal of the 2007 Illinois tax law change, that resulted in the \$11 million tax increase. The Company currently expects to reverse the \$11 million net charge during first quarter 2008.

***2006 Compared With 2005***

The Company's consolidated net income for 2006 was \$499 million (\$.61 per share, diluted), as compared to 2005 net income of \$484 million (\$.60 per share, diluted), an increase of \$15 million, or 3.1 percent. Operating income for 2006 was \$934 million, an increase of \$209 million, or 28.8 percent, compared to 2005. The 2006 increase in operating income was due primarily to higher revenues from the Company's fleet growth, improved load factors, and higher fares, which more than offset a significant increase in the cost of jet fuel. In both 2006 and 2005, the Company recognized adjustments related to the ineffectiveness of hedges and the loss of hedge accounting for certain fuel derivatives, which are included in "Other (gains) losses." For 2006, these adjustments totaled net losses of \$101 million. For 2005, these adjustments totaled net gains of \$110 million.

***Operating Revenues***

Consolidated operating revenues increased \$1.5 billion, or 19.8 percent, almost entirely due to a \$1.5 billion, or 20.2 percent, increase in passenger revenues. The increase in passenger revenues was due primarily to an increase in capacity, an increase in RPM yield, and an increase in load factor. Approximately 45 percent of the increase in passenger revenue was due to the Company's 8.8 percent increase in available seat miles compared to 2005. The Company increased available seat miles as a result of the addition of 36 737-700 aircraft. Approximately 35 percent of the increase in passenger revenue was due to a 6.9 percent increase in passenger yields. Average passenger fares increased 11.4 percent compared to 2005, primarily due to less fare discounting because of strong demand for air travel coupled with the availability of fewer seats as a result of industrywide domestic capacity reductions. The remainder of the passenger revenue increase was due primarily to the 2.4 point increase in the Company's load factor compared to 2005.

The airline revenue environment changed significantly from the first half of 2006 to the second half of the year. The Company believes this was due to both reduced demand related to domestic economic factors, as well as the effects of the increased carryon baggage restrictions put in place following the terrorist plot uncovered by London authorities in August 2006. The airline revenue environment regained some momentum during late fourth quarter 2006, and, despite growing capacity 10 percent during the quarter, the Company achieved a record load factor of 70.2 percent at healthy yields, which resulted in a unit revenue growth rate of 4.2 percent.

Consolidated freight revenues increased slightly versus 2005. An \$18 million, or 17.1 percent, increase in freight and cargo revenues, primarily as a result of higher rates charged, was almost entirely offset by lower mail revenues. The lower mail revenues were due to the Company's decision to discontinue carrying mail for the U.S. Postal Service effective as of the end of second quarter 2006. "Other revenues" increased \$30 million, or 17.4 percent, compared to 2005, primarily from higher commissions earned from programs the Company sponsors with certain business partners, such as the Company sponsored Chase® Visa card.

***Operating Expenses***

Consolidated operating expenses for 2006 increased \$1.3 billion, or 18.9 percent, compared to the 8.8 percent increase in capacity. Historically, changes in operating expenses for airlines are typically driven by changes in capacity, or

ASMs. The following presents Southwest's operating expenses per ASM for 2006 and 2005 followed by explanations of these changes on a per-ASM and/or an absolute dollar basis:

	<u>2006</u>	<u>2005</u>	<u>Increase (Decrease)</u>	<u>Percent Change</u>
Salaries, wages, and benefits	3.29¢	3.27¢	.02¢	.6%
Fuel and oil	2.31	1.58	.73	46.2
Maintenance materials and repairs	.51	.52	(.01)	(1.9)
Aircraft rentals	.17	.19	(.02)	(10.5)
Landing fees and other rentals	.53	.53	—	—
Depreciation and amortization	.56	.55	.01	1.8
Other	1.43	1.41	.02	1.4
Total	<u>8.80¢</u>	<u>8.05¢</u>	<u>.75¢</u>	<u>9.3%</u>

Operating expenses per ASM increased 9.3 percent to 8.80 cents, primarily due to an increase in jet fuel prices, net of gains from the Company's fuel hedging program. The Company's average cost per gallon of fuel increased 48.5 percent versus the prior year.

Salaries, wages, and benefits expense per ASM increased .6 percent compared to 2005, primarily due to an increase in average wage rates, largely offset by productivity efforts that enabled the Company to grow overall headcount at a rate less than the growth in ASMs. The Company's headcount at December 31, 2006, was 2.9 percent higher than at December 31, 2005, despite the 8.8 percent growth in available seat miles. On a dollar basis, Salaries, wages and benefits increased \$270 million, of which \$197 million was solely wages. The \$197 million increase in wages represented a 10.1 percent increase compared to 2005, on an 8.8 percent increase in ASMs. Of the \$197 million increase in wages, the majority was related to the increase in average wage rates.

Fuel and oil expense increased \$797 million, and on a per-ASM basis increased 46.2 percent, net of hedging gains, primarily due to a significant increase in the average cost per gallon of jet fuel. Although the Company's fuel hedge position was not as strong as the position the Company held in 2005, the Company's hedging program still resulted in the realization of \$675 million in cash settlements during 2006. These settlements resulted in a 2006 reduction to Fuel and oil expense of \$634 million. However, even with this hedge position, the Company's jet fuel cost per gallon increased 48.5 percent versus 2005. The average cost per gallon of jet fuel in 2006 was \$1.53 compared to \$1.03 in 2005, excluding fuel-related taxes and net of hedging gains. See Note 10 to the Consolidated Financial Statements. The increase in fuel prices was partially offset by steps the Company has taken to improve the fuel efficiency of its aircraft, including the addition of blended winglets to all of the Company's 737-700 aircraft.

On an absolute dollar basis, maintenance materials and repairs expense increased \$22 million, primarily due to an increase in the number of aircraft engine repairs. However, on a per-ASM basis, maintenance materials and repairs decreased 1.9 percent compared to 2005, as the dollar increase was only 4.9 percent versus the capacity (ASM) increase of 8.8 percent.

Aircraft rentals per ASM decreased 10.5 percent. The Company's 8.8 percent increase in ASMs was generated by the 36 aircraft the Company acquired during 2006, all of which were purchased. The number of aircraft on operating lease remained the same, thereby reducing the percentage of these aircraft in the total fleet. On an absolute dollar basis, expense decreased \$5 million due to the renegotiation of some aircraft leases at lower rates.

Landing fees and other rentals per ASM was flat compared to 2005. On a dollar basis, expense increased \$41 million, primarily due to the Company's increase in airport space to support additional flight activity.

Depreciation and amortization expense per ASM increased 1.8 percent, and on a dollar basis increased \$46 million. These increases were primarily due to an increase in depreciation expense per ASM from 36 new 737-700 aircraft purchased during 2006 and the resulting higher percentage of owned aircraft.

In absolute dollars, Other operating expenses increased \$122 million, of which \$39 million related to credit card processing fees. The \$39 million increase in credit card processing fees represented a 22.2 percent increase from 2005 compared to the Company's 20.2 percent increase in Passenger revenues. In excess of 97 percent of Passenger revenues are booked via customer credit cards, resulting in a close correlation between these two measures. The second

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and third largest increases in Other operating expenses on an absolute dollar basis were in Fuel taxes (\$18 million, or 14.0 percent, primarily due to a 15.0 percent increase in the unhedged cost of jet fuel per gallon and a 7.9 percent increase in gallons consumed), and Personnel expenses (\$16 million, or 11.9 percent, primarily representing hotel and per diem costs for Pilots and Flight Attendants, primarily due to a 6.2 percent increase in trips flown). Other operating expenses per ASM increased 1.4 percent compared to 2005, primarily due to the increase in revenue-related costs, such as credit card processing fees, related to the Company's 20.2 percent increase in Passenger revenues.

**Other**

"Other expenses (income)" included interest expense, capitalized interest, interest income, and other gains and losses. Interest expense increased by \$6 million, or 4.9 percent, primarily due to an increase in floating interest rates. This was partially offset by the Company's repayment during 2006 of \$607 million in debt. The majority of the Company's long-term debt is at floating rates. In addition, the Company issued \$300 million in senior unsecured notes during December 2006. See Note 7 to the Consolidated Financial Statements for more information. Capitalized interest increased \$12 million, or 30.8 percent, compared to 2005, due to higher 2006 progress payment balances for scheduled future aircraft deliveries as well as higher interest rates. Interest income increased \$37 million, or 78.7 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 2006, the Company recorded losses related to the ineffectiveness of its hedges as well as the decrease in market value of fuel derivative contracts that were marked to market because they didn't qualify for SFAS 133 hedge accounting. The losses resulted from the decrease in the fair value of the Company's portfolio of fuel derivative instruments as commodity prices declined during the year. During 2005, the Company recorded significant gains related to the ineffectiveness of its hedges as well as the increase in market value of fuel derivative contracts that were marked to market because they didn't qualify for SFAS 133 hedge accounting, as commodity prices increased during that year. The following table displays the components of Other (gains) losses, net, for the years ended December 31, 2007 and 2006:

<u>(In millions)</u>	<u>2006</u>	<u>2005</u>
Mark-to-market impact from fuel contracts settling in future periods — included in Other (gains) losses, net	\$ 42	\$ (77)
Ineffectiveness from fuel hedges settling in future periods — included in Other (gains) losses, net	39	(9)
Realized ineffectiveness and mark-to-market (gains) or losses — included in Other (gains) losses, net	20	(24)
Premium cost of fuel contracts included in Other (gains) losses, net	52	35
Other	(2)	(15)
	<u>\$ 151</u>	<u>\$ (90)</u>

See Note 10 to the Consolidated Financial Statements for further information on the Company's hedging activities.

**Income Taxes**

The provision for income taxes, as a percentage of income before taxes, decreased to 36.8 percent in 2006 from 37.9 percent in 2005. The decrease in the 2006 rate was due primarily to a \$9 million net reduction related to a revision in the State of Texas franchise tax law enacted during 2006.

**Liquidity and Capital Resources**

Net cash provided by operating activities was \$2.8 billion in 2007 compared to \$1.4 billion in 2006. For the Company, operating cash inflows primarily are derived from providing air transportation for Customers. The vast majority of tickets are purchased prior to the day on which travel is provided and, in some cases, several months before the anticipated travel date. Operating cash outflows primarily are related to the recurring expenses of operating the airline. The operating cash flows in both 2007 and 2006 were also significantly impacted by fluctuations in counterparty deposits associated with the Company's fuel hedging program (counterparty deposits are reflected as an increase to Cash and a corresponding increase to Accrued liabilities). There was an increase in counterparty deposits of \$1.5 billion for 2007, versus a decrease of \$410 million during 2006. The increase in these deposits during 2007 was due to the significant increase in fair value of the Company's fuel derivative portfolio from December 31, 2006, to December 31, 2007. The decrease during 2006 was due primarily to a decrease in the fair value of the Company's fuel derivative instruments, as a result of a decline in energy commodity

prices during 2006. Cash flows associated with purchasing and/or selling derivatives are also classified as operating cash flows, although these amounts were not material for 2007 or 2006. Cash flows from operating activities for 2007 were also driven by the \$645 million in net income, plus noncash depreciation and amortization expense of \$555 million. For further information on the Company's hedging program and counterparty deposits, see Note 10 to the Consolidated Financial Statements, and Item 7A. Qualitative and Quantitative Disclosures about Market Risk, respectively. Cash generated in 2007 and in 2006 was used primarily to finance aircraft-related capital expenditures and to provide working capital.

Net cash flows used in investing activities in 2007 totaled \$1.5 billion, approximately the same as in 2006. Investing activities in both years primarily consisted of payments for new 737-700 aircraft delivered to the Company and progress payments for future aircraft deliveries. The Company purchased 37 new 737-700 aircraft in 2007 (the remaining two 737-700s added to the fleet during 2007 were leased) versus the purchase of 36 737-700s in 2006. See Note 4 to the Consolidated Financial Statements. Investing activities for 2007 were also reduced by \$198 million related to a change in the balance of the Company's short-term investments, namely auction rate securities.

Net cash used in financing activities was \$493 million in 2007, primarily from the repurchase of \$1.0 billion of common stock. The Company repurchased a total of 66 million shares of outstanding common stock during 2007 as a result of buyback programs authorized by the Company's Board of Directors. These uses were partially offset by the October 2007 issuance of \$500 million Pass Through Certificates consisting of \$412 million 6.15% Series A certificates and \$88 million 6.65% Series B certificates. Net cash used in financing activities was \$801 million in 2006, primarily from the repurchase of \$800 million of common stock and the repayment of \$607 million in debt. The Company repurchased a total of 49 million shares of outstanding common stock during 2006 as a result of three buyback programs authorized by the Company's Board of Directors. These uses were partially offset by the issuance of \$300 million senior unsecured 5.75% notes in December 2006 and \$260 million in proceeds from exercises of Employee stock options. See Note 7 to the Consolidated Financial Statements for more information on the issuance and redemption of long-term debt.

The Company has various options available to meet its 2008 capital and operating commitments, including cash on hand and short-term investments at December 31, 2007, totaling \$2.8 billion, internally generated funds, and a \$600 million bank revolving line of credit. In addition, the Company will also consider various borrowing or leasing options to maximize earnings and supplement cash requirements. The Company believes it has access to a wide variety of financing arrangements because of its excellent credit ratings, unencumbered assets, modest leverage, and consistent profitability. The Company currently has outstanding shelf registrations for the issuance of up to \$540 million in public debt securities and pass through certificates, which it may utilize for aircraft financings or other purposes in the future.

#### **Off-Balance Sheet Arrangements, Contractual Obligations, and Contingent Liabilities and Commitments**

Southwest has contractual obligations and commitments primarily with regard to future purchases of aircraft, payment of debt, and lease arrangements. The Company received 39 Boeing 737-700 aircraft in 2007 — 37 of which were new aircraft from Boeing, and two of which were pre-owned and leased from a third party. As of December 31, 2007, the Company had exercised all remaining options for aircraft to be delivered in 2008, and had firm orders for 29 737-700 aircraft in 2008, 20 in 2009, 10 each in 2010-2012, and 29 thereafter. The Company also had options for 8 737-700 aircraft in 2009, 24 in 2010, 22 in 2011 and 30 in 2012. Southwest also has an additional 54 purchase rights for 737-700 aircraft for the years 2008 through 2014. The Company has the option to substitute 737-600s or -800s for the -700s. This option is applicable to aircraft ordered from Boeing and must be exercised 18 months prior to the contractual delivery date.

The leasing of aircraft effectively provides flexibility to the Company as a source of financing. Although the Company is responsible for all maintenance, insurance, and expense associated with operating the aircraft, and retains the risk of loss for leased aircraft, it has not made any guarantees to the lessors regarding the residual value (or market value) of the aircraft at the end of the lease terms. The Company operates 95 leased aircraft, of which 86 are operating leases. As prescribed by GAAP, assets and obligations under operating leases are not included in the Company's Consolidated Balance Sheet. Disclosure of the contractual obligations associated with the Company's leased aircraft is included below as well as in Note 8 to the Consolidated Financial Statements.

The Company is required to provide standby letters of credit to support certain obligations that arise in the ordinary course of business. Although the letters of credit

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are an off-balance sheet item, the majority of obligations to which they relate are reflected as liabilities in the Consolidated Balance Sheet. Outstanding letters of credit totaled \$211 million at December 31, 2007.

The following table aggregates the Company's material expected contractual obligations and commitments as of December 31, 2007:

Contractual Obligations	Obligations by Period				Total
	2008	2009 - 2010	2011 - 2012 (In millions)	Beyond 2012	
Long-term debt(1)	\$ 27	\$ 65	\$ 451	\$ 1,499	\$ 2,042
Interest commitments(2)	115	229	208	556	1,108
Capital lease commitments(3)	16	32	12	—	60
Operating lease commitments	400	633	430	876	2,339
Aircraft purchase commitments(4)	747	839	902	684	3,172
Other purchase commitments	60	64	14	—	138
Total contractual obligations	<u>\$ 1,365</u>	<u>\$ 1,862</u>	<u>\$ 2,017</u>	<u>\$ 3,615</u>	<u>\$ 8,859</u>

(1) Includes current maturities, but excludes amounts associated with interest rate swap agreements

(2) Related to fixed-rate debt

(3) Includes amounts classified as interest

(4) Firm orders from Boeing

There were no outstanding borrowings under the revolving credit facility at December 31, 2007. See Note 6 to the Consolidated Financial Statements for more information on the Company's revolving credit facility.

In January 2004, the Company's Board of Directors authorized the repurchase of up to \$300 million of the Company's common stock, utilizing present and anticipated proceeds from the exercise of Employee stock options. Repurchases were made in accordance with applicable securities laws in the open market or in private transactions from time to time, depending on market conditions. This program was completed during first quarter 2005, resulting in the total repurchase of approximately 21 million of the Company's common shares.

In 2006 and 2007, the Company's Board of Directors authorized five separate programs for the repurchase of up to a total of \$1.8 billion of the Company's Common Stock — \$300 million authorized in January 2006, \$300 million authorized in May 2006, \$400 million authorized in November 2006, \$300 million authorized in March 2007, and \$500 million authorized in May 2007. Repurchases were made in accordance with applicable securities laws in the open market or in private transactions from time to time, depending on market conditions. These programs, the last of which was completed during third quarter 2007, resulted in the repurchase of a total of approximately 116 million shares.

During January 2008, the Company's Board of Directors authorized an additional program for the repurchase of up to \$500 million of the Company's Common Stock. Repurchases will be made in accordance with applicable securities laws in the open market or in private transactions from time to time, depending on market conditions.

#### Critical Accounting Policies and Estimates

The Company's Consolidated Financial Statements have been prepared in accordance with U.S. Generally Accepted Accounting Principles (GAAP). The Company's significant accounting policies are described in Note 1 to the Consolidated Financial Statements. 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 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 below.

### Revenue Recognition

As described in Note 1 to the Consolidated Financial Statements, tickets sold for passenger air travel are initially deferred as "Air traffic liability." Passenger revenue is recognized and air traffic liability is reduced when the service is provided (i.e., when the flight takes place). "Air traffic liability" represents tickets sold for future travel dates and estimated future refunds and exchanges of tickets sold for past travel dates. The balance in "Air traffic liability" fluctuates throughout the year based on seasonal travel patterns and fare sale activity. The Company's "Air traffic liability" balance at December 31, 2007 was \$931 million, compared to \$799 million as of December 31, 2006.

Estimating the amount of tickets that will be refunded, exchanged, or forfeited involves some level of subjectivity and judgment. The majority of the Company's tickets sold are nonrefundable, which is the primary source of forfeited tickets. According to the Company's "Contract of Carriage", tickets (whether refundable or nonrefundable) that are sold but not flown on the travel date can be reused for another flight, up to a year from the date of sale, or can be refunded (if the ticket is refundable). A small percentage of tickets (or partial tickets) expire unused. Fully refundable tickets are rarely forfeited. "Air traffic liability" includes an estimate of the amount of future refunds and exchanges, net of forfeitures, for all unused tickets once the flight date has passed. These estimates are based on historical experience over many years. The Company and members of the airline industry have consistently applied this accounting method to estimate revenue from forfeited tickets at the date of travel. Estimated future refunds and exchanges included in the air traffic liability account are constantly evaluated based on subsequent refund and exchange activity to validate the accuracy of the Company's estimates with respect to forfeited tickets. Holding other factors constant, a ten-percent change in the Company's estimate of the amount of refunded, exchanged, or forfeited tickets for 2007 would have resulted in a \$20 million, or .2%, change in Passenger revenues recognized for that period.

Events and circumstances outside of historical fare sale activity or historical Customer travel patterns can result in actual refunds, exchanges, or forfeited tickets differing significantly from estimates. The Company evaluates its estimates within a narrow range of acceptable amounts. If actual refunds, exchanges, or forfeiture experience results in an amount outside of this range, estimates and assumptions are reviewed and adjustments to "Air traffic liability" and to "Passenger revenue" are recorded, as necessary. Additional factors that may affect estimated refunds and exchanges include, but may not be limited to, the Company's refund and exchange policy, the mix of refundable and nonrefundable fares, and promotional fare activity. The Company's estimation techniques have been consistently applied from year to year; however, as with any estimates, actual refund, exchange, and forfeiture activity may vary from estimated amounts. No material adjustments were recorded for years 2005, 2006, or 2007.

The Company believes it is unlikely that materially different estimates for future refunds, exchanges, and forfeited tickets would be reported based on other reasonable assumptions or conditions suggested by actual historical experience and other data available at the time estimates were made.

### Accounting for Long-Lived Assets

As of December 31, 2007, the Company had approximately \$15.2 billion (at cost) of long-lived assets, including \$13.0 billion (at cost) in flight equipment and related assets. Flight equipment primarily relates to the 434 Boeing 737 aircraft in the Company's fleet at December 31, 2007, which are either owned or on capital lease. The remaining 86 Boeing 737 aircraft in the Company's fleet at December 31, 2007, are on operating lease. In accounting for long-lived assets, the Company must make estimates about the expected useful lives of the assets, the expected residual values of the assets, and the potential for impairment based on the fair value of the assets and the cash flows they generate.

The following table shows a breakdown of the Company's long-lived asset groups along with information about estimated useful lives and residual values of these groups:

	Estimated Useful Life	Estimated Residual value
Aircraft and engines	23 to 25 years	15%
Aircraft parts	Fleet life	4%
Ground property and equipment	5 to 30 years	0%-10%
Leasehold improvements	5 years or lease term	0%

In estimating the lives and expected residual values of its aircraft, the Company primarily has relied upon actual experience with the same or similar aircraft types and recommendations from Boeing. Aircraft estimated useful lives are based on the number of "cycles" flown (one take-off and landing). The Company has made a conversion of cycles into years based on both its historical and anticipated future utilization of the aircraft.

Subsequent revisions to these estimates, which can be significant, could be caused by changes to the Company's maintenance program, changes in utilization of the aircraft (actual cycles during a given period of time), governmental regulations on aging aircraft, and changing market prices of new and used aircraft of the same or similar types. The Company evaluates its estimates and assumptions each reporting period and, when warranted, adjusts these estimates and assumptions. Generally, these adjustments are accounted for on a prospective basis through depreciation and amortization expense, as required by GAAP.

When appropriate, the Company evaluates its long-lived assets for impairment. Factors that would indicate potential impairment may include, but are not limited to, significant decreases in the market value of the long-lived asset(s), a significant change in the long-lived asset's physical condition, and operating or cash flow losses associated with the use of the long-lived asset. While the airline industry as a whole has experienced many of these indicators, Southwest has continued to operate all of its aircraft, generate positive cash flow, and produce profits. Consequently, the Company has not identified any impairments related to its existing aircraft fleet. The Company will continue to monitor its long-lived assets and the airline operating environment.

The Company believes it unlikely that materially different estimates for expected lives, expected residual values, and impairment evaluations would be made or reported based on other reasonable assumptions or conditions suggested by actual historical experience and other data available at the time estimates were made.

#### ***Financial Derivative Instruments***

The Company utilizes financial derivative instruments primarily to manage its risk associated with changing jet fuel prices, and accounts for them under Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended (SFAS 133). See "Quantitative and Qualitative Disclosures about Market Risk" for more information on these risk management activities and see Note 10 to the Consolidated Financial Statements for more information on SFAS 133, the Company's fuel hedging program, and financial derivative instruments.

SFAS 133 requires that all derivatives be reflected at market (fair value) and recorded on the Consolidated Balance Sheet. At December 31, 2007, the Company was a party to over 346 financial derivative instruments, related to its fuel hedging program, for year 2008 and beyond. The fair value of the Company's fuel hedging financial derivative instruments recorded on the Company's Consolidated Balance Sheet as of December 31, 2007, was \$2.4 billion, compared to \$999 million at December 31, 2006. The large increase in fair value was due primarily to the significant increase in energy prices in the second half of 2007, net of the expiration (i.e., settlement) of approximately \$727 million in fuel derivative instruments that related to 2007 and net of new derivative instruments the Company added for future years. Of the remaining \$2.4 billion in fair value of fuel hedging financial derivative instruments at December 31, 2007, approximately \$1.1 billion is expected to settle, or expire during 2008. Changes in the fair values of these instruments can vary dramatically, as was evident during recent years, based on changes in the underlying commodity prices. Market price changes can be driven by factors such as supply and demand, inventory levels, weather events, refinery capacity, political agendas, and general economic conditions, among other items. The financial derivative instruments utilized by the Company primarily are a combination of collars, purchased call options, and fixed price swap agreements. The Company does not purchase or hold any derivative instruments for trading purposes.

The Company enters into financial derivative instruments with third party institutions in "over-the-counter" markets. Since the majority of the Company's financial derivative instruments are not traded on a market exchange, the Company estimates their fair values. Depending on the type of instrument, the values are 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. Also, since there is not a reliable forward market for jet fuel, the Company must estimate the future prices of jet fuel in order to measure the effectiveness of the hedging instruments in offsetting changes to those prices, as required by SFAS 133. Forward jet fuel prices are estimated through the observation of similar commodity futures prices (such as crude oil, heating oil, and unleaded gasoline) and adjusted based on variations of those like commodities to the Company's ultimate expected price to be paid for jet fuel at the specific locations in which the Company hedges.

Fair values for financial derivative instruments and forward jet fuel prices are both estimated prior to the time that the financial derivative instruments settle, and the time that jet fuel is purchased and consumed, respectively. However, once settlement of the financial derivative instruments occurs and the hedged jet fuel is purchased and consumed, all values and prices are known and are recognized in the financial statements. In recent years,

because of increased volatility in energy markets, the Company's estimates of the presumed effectiveness of its hedges made at the time the hedges were initially designated have materially differed from actual results, resulting in increased volatility in the Company's periodic financial results. For example, historical data had been utilized in qualifying unleaded gasoline for SFAS 133 hedge accounting under the presumption that derivatives of such commodity would result in effective hedges, as defined. This historical data is updated every quarterly reporting period to ascertain whether SFAS 133 hedge accounting is allowed for every commodity the Company uses in its hedging program. During 2006, based on these updates, the Company in fact lost SFAS 133 hedge accounting for all unleaded gasoline derivative instruments, and thus has marked all such derivatives to market value in each subsequent quarterly period since that time, with all changes in value reflected as a component of Other gains/losses in the Consolidated Statement of Income. Although commodities such as crude oil and heating oil have continued to qualify for hedge accounting in most cases, there have been instances in which the Company has also lost hedge accounting in specific geographic locations for these commodities. In these instances, the Company has also marked such derivatives to market value with changes reflected in the income statement each reporting period. Although the Company's prospective assessment has been utilized to ensure that crude oil and heating oil in most cases still qualify for SFAS 133 hedge accounting in specific locations where the Company hedges, there are no assurances that these commodities will continue to qualify in the future. This is due to the fact that future price changes in these refined products may not be consistent with historical price changes. If recent volatility in these commodity markets continues for an extended period of time or worsens in the near future, the Company could lose hedge accounting altogether for all crude oil and heating oil derivatives, which would create further volatility in the Company's financial results.

Estimating the fair value of these fuel derivative instruments and forward prices for jet fuel will also result in changes in their values from period to period and thus determine how they are accounted for under SFAS 133. To the extent that the change in the estimated fair value of a fuel derivative instrument differs from the change in the estimated price of the associated jet fuel to be purchased, both on a cumulative and a period-to-period basis, ineffectiveness of the fuel hedge can result, as defined by SFAS 133. This could result in the immediate recording of noncash charges or income, representing the change in the fair value of the derivative, even though the derivative instrument may not expire/settle until a future period. Likewise, if a derivative contract ceases to qualify for hedge accounting, the changes in the fair value of the derivative instrument is recorded every period 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 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 for a specific commodity. This may result, and has resulted, in increased volatility in the Company's financial statements. The significant increase in the amount of hedge ineffectiveness and unrealized gains and losses on the change in value of derivative contracts settling in future periods recorded during recent periods has been due to a number of factors. These factors include: the significant fluctuation in energy prices, the number of derivative positions the Company holds, significant weather events that have affected refinery capacity and the production of refined products, and the volatility of the different types of products the Company uses for protection. The number of instances in which the Company has discontinued hedge accounting for specific hedges and for specific refined products, such as unleaded gasoline, has increased recently, primarily due to these reasons. In these cases, the Company has determined 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 can fluctuate significantly in amount from period to period, it is probable 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 because small differences in the correlation of crude oil related products are leveraged over large dollar volumes.

SFAS 133 is a complex accounting standard with stringent requirements, including the documentation of a Company hedging strategy, statistical analysis to qualify a commodity for hedge accounting both on a historical and a prospective basis, and strict contemporaneous

documentation that is required at the time each hedge is designated by the Company. As required by SFAS 133, the Company assesses the effectiveness of each of its individual hedges on a quarterly basis. The Company also examines the effectiveness of its entire hedging program on a quarterly basis utilizing statistical analysis. This analysis involves utilizing regression and other statistical analyses that compare changes in the price of jet fuel to changes in the prices of the commodities used for hedging purposes.

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 an important component 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 these future cash flows. Prior to 2006, the Company had estimated future cash flows using actual market forward prices of a single like commodity and adjusting for historical differences from the Company's actual jet fuel purchase prices. The Company implemented an improved model for forecasting forward jet fuel prices during 2006, due to the fact that different types of commodities are statistically better predictors of forward jet fuel prices, depending on specific geographic locations in which the Company hedges. In accordance with SFAS 133, the Company then adjusts for certain items, such as transportation costs, that are stated in fuel purchasing contracts with its vendors, in order to estimate the actual price paid for jet fuel associated with each hedge. This improved methodology for estimating future cash flows (i.e., jet fuel prices) was applied prospectively, in accordance with the Company's interpretation of SFAS 133. The Company did not, however, change its method for either assessing or measuring hedge ineffectiveness. As a result of this new method for forecasting future jet fuel prices, the Company believes its hedges are more likely to be effective over the long-term.

The Company also utilizes financial derivative instruments in the form of interest rate swap agreements. The primary objective for the Company's use of interest rate hedges is to reduce the volatility of net interest income by better matching the repricing of its assets and liabilities. The Company currently holds interest rate swap agreements related to its \$385 million 6.5% senior unsecured notes due 2012, its \$350 million 5.25% senior unsecured notes due 2014, its \$300 million 5.125% senior unsecured notes due 2017, and its \$100 million 7.375% senior unsecured debentures due 2027. The interest rate swaps associated with the \$300 million 5.125% notes and \$100 million 7.375% debentures were entered into during 2007.

The floating rate paid under the swap associated with the \$385 million 6.5% senior unsecured notes due 2012 is set in arrears. The Company pays the London InterBank Offered Rate (LIBOR) plus a margin every six months and receives 6.5 percent every six months on a notional amount of \$385 million until 2012. The average floating rate paid under this agreement during 2007 is estimated to be 7.31 percent based on actual and forward rates at December 31, 2007. The floating rate for the swap agreement relating to its \$350 million 5.25% senior unsecured notes due 2014 is set at the beginning of each six month period. Under this agreement, the Company pays LIBOR plus a margin every six months and receives 5.25 percent every six months on a notional amount of \$350 million until 2014. The average floating rate paid under this agreement during 2007 was 6.02 percent. For both the swap agreements associated with the \$300 million 5.125% notes and \$100 million 7.375% debentures, the Company pays the LIBOR plus a margin every six months on the notional amount of the debt, and receives the fixed stated rate of the notes or debentures every six months until the date the notes or debentures become due. The average floating rate paid during 2007 under the agreement associated with the \$300 million 5.125% notes due 2016 was 4.64 percent. The average floating rate paid during 2007 under the agreement associated with the \$100 million 7.375% debentures due 2027 was 6.73 percent.

The Company's interest rate swap agreements qualify as fair value hedges, as defined by SFAS 133. In addition, these interest rate swap agreements qualify for the "shortcut" method of accounting for hedges, as defined by SFAS 133. Under the "shortcut" method, the hedges are assumed to be perfectly effective, and, thus, there is no ineffectiveness to be recorded in earnings. The fair values of the interest rate swap agreements, which are adjusted regularly, is recorded in the Consolidated Balance Sheet, as necessary, with a corresponding adjustment to the carrying value of the long-term debt. The total fair value of the interest rate swap agreements, excluding accrued interest, at December 31, 2007, was an asset of approximately \$16 million. The total fair value of the swap agreements held at December 31, 2006, was a liability of \$30 million. The long-term portion of these amounts is recorded in "Other deferred liabilities" in the Consolidated Balance Sheet for each respective year. In accordance with fair value hedging, the offsetting entry is an adjustment to decrease the carrying value of long-term debt. See Note 10 to the Consolidated Financial Statements.

The Company believes it is unlikely that materially different estimates for the fair value of financial derivative instruments, and forward jet fuel prices, would be made or reported based on other reasonable assumptions or conditions suggested by actual historical experience and other data available at the time estimates were made.

#### *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 the Executive Chairman 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 periods were retroactively adjusted utilizing the pro forma disclosures in those prior financial statements. 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 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 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 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 2006 and 2007, the Company has relied on observations of 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 2007 and 2006 stock option grants, the Company utilized expected volatility based on the expected life of the option, but within a range of 24 percent to 27 percent. Prior to 2005, the Company relied exclusively on historical volatility as an input for determining the estimated fair value of stock options. 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 were actual U.S. Treasury zero-coupon rates for bonds matching the expected term of the option on the date of grant. 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.

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 generally 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, the Company recognizes 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 December 31, 2007, the Company had \$37 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 2.25 years. The total recognition period for the remaining unrecognized compensation cost was approximately eight years; however, the majority of this cost will be recognized over the next two years, in accordance with vesting provisions. The majority of the \$37 million in share-based compensation expense reflected in the Consolidated Statement of Income for the year ended December 31, 2007, was related to options granted prior to the adoption of SFAS 123R. Based on Employee stock options expected to vest during 2008, and the Company's expectation of future grants, the Company expects the expense related to share-based compensation to once again decrease during 2008 compared to 2007 expense.

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.

#### ***Recent Accounting Developments***

In September 2006, the FASB issued statement No. 157, "Fair Value Measurements", (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States, and expands disclosures about fair value measurements. The Company is subject to the provisions of SFAS 157 beginning January 1, 2008. The Company has not yet determined whether SFAS 157 will have a material impact on its financial condition, results of operations, or cash flow. However, the Company believes it will likely be required to provide additional disclosures as part of future financial statements, beginning with first quarter 2008.

In February 2007, the FASB issued Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (Statement 159). Statement 159 allows entities the option to measure eligible financial instruments at fair value as of specified dates. Such election, which may be applied on an instrument by instrument basis, is typically irrevocable once elected. Statement 159 is effective for fiscal years beginning after November 15, 2007. The Company does not believe Statement 159 will result in a material adverse effect on its financial condition, results of operations, or cash flow.

#### **Item 7A. *Quantitative and Qualitative Disclosures About Market Risk***

Southwest has interest rate risk in its floating rate debt obligations and interest rate swaps, and has commodity price risk in jet fuel required to operate its aircraft fleet. The Company purchases jet fuel at prevailing market prices, but seeks to manage market risk through execution of a documented hedging strategy. Southwest has market sensitive instruments in the form of fixed rate debt instruments and financial derivative instruments used to hedge its exposure to jet fuel price increases. The Company also operates 95 aircraft under operating and capital leases. However, leases are not considered market sensitive financial instruments and, therefore, are not included in the interest rate sensitivity analysis below. Commitments related to leases are disclosed in Note 8 to the Consolidated Financial Statements. The Company does not purchase or hold any derivative financial instruments for trading purposes. See Note 10 to the Consolidated Financial Statements for information on the Company's accounting for its hedging program and for further details on the Company's financial derivative instruments.

#### ***Fuel Hedging***

The Company utilizes financial derivative instruments, on both a short-term and a long-term basis, as a form of insurance against significant increases in fuel prices. The Company believes there is significant risk in not hedging against the possibility of such fuel price increases. The Company expects to consume approximately 1.5 billion gallons of jet fuel in 2008. Based on this usage, a change in jet fuel prices of just one cent per gallon would impact the Company's "Fuel and oil expense" by approximately \$15 million per year, excluding any impact of the Company's derivative instruments.

The fair values of outstanding financial derivative instruments related to the Company's jet fuel market price risk at December 31, 2007, were net assets of \$2.4 billion. The current portion of these financial derivative instruments, or \$1.1 billion, is classified as "Fuel derivative contracts" in the Consolidated Balance Sheet. The long-term portion of these financial derivative instruments, or \$1.3 billion, is included in "Other assets."

The fair values of the derivative instruments, depending on the type of instrument, were determined by use of present value methods or standard option value models with assumptions about commodity prices based on those observed in underlying markets. An immediate ten-percent increase or decrease in underlying fuel-related commodity prices from the December 31, 2007, prices would correspondingly change the fair value of the commodity derivative instruments in place by up to \$658 million. Changes in the related commodity derivative instrument cash flows may change by more or less than this amount based upon further fluctuations in futures prices as well as related income tax effects. This sensitivity analysis uses industry standard valuation models and holds all inputs constant at December 31, 2007, levels, except underlying futures prices.

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 its 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 will periodically review 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 December 31, 2007, the Company had agreements with nine 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 December 31, 2007, the Company held \$2.0 billion in 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 deposits are included in "Accrued liabilities" on the Consolidated Balance Sheet. See also Note 10 to the Consolidated Financial Statements.

#### **Financial Market Risk**

The vast majority of the Company's assets are aircraft, which are long-lived. The Company's strategy is to maintain a conservative balance sheet and grow capacity steadily and profitably. While the Company uses financial leverage, it has maintained a strong balance sheet and an "A" credit rating on its senior unsecured fixed-rate debt with Standard & Poor's and Fitch ratings agencies, and a "Baa1" credit rating with Moody's rating agency as of December 31, 2007. In January 2008, Fitch announced a cut in the Company's senior unsecured debt rating to "A-". The Company's 1999 and 2004 French Credit Agreements do not give rise to significant fair value risk but do give rise to interest rate risk because these borrowings are floating-rate debt. In addition, as disclosed in Note 10 to the Consolidated Financial Statements, the Company has converted certain of its long-term debt to floating rate debt by entering into interest rate swap agreements. This includes the Company's \$385 million 6.5% senior unsecured notes due 2012, the \$350 million 5.25% senior unsecured notes due 2014, the \$300 million 5.125% senior unsecured notes due 2017, and the \$100 million 7.375% senior unsecured debentures due 2027. Although there is interest rate risk associated with these floating rate borrowings, the risk for the 1999 and 2004 French Credit Agreements is somewhat mitigated by the fact that the Company may prepay this debt under certain conditions. See Notes 6 and 7 to the Consolidated Financial Statements for more information on the material terms of the Company's short-term and long-term debt.

Excluding the notes or debentures that were converted to a floating rate as previously noted, the Company's only fixed-rate senior unsecured notes at December 31, 2007 were its \$300 million notes due 2016. These senior unsecured notes have a fixed-rate of 5.75 percent, which is comparable to average rates prevailing for similar debt instruments over the last ten years. The Company's outstanding \$500 million EETCs, which are secured by 16 Boeing 737-700 aircraft, had an effective fixed-rate of 6.24 percent. The carrying value of the Company's floating rate debt totaled \$1.3 billion, and this debt had a weighted-average maturity of 6.1 years at floating rates averaging 5.68 percent for the twelve months ended December 31, 2007. In total, the Company's fixed rate debt and floating rate debt represented 6.5 percent and 10.3 percent, respectively, of total noncurrent assets at December 31, 2007.

The Company also has some risk associated with changing interest rates due to the short-term nature of its invested cash, which totaled \$2.2 billion, and short-term investments, which totaled \$566 million, at December 31, 2007. However, the Company generally does not retain the interest earnings on the \$2.0 billion in cash collateral deposits from counterparties associated with the Company's fuel derivative instruments. See Notes 1 and 10 to the Consolidated Financial Statements for further information. The Company invests available cash in certificates of deposit, highly rated money market instruments, investment grade commercial paper, auction rate securities, and other highly rated financial instruments. Because of the short-term nature of these investments, the returns earned parallel closely with short-term floating interest

rates. The Company has not undertaken any additional actions to cover interest rate market risk and is not a party to any other material market interest rate risk management activities.

A hypothetical ten percent change in market interest rates as of December 31, 2007, would not have a material effect on the fair value of the Company's fixed rate debt instruments. See Note 10 to the Consolidated Financial Statements for further information on the fair value of the Company's financial instruments. A change in market interest rates could, however, have a corresponding effect on the Company's earnings and cash flows associated with its floating rate debt, invested cash (excluding cash collateral deposits), and short-term investments because of the floating-rate nature of these items. Assuming floating market rates in effect as of December 31, 2007, were held constant throughout a 12-month period, a hypothetical ten percent change in those rates would correspondingly change the Company's net earnings and cash flows associated with these items by less than \$3 million. Utilizing these assumptions and considering the Company's cash balance (excluding cash collateral deposits), short-term investments, and floating-rate debt outstanding at December 31, 2007, an increase in rates would have a net positive effect on the Company's earnings and cash flows, while a decrease in rates would have a net negative effect on the Company's earnings and cash flows. However, a ten percent change in market rates would not impact the Company's earnings or cash flow associated with the Company's publicly traded fixed-rate debt.

The Company is also subject to various financial covenants included in its credit card transaction processing agreement, the revolving credit facility, and outstanding debt agreements. Covenants include the maintenance of minimum credit ratings. For the revolving credit facility, the Company must also maintain, at all times, a Coverage Ratio, as defined in the agreement, of not less than 1.00 to 1.25. The Company met or exceeded the minimum standards set forth in these agreements as of December 31, 2007. However, if conditions change and the Company fails to meet the minimum standards set forth in the agreements, it could reduce the availability of cash under the agreements or increase the costs to keep these agreements intact as written.

Item 8. *Financial Statements and Supplementary Data*

**SOUTHWEST AIRLINES CO.  
CONSOLIDATED BALANCE SHEET**

	December 31,	
	2007	2006
	(In millions, except share data)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 2,213	\$ 1,390
Short-term investments	566	369
Accounts and other receivables	279	241
Inventories of parts and supplies, at cost	259	181
Fuel derivative contracts	1,069	369
Prepaid expenses and other current assets	57	51
Total current assets	4,443	2,601
Property and equipment, at cost:		
Flight equipment	13,019	11,769
Ground property and equipment	1,515	1,356
Deposits on flight equipment purchase contracts	626	734
	15,160	13,859
Less allowance for depreciation and amortization	4,286	3,765
	10,874	10,094
Other assets	1,455	765
	\$ 16,772	\$ 13,460
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 759	\$ 643
Accrued liabilities	3,107	1,323
Air traffic liability	931	799
Current maturities of long-term debt	41	122
Total current liabilities	4,838	2,887
Long-term debt less current maturities	2,050	1,567
Deferred income taxes	2,535	2,104
Deferred gains from sale and leaseback of aircraft	106	120
Other deferred liabilities	302	333
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$1.00 par value; 2,000,000,000 shares authorized; 807,611,634 shares issued in 2007 and 2006	808	808
Capital in excess of par value	1,207	1,142
Retained earnings	4,788	4,307
Accumulated other comprehensive income	1,241	582
Treasury stock, at cost: 72,814,104 and 24,302,215 shares in 2007 and 2006, respectively	(1,103)	(390)
Total stockholders' equity	6,941	6,449
	\$ 16,772	\$ 13,460

See accompanying notes.

SOUTHWEST AIRLINES CO.  
CONSOLIDATED STATEMENT OF INCOME

	Years Ended December 31,		
	2007	2006	2005
	(In millions, except per share amounts)		
<b>OPERATING REVENUES:</b>			
Passenger	\$ 9,457	\$ 8,750	\$ 7,279
Freight	130	134	133
Other	274	202	172
Total operating revenues	<u>9,861</u>	<u>9,086</u>	<u>7,584</u>
<b>OPERATING EXPENSES:</b>			
Salaries, wages, and benefits	3,213	3,052	2,782
Fuel and oil	2,536	2,138	1,341
Maintenance materials and repairs	616	468	446
Aircraft rentals	156	158	163
Landing fees and other rentals	560	495	454
Depreciation and amortization	555	515	469
Other operating expenses	1,434	1,326	1,204
Total operating expenses	<u>9,070</u>	<u>8,152</u>	<u>6,859</u>
<b>OPERATING INCOME</b>	<u>791</u>	<u>934</u>	<u>725</u>
<b>OTHER EXPENSES (INCOME):</b>			
Interest expense	119	128	122
Capitalized interest	(50)	(51)	(39)
Interest income	(44)	(84)	(47)
Other (gains) losses, net	(292)	151	(90)
Total other expenses (income)	<u>(267)</u>	<u>144</u>	<u>(54)</u>
<b>INCOME BEFORE INCOME TAXES</b>	<u>1,058</u>	<u>790</u>	<u>779</u>
<b>PROVISION FOR INCOME TAXES</b>	<u>413</u>	<u>291</u>	<u>295</u>
<b>NET INCOME</b>	<u>\$ 645</u>	<u>\$ 499</u>	<u>\$ 484</u>
<b>NET INCOME PER SHARE, BASIC</b>	<u>\$ .85</u>	<u>\$ .63</u>	<u>\$ .61</u>
<b>NET INCOME PER SHARE, DILUTED</b>	<u>\$ .84</u>	<u>\$ .61</u>	<u>\$ .60</u>

See accompanying notes.

**SOUTHWEST AIRLINES CO.**  
**CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY**

	Years Ended December 31, 2007, 2006, and 2005					Total
	Common Stock	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	
	(In millions, except per share amounts)					
Balance at December 31, 2004	\$ 790	\$ 777	\$ 3,614	\$ 417	\$ (71)	\$ 5,527
Purchase of shares of treasury stock	—	—	—	—	(55)	(55)
Issuance of common and treasury stock pursuant to Employee stock plans	12	59	(66)	—	126	131
Tax benefit of options exercised	—	47	—	—	—	47
Share-based compensation	—	80	—	—	—	80
Cash dividends, \$.018 per share	—	—	(14)	—	—	(14)
Comprehensive income (loss)	—	—	—	—	—	—
Net income	—	—	484	—	—	484
Unrealized gain on derivative instruments	—	—	—	474	—	474
Other	—	—	—	1	—	1
Total comprehensive income	—	—	—	—	—	959
Balance at December 31, 2005	\$ 802	\$ 963	\$ 4,018	\$ 892	\$ —	\$ 6,675
Purchase of shares of treasury stock	—	—	—	—	(800)	(800)
Issuance of common and treasury stock pursuant to Employee stock plans	6	39	(196)	—	410	259
Tax benefit of options exercised	—	60	—	—	—	60
Share-based compensation	—	80	—	—	—	80
Cash dividends, \$.018 per share	—	—	(14)	—	—	(14)
Comprehensive income (loss)	—	—	—	—	—	—
Net income	—	—	499	—	—	499
Unrealized loss on derivative instruments	—	—	—	(306)	—	(306)
Other	—	—	—	(4)	—	(4)
Total comprehensive income	—	—	—	—	—	189
Balance at December 31, 2006	\$ 808	\$ 1,142	\$ 4,307	\$ 582	\$ (390)	\$ 6,449
Purchase of shares of treasury stock	—	—	—	—	(1,001)	(1,001)
Issuance of common and treasury stock pursuant to Employee stock plans	—	—	(150)	—	288	138
Tax benefit of options exercised	—	28	—	—	—	28
Share-based compensation	—	37	—	—	—	37
Cash dividends, \$.018 per share	—	—	(14)	—	—	(14)
Comprehensive income (loss)	—	—	—	—	—	—
Net income	—	—	645	—	—	645
Unrealized gain on derivative instruments	—	—	—	636	—	636
Other	—	—	—	23	—	23
Total comprehensive income	—	—	—	—	—	1,304
Balance at December 31, 2007	\$ 808	\$ 1,207	\$ 4,788	\$ 1,241	\$ (1,103)	\$ 6,941

See accompanying notes.

SOUTHWEST AIRLINES CO.  
CONSOLIDATED STATEMENT OF CASH FLOWS

	Years Ended December 31,		
	2007	2006 (In millions)	2005
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income	\$ 645	\$ 499	\$ 484
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	555	515	469
Deferred income taxes	328	277	291
Amortization of deferred gains on sale and leaseback of aircraft	(14)	(16)	(16)
Share-based compensation expense	37	80	80
Excess tax benefits from share-based compensation arrangements	(28)	(60)	(47)
Changes in certain assets and liabilities:			
Accounts and other receivables	(38)	(5)	(9)
Other current assets	(229)	87	(59)
Accounts payable and accrued liabilities	1,609	(223)	855
Air traffic liability	131	150	120
Other, net	(151)	102	(50)
Net cash provided by operating activities	<u>2,845</u>	<u>1,406</u>	<u>2,118</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchases of property and equipment, net	(1,331)	(1,399)	(1,146)
Purchases of short-term investments	(5,086)	(4,509)	(1,804)
Proceeds from sales of short-term investments	4,888	4,392	1,810
Payment for assets of ATA Airlines, Inc.	—	—	(6)
Debtor in possession loan to ATA Airlines, Inc.	—	20	—
Other, net	—	1	—
Net cash used in investing activities	<u>(1,529)</u>	<u>(1,495)</u>	<u>(1,146)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Issuance of long-term debt	500	300	300
Proceeds from Employee stock plans	139	260	132
Payments of long-term debt and capital lease obligations	(122)	(607)	(149)
Payments of cash dividends	(14)	(14)	(14)
Repurchase of common stock	(1,001)	(800)	(55)
Excess tax benefits from share-based compensation arrangements	28	60	47
Other, net	(23)	—	(1)
Net cash provided by (used in) financing activities	<u>(493)</u>	<u>(801)</u>	<u>260</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>823</b>	<b>(890)</b>	<b>1,232</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>	<b>1,390</b>	<b>2,280</b>	<b>1,048</b>
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b>\$ 2,213</b>	<b>\$ 1,390</b>	<b>\$ 2,280</b>
<b>SUPPLEMENTAL DISCLOSURES</b>			
Cash payments for:			
Interest, net of amount capitalized	\$ 63	\$ 78	\$ 71
Income taxes	\$ 94	\$ 15	\$ 8
Noncash rights to airport gates acquired through reduction in debtor in possession loan to ATA Airlines, Inc.	\$ —	\$ —	\$ 20

See accompanying notes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2007

1. Summary of Significant Accounting Policies

*Basis of Presentation*

Southwest Airlines Co. (the Company or Southwest) is a major domestic airline that provides point-to-point, low-fare service. The Consolidated Financial Statements include the accounts of Southwest and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated. The preparation of financial statements in conformity with accounting principles generally accepted in the United States (GAAP) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

*Cash and Cash Equivalents*

Cash in excess of that necessary for operating requirements is invested in short-term, highly liquid, income-producing investments. Investments with maturities of three months or less are classified as cash and cash equivalents, which primarily consist of certificates of deposit, money market funds, and investment grade commercial paper issued by major corporations and financial institutions. Cash and cash equivalents are stated at cost, which approximates market value.

*Short-Term Investments*

Short-term investments consist of auction rate securities with auction reset periods of less than 12 months. These investments are classified as available-for-sale securities and are stated at fair value. At each reset period, the Company accounts for the transaction as "Proceeds from sales of short-term investments" for the security relinquished, and a "Purchase of short-investments" for the security purchased, in the accompanying Consolidated Statement of Cash Flows. Unrealized gains and losses, net of tax, are recognized in "Accumulated other comprehensive income (loss)" in the accompanying Consolidated Balance Sheet. Realized gains and losses on specific investments, which totaled \$17 million in 2007, \$17 million in 2006, and \$4 million in 2005, are reflected in "Interest income" in the accompanying Consolidated Income Statement.

The Company's cash and cash equivalents and short-term investments as of December 31, 2006 and 2007, included \$540 million and \$2.0 billion, respectively, in collateral deposits received from the counterparties of the Company's fuel derivative instruments. Although these amounts are not restricted in any way, the Company generally must remit the investment earnings from these amounts back to the counterparties. Depending on the fair value of the Company's fuel derivative instruments, the amounts of collateral deposits held at any point in time can fluctuate significantly. Therefore, the Company generally excludes the cash collateral deposits in its decisions related to long-term cash planning and forecasting. See Note 10 for further information on these collateral deposits and fuel derivative instruments.

*Accounts and Other Receivables*

Accounts and other receivables are carried at cost. They primarily consist of amounts due from credit card companies associated with sales of tickets for future travel and amounts due from counterparties associated with fuel derivative instruments that have settled. The amount of allowance for doubtful accounts as of December 31, 2005, 2006 and 2007 was immaterial. In addition, the provision for doubtful accounts and write-offs for 2005, 2006, and 2007 were immaterial.

*Inventories*

Inventories primarily consist of flight equipment expendable parts, materials, aircraft fuel, and supplies. All of these items are carried at average cost, less an allowance for obsolescence. These items are generally charged to expense when issued for use. The reserve for obsolescence was immaterial at December 31, 2005, 2006 and 2007. In addition, the Company's provision for obsolescence and write-offs for 2005, 2006, and 2007 were immaterial.

*Property and Equipment*

Property and equipment is stated at cost. Depreciation is provided by the straight-line method to estimated residual values over periods generally ranging from 23 to 25 years for flight equipment and 5 to 30 years for ground property and equipment once the asset is placed in service. Residual values estimated for aircraft are generally 15 percent and for ground property and equipment range from zero to 10 percent. Property under capital leases and related obligations is recorded at an amount equal to the present value of future minimum lease payments computed on the basis of the Company's incremental borrowing rate or, when known, the interest rate implicit in

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

the lease. Amortization of property under capital leases is on a straight-line basis over the lease term and is included in depreciation expense.

In estimating the lives and expected residual values of its aircraft, the Company primarily has relied upon actual experience with the same or similar aircraft types, recommendations from Boeing, the manufacturer of the Company's aircraft, and current fair values in markets for similar used aircraft. Subsequent revisions to these estimates, which can be significant, could be caused by changes to the Company's maintenance program, modifications or improvements to the aircraft, changes in utilization of the aircraft (actual flight hours or cycles during a given period of time), governmental regulations on aging aircraft, changing market prices of new and used aircraft of the same or similar types, etc. The Company evaluates its estimates and assumptions each reporting period and, when warranted, adjusts these estimates and assumptions. Generally, these adjustments are accounted for on a prospective basis through depreciation and amortization expense, as required by GAAP.

When appropriate, the Company evaluates its long-lived assets used in operations for impairment. Impairment losses would be recorded when events and circumstances indicate that an asset might be impaired and the undiscounted cash flows to be generated by that asset are less than the carrying amounts of the asset. Factors that would indicate potential impairment include, but are not limited to, significant decreases in the market value of the long-lived asset(s), a significant change in the long-lived asset's physical condition, operating or cash flow losses associated with the use of the long-lived asset, etc. The Company continues to experience positive cash flow and operate all of its aircraft, and there have been no significant impairments of long-lived assets recorded during 2005, 2006, or 2007.

***Aircraft and Engine Maintenance***

The cost of scheduled inspections and repairs and routine maintenance costs for all aircraft and engines are charged to maintenance expense as incurred. Modifications that significantly enhance the operating performance or extend the useful lives of aircraft or engines are capitalized and amortized over the remaining life of the asset.

***Intangible Assets***

Intangible assets primarily consist of leasehold rights to airport owned gates. These assets are amortized on a straight-line basis over the expected useful life of the lease, approximately 20 years. The accumulated amortization related to the Company's intangible assets at December 31, 2007, and 2006, was \$9 million and \$5 million, respectively. The Company periodically assesses its intangible assets for impairment in accordance with SFAS 142, *Goodwill and Other Intangible Assets*; however, no impairments have been noted.

***Revenue Recognition***

Tickets sold are initially deferred as "Air traffic liability". Passenger revenue is recognized when transportation is provided. "Air traffic liability" primarily represents tickets sold for future travel dates and estimated refunds and exchanges of tickets sold for past travel dates. The majority of the Company's tickets sold are nonrefundable. Tickets that are sold but not flown on the travel date (whether refundable or nonrefundable) can be reused for another flight, up to a year from the date of sale, or refunded (if the ticket is refundable). A small percentage of tickets (or partial tickets) expire unused. The Company estimates the amount of future refunds and exchanges, net of forfeitures, for all unused tickets once the flight date has passed. These estimates are based on historical experience over many years. The Company and many members of the airline industry have consistently applied this accounting method to estimate revenue from forfeited tickets at the date travel is provided. Estimated future refunds and exchanges included in the air traffic liability account are constantly evaluated based on subsequent refund and exchange activity to validate the accuracy of the Company's revenue recognition method with respect to forfeited tickets.

Events and circumstances outside of historical fare sale activity or historical Customer travel patterns can result in actual refunds, exchanges or forfeited tickets differing significantly from estimates; however, these differences have historically not been material. Additional factors that may affect estimated refunds, exchanges, and forfeitures include, but may not be limited to, the Company's refund and exchange policy, the mix of refundable and nonrefundable fares, and fare sale activity. The Company's estimation techniques have been consistently applied from year to year; however, as with any estimates, actual refund and exchange activity may vary from estimated amounts.

The Company is also required to collect certain taxes and fees from Customers on behalf of government agencies and remit these back to the applicable

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

governmental entity on a periodic basis. These taxes and fees include U.S. federal transportation taxes, federal security charges, and airport passenger facility charges. These items are collected from Customers at the time they purchase their tickets, but are not included in Passenger revenue. The Company records a liability upon collection from the Customer and relieves the liability when payments are remitted to the applicable governmental agency.

***Frequent Flyer Program***

The Company records a liability for the estimated incremental cost of providing free travel under its Rapid Rewards frequent flyer program at the time an award is earned. The estimated incremental cost includes direct passenger costs such as fuel, food, and other operational costs, but does not include any contribution to overhead or profit.

The Company also sells frequent flyer credits and related services to companies participating in its Rapid Rewards frequent flyer program. Funds received from the sale of flight segment credits are accounted for under the residual value method. Under this method, the Company has determined the portion of funds received for sale of flight segment credits that relate to free travel, currently estimated at 75 percent of the amount received per flight segment credit sold. These amounts are deferred and recognized as "Passenger revenue" when the ultimate free travel awards are flown or the credits expire unused. The remaining 25 percent of the amount received per flight segment credit sold, which is assumed not to be associated with future travel, includes items such as access to the Company's frequent flyer program population for marketing/solicitation purposes, use of the Company's logo on co-branded credit cards, and other trademarks, designs, images, etc. of Southwest for use in marketing materials. This remaining portion is recognized in "Other revenue" in the period earned.

***Advertising***

The Company expenses the costs of advertising as incurred. Advertising expense for the years ended December 31, 2007, 2006, and 2005 was \$191 million, \$182 million, and \$173 million, respectively.

***Share-Based Employee Compensation***

The Company has stock-based compensation plans covering the majority of its Employee groups, including a plan covering the Company's Board of Directors and plans related to employment contracts with the Executive Chairman of the Company. The Company accounts for stock-based compensation utilizing the fair value recognition provisions of SFAS No. 123R, "Share-Based Payment." See Note 13.

***Financial Derivative Instruments***

The Company accounts for financial derivative instruments utilizing Statement of Financial Accounting Standards No. 133 (SFAS 133), "Accounting for Derivative Instruments and Hedging Activities," as amended. The Company utilizes various derivative instruments, including crude oil, unleaded gasoline, and heating oil-based derivatives, to attempt to reduce the risk of its exposure to jet fuel price increases. These instruments primarily consist of purchased call options, collar structures, and fixed-price swap agreements, and upon proper qualification are accounted for as cash-flow hedges, as defined by SFAS 133. The Company has also entered into interest rate swap agreements to convert a portion of its fixed-rate debt to floating rates. These interest rate hedges are accounted for as fair value hedges, as defined by SFAS 133.

Since the majority of the Company's financial derivative instruments are not traded on a market exchange, the Company estimates their fair values. Depending on the type of instrument, the values are 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. Also, since there is not a reliable forward market for jet fuel, the Company must estimate the future prices of jet fuel in order to measure the effectiveness of the hedging instruments in offsetting changes to those prices, as required by SFAS 133. Forward jet fuel prices are estimated through utilization of 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.

For the effective portion of settled hedges, as defined in SFAS 133, the Company records the associated gains or losses as a component of Fuel and oil expense in the Consolidated Statement of Income. For amounts representing ineffectiveness, as defined, or changes in fair value of derivative instruments for which hedge accounting is not applied, the Company records any gains or losses as a component of Other (gains) losses, net, in the Consolidated Statement of Income. Amounts that are paid or

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

received associated with the purchase or sale of financial derivative instruments (i.e., premium costs of option contracts) are classified as a component of Other (gains) losses, net, in the Consolidated Statement of Income in the period in which the instrument settles or expires. All cash flows associated with purchasing and selling derivatives are classified as operating cash flows in the Consolidated Statement of Cash Flows, either as a component of changes in Other current assets or Other, net, depending on whether the derivative will settle within twelve months or beyond twelve months, respectively. See Note 10 for further information on SFAS 133 and financial derivative instruments.

**Income Taxes**

The Company accounts for deferred income taxes utilizing Statement of Financial Accounting Standards No. 109 (SFAS 109), "Accounting for Income Taxes", as amended. SFAS 109 requires an asset and liability method, whereby deferred tax assets and liabilities are recognized based on the tax effects of temporary differences between the financial statements and the tax bases of assets and liabilities, as measured by current enacted tax rates. When appropriate, in accordance with SFAS 109, the Company evaluates the need for a valuation allowance to reduce deferred tax assets.

**Concentration Risk**

A significant number of the Company's Employees are unionized and are covered by collective bargaining agreements. The following Employee groups are under agreements that are currently amendable or will become amendable during 2008: the Company's Pilots (became amendable in 2006, and currently in discussions on a new agreement); the Company's Flight Attendants (becomes amendable in June 2008); the Company's Ramp, Operations, Provisioning, and Freight Agents (becomes amendable in July 2008, and began negotiations in January 2008); the Company's Stock Clerks and Mechanics (both become amendable in August 2008); and the Company's Customer Service and Reservations Agents (becomes amendable in November 2008.)

The Company attempts to minimize its concentration risk with regards to its cash, cash equivalents, and its investment portfolio. This is accomplished by diversifying and limiting amounts among different counterparties, the type of investment, and the amount invested in any individual security or money market fund.

To manage risk associated with financial derivative instruments held, the Company selects and will periodically review 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 December 31, 2007, the Company had agreements with nine 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 December 31, 2007, the Company held \$2.0 billion in 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 Company operates an all-Boeing 737 fleet of aircraft. If the Company was unable to acquire additional aircraft from Boeing, or Boeing was unable or unwilling to provide adequate support for its products, the Company's operations could be adversely impacted. However, the Company considers its relationship with Boeing to be good and believes the advantages of operating a single fleet type outweigh the risks of such a strategy.

**2. Recent Accounting Developments**

In September 2006, the FASB issued statement No. 157, "Fair Value Measurements", (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States, and expands disclosures about fair value measurements. The Company is subject to the provisions of SFAS 157 beginning January 1, 2008. The Company has not yet determined whether SFAS 157 will have a material impact on its financial condition, results of operations, or cash flow. However, the Company believes it will likely be required to provide additional disclosures as part of future financial statements, beginning with first quarter 2008.

In February 2007, the FASB issued Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (Statement 159). Statement 159 allows entities the option to measure eligible financial instruments at fair value as of specified dates. Such election, which may be applied on an instrument by instrument basis, is typically irrevocable once elected. Statement 159 is effective for fiscal years beginning after November 15, 2007. The Company does not believe Statement 159 will result in a material adverse effect

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

on its financial condition, results of operations, or cash flow.

### 3. 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 Airlines, Inc. (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 also agreed on a code share arrangement, under which each carrier can exchange passengers on certain designated flights. This agreement was approved and implemented during first quarter 2005, although it has since been enhanced and adjusted.

### 4. Commitments

The Company's contractual purchase commitments primarily consist of scheduled aircraft acquisitions from Boeing. As of December 31, 2007, the Company had contractual purchase commitments with Boeing for 29 737-700 aircraft deliveries in 2008, 20 scheduled for delivery in 2009, 10 each in 2010 thru 2012, and 29 thereafter. In addition, the Company has options and purchase rights for an additional 138 737-700s that it may acquire during 2009-2014. The Company has the option, which must be exercised 18 months prior to the contractual delivery date, to substitute 737-600s or 737-800s for the 737-700s. As of December 31, 2007, aggregate funding needed for firm commitments is approximately \$3.2 billion, subject to adjustments for inflation, due as follows: \$747 million in 2008, \$498 million in 2009, \$341 million in 2010, \$444 million in 2011, \$458 million in 2012, and \$684 million thereafter.

### 5. Accrued Liabilities

	2007	2006
	(In millions)	
Retirement plans (Note 14)	\$ 132	\$ 165
Aircraft rentals	125	128
Vacation pay	164	151
Advances and deposits (Note 10)	2,020	546
Deferred income taxes	370	78
Other	296	255
Accrued liabilities	<u>\$ 3,107</u>	<u>\$ 1,323</u>

### 6. Revolving Credit Facility

The Company has a revolving credit facility under which it can borrow up to \$600 million from a group of banks. The facility expires in August 2010 and is unsecured. At the Company's option, interest on the facility can be calculated on one of several different bases. For most borrowings, Southwest would anticipate choosing a

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

floating rate based upon LIBOR. If the facility had been fully drawn at December 31, 2007, the spread over LIBOR would have been 62.5 basis points given Southwest's credit rating at that date. The facility also contains a financial covenant requiring a minimum coverage ratio of adjusted pre-tax income to fixed obligations, as defined. As of December 31, 2007, the Company was in compliance with this covenant, and there were no outstanding amounts borrowed under this facility.

**7. Long-Term Debt**

	2007	2006
	(In millions)	
7 <sup>7</sup> / <sub>8</sub> % Notes due 2007	\$ —	\$ 100
French Credit Agreements due 2012	32	37
6 <sup>1</sup> / <sub>2</sub> % Notes due 2012	386	369
5 <sup>1</sup> / <sub>4</sub> % Notes due 2014	352	336
5 <sup>3</sup> / <sub>4</sub> % Notes due 2016	300	300
5 <sup>1</sup> / <sub>8</sub> % Notes due 2017	311	300
French Credit Agreements due 2017	94	100
Pass Through Certificates	480	—
7 <sup>3</sup> / <sub>8</sub> % Debentures due 2027	103	100
Capital leases (Note 8)	52	63
	<u>2,110</u>	<u>1,705</u>
Less current maturities	41	122
Less debt discount and issuance costs	19	16
	<u>\$ 2,050</u>	<u>\$ 1,567</u>

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

On October 3, 2007, grantor trusts established by the Company issued \$500 million Pass Through Certificates consisting of \$412 million 6.15% Series A certificates and \$88 million 6.65% Series B certificates. A separate trust was established for each class of certificates. The trusts used the proceeds from the sale of certificates to acquire equipment notes in the same amounts, which were issued by Southwest on a full recourse basis. Payments on the equipment notes held in each trust will be passed through to the holders of certificates of such trust. The equipment notes were issued for each of 16 Boeing 737-700 aircraft owned by Southwest and are secured by a mortgage on each aircraft. Interest on the equipment notes held for the certificates is payable semi-annually, beginning February 1, 2008. Also beginning February 1, 2008, principal payments on the equipment notes held for both series of certificates are due semi-annually until the balance of the certificates mature on August 1, 2022. The Company utilized the proceeds from the issuance of the Pass Through Certificates for general corporate purposes. Prior to their issuance, the Company also entered into swap agreements to hedge the variability in interest rates on the Pass Through Certificates. The swap agreements were accounted for as cash flow hedges, and resulted in a payment by the Company of \$20 million upon issuance of the Pass Through Certificates. The effective portion of the hedge is being amortized to interest expense concurrent with the amortization of the debt and is reflected in the above table as a reduction in the debt balance. The ineffectiveness of the hedge transaction was immaterial.

During December 2006, the Company issued \$300 million senior unsecured Notes due 2016. The notes bear interest at 5.75 percent, payable semi-annually in arrears, with the first payment made on June 15, 2007. Southwest used the net proceeds from the issuance of the notes for general corporate purposes.

During February 2005, the Company issued \$300 million senior unsecured Notes due 2017. The notes bear interest at 5.125 percent, payable semi-annually in arrears, with the first payment made on September 1, 2005. Southwest used the net proceeds from the issuance of the notes for general corporate purposes. In January 2007, the Company entered into an interest-rate swap

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

agreement to convert this fixed-rate debt to a floating rate. See Note 10 for more information on the interest-rate swap agreement.

In fourth quarter 2004, the Company entered into four identical 13-year floating-rate financing arrangements, whereby it borrowed a total of \$112 million from French banking partnerships. Although the interest rates on the borrowings float, the Company estimates that, considering the full effect of the "net present value benefits" included in the transactions, the effective economic yield over the 13-year term of the loans will be approximately LIBOR minus 45 basis points. Principal and interest are payable semi-annually on June 30 and December 31 for each of the loans, and the Company may terminate the arrangements in any year on either of those dates, under certain conditions. The Company pledged four aircraft as collateral for the transactions.

In September 2004, the Company issued \$350 million senior unsecured Notes due 2014. The notes bear interest at 5.25 percent, payable semi-annually in arrears, on April 1 and October 1. Concurrently, the Company entered into an interest-rate swap agreement to convert this fixed-rate debt to a floating rate. See Note 10 for more information on the interest-rate swap agreement. Southwest used the net proceeds from the issuance of the notes for general corporate purposes.

On March 1, 2002, the Company issued \$385 million senior unsecured Notes due March 1, 2012. The notes bear interest at 6.5 percent, payable semi-annually on March 1 and September 1. Southwest used the net proceeds from the issuance of the notes for general corporate purposes. During 2003, the Company entered into an interest rate swap agreement relating to these notes. See Note 10 for further information.

In fourth quarter 1999, the Company entered into two identical 13-year floating rate financing arrangements, whereby it borrowed a total of \$56 million from French banking partnerships. Although the interest rates on the borrowings float, the Company estimates that, considering the full effect of the "net present value benefits" included in the transactions, the effective economic yield over the 13-year term of the loans will be approximately LIBOR minus 67 basis points. Principal and interest are payable semi-annually on June 30 and December 31 for each of the loans and the Company may terminate the arrangements in any year on either of those dates, with certain conditions. The Company pledged two aircraft as collateral for the transactions.

On February 28, 1997, the Company issued \$100 million of senior unsecured 7<sup>3</sup>/<sub>8</sub>% Debentures due March 1, 2027. Interest is payable semi-annually on March 1 and September 1. The debentures may be redeemed, at the option of the Company, in whole at any time or in part from time to time, at a redemption price equal to the greater of the principal amount of the debentures plus accrued interest at the date of redemption or the sum of the present values of the remaining scheduled payments of principal and interest thereon, discounted to the date of redemption at the comparable treasury rate plus 20 basis points, plus accrued interest at the date of redemption. In January 2007, the Company entered into an interest-rate swap agreement to convert this fixed-rate debt to a floating rate. See Note 10 for more information on the interest-rate swap agreement.

The Company is required to provide standby letters of credit to support certain obligations that arise in the ordinary course of business. Although the letters of credit are an off-balance sheet item, the majority of obligations to which they relate are reflected as liabilities in the Consolidated Balance Sheet. Outstanding letters of credit totaled \$211 million at December 31, 2007.

The net book value of the assets pledged as collateral for the Company's secured borrowings, primarily aircraft and engines, was \$660 million at December 31, 2007.

As of December 31, 2007, aggregate annual principal maturities of debt and capital leases (not including amounts associated with interest rate swap agreements and interest on capital leases) for the five-year period ending December 31, 2012, were \$40 million in 2008, \$42 million in 2009, \$50 million in 2010, \$44 million in 2011, \$418 million in 2012, and \$1.5 billion thereafter.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

8. Leases

The Company had nine aircraft classified as capital leases at December 31, 2007. The amounts applicable to these aircraft included in property and equipment were:

	2007	2006
	(In millions)	
Flight equipment	\$ 168	\$ 168
Less accumulated depreciation	133	123
	<u>\$ 35</u>	<u>\$ 45</u>

Total rental expense for operating leases, both aircraft and other, charged to operations in 2007, 2006, and 2005 was \$469 million, \$433 million, and \$409 million, respectively. The majority of the Company's terminal operations space, as well as 86 aircraft, were under operating leases at December 31, 2007. Future minimum lease payments under capital leases and noncancelable operating leases with initial or remaining terms in excess of one year at December 31, 2007, were:

	Capital Leases	Operating Leases
	(In millions)	
2008	\$ 16	\$ 400
2009	17	335
2010	15	298
2011	12	235
2012	—	195
After 2012	—	876
Total minimum lease payments	60	<u>\$ 2,339</u>
Less amount representing interest	8	
Present value of minimum lease payments	52	
Less current portion	13	
Long-term portion	<u>\$ 39</u>	

The aircraft leases generally can be renewed at rates based on fair market value at the end of the lease term for one to five years. Most aircraft leases have purchase options at or near the end of the lease term at fair market value, generally limited to a stated percentage of the lessor's defined cost of the aircraft.

9. Project Early Departure

Project Early Departure was a voluntary early retirement program offered in July 2007 to eligible Employees, in which the Company offered a cash bonus of \$25,000 plus medical/dental continuation coverage and travel privileges based on eligibility.

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

Project Early Departure resulted in a pre-tax, pre-profitsharing, one-time charge of approximately \$25 million during third quarter 2007, all of which is reflected in "Salaries, wages and benefits" in the accompanying Consolidated Statement of Income. Approximately \$14 million remained to be paid and is recorded as an accrued liability in the accompanying Consolidated Balance Sheet as of December 31, 2007. The Company will continue to address future staffing needs, but currently anticipates that the majority of the positions will be filled with entry-level Employees at lower wage rates to meet operational demands. The purpose of this voluntary initiative and

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

other initiatives is to help the Company reduce future operating costs.

**10. Derivative and Financial 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 during 2007, 2006, and 2005 represented approximately 28.0 percent, 26.2 percent, and 19.6 percent of Southwest's operating expenses, respectively. The primary reason that fuel and oil has become an increasingly large portion of the Company's operating expenses has been due to the dramatic increase in all energy prices over this period. The Company endeavors to acquire jet fuel at the lowest possible cost. Because jet fuel is not traded on an organized futures exchange, there are limited opportunities to hedge directly in jet fuel. However, the Company has found that financial derivative instruments in other commodities, such as crude oil, and refined products such as heating oil and unleaded gasoline, can be useful in decreasing 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 protective fuel derivative positions the Company had in place during 2007, the Company also has significant future positions. The Company currently has a mixture of purchased call options, collar structures, and fixed price swap agreements in place to protect against over 70 percent of its 2008 total anticipated jet fuel requirements at average crude oil equivalent prices of approximately \$51 per barrel, and has also added refinery margins on most of those positions. Based on current growth plans, the Company also has fuel derivative contracts in place for over 55 percent of its expected fuel consumption for 2009 at approximately \$51 per barrel, nearly 30 percent for 2010 at approximately \$63 per barrel, over 15 percent for 2011 at \$64 per barrel, and over 15 percent in 2012 at \$63 per barrel.

Upon proper qualification, the Company endeavors to account for its fuel derivative instruments as cash flow hedges, as defined in Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended (SFAS 133). Under SFAS 133, all derivatives 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 11 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 fair value of the derivative instrument exceeds the change in the value of the Company's expected future cash outlay to purchase and consume jet fuel. To the extent that the periodic changes in the fair value of the derivatives 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, any change in the fair value of derivative instruments since the last period is recorded to Other gains and losses in the income statement in the period of the change; however, in accordance with SFAS 133, any amounts previously recorded to Accumulated other comprehensive income would remain there until such time as the original forecasted transaction occurs, then would be reclassified to Fuel and oil expense. In a situation where it becomes probable that a hedged forecasted transaction will not occur, any gains and/or losses that have been recorded to Accumulated other comprehensive income would be required to be immediately reclassified into earnings. The Company did not have any such situations occur in 2005, 2006, or 2007.

Ineffectiveness is inherent in hedging jet fuel with derivative positions based in other crude oil related commodities, especially given the magnitude of the current fair market value of the Company's fuel derivatives and the recent volatility in the prices of refined products. 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 for a specific commodity. This may result, and has resulted, in increased volatility in the Company's results. The significant increase in the amount of hedge ineffectiveness and unrealized gains and losses on derivative contracts settling in future periods recorded during the past few years has been due to a number of factors. These factors included: the significant fluctuation in energy prices, the number of derivative positions the Company holds, significant weather events that have affected refinery capacity and

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

the production of refined products, and the volatility of the different types of products the Company uses for protection. The number of instances in which the Company has discontinued hedge accounting for specific hedges and for specific refined products, such as unleaded gasoline, 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. However, even though these derivatives may not qualify for SFAS 133 special hedge accounting, the Company continues to hold the instruments as it believes they continue to represent good "economic hedges" in its goal to minimize jet fuel costs. As the fair value of the Company's hedge positions can fluctuate significantly in amount from period to period, it is more probable that there will be continued variability recorded in the income statement and that the amount of hedge ineffectiveness and unrealized gains or losses for changes in value of the derivatives recorded in future periods will be material. This is primarily due to the fact that small differences in the correlation of crude oil related products are leveraged over large dollar volumes.

All cash flows associated with purchasing and selling derivatives are classified as operating cash flows in the Consolidated Statement of Cash Flows, either as a component of changes in Other current assets or Other, net, depending on whether the derivative will settle within twelve months or beyond twelve months, respectively. The following table presents the location of pre-tax gains and/or losses on derivative instruments within the Consolidated Statement of Income.

	2007	2006 (In millions)	2005
Fuel hedge (gains) included in Fuel and oil expense	\$ (686)	\$ (634)	\$ (892)
Mark-to-market impact from fuel contracts settling in future periods — included in Other (gains) losses, net	(219)	42	(77)
Ineffectiveness from fuel hedges settling in future periods — included in Other (gains) losses, net	(51)	39	(9)
Realized ineffectiveness and mark-to-market (gains) or losses — included in Other (gains) losses, net	(90)	20	(24)
Premium cost of fuel contracts included in Other (gains) losses, net	58	52	35

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

	2007	2006 (In millions)
Fair value of current fuel contracts (Fuel derivative contracts)	\$ 1,069	\$ 369
Fair value of noncurrent fuel contracts (Other assets)	1,318	630
Due from third parties for settled fuel contracts (Accounts and other receivables)	109	42
Net unrealized gains from fuel hedges, net of tax (Accumulated other comprehensive income)	1,221	584

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. Included in the above total net unrealized gains from fuel hedges as of December 31, 2007, are approximately \$556 million in net unrealized gains that are expected to be realized in earnings during 2008. In addition, as of December 31, 2007, the Company had already recognized gains due to ineffectiveness and derivatives that do not qualify for hedge accounting totaling \$180 million, net of taxes. These gains were recognized in 2007 and prior periods, and are reflected in Retained earnings as of December 31, 2007, but the underlying derivative instruments will not expire/settle until 2008 or future periods.

**Interest Rate Swaps**

During first quarter 2007, the Company executed interest rate swap agreements relating to its \$300 million

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

5.125% senior unsecured notes due 2017 and its \$100 million 7.375% senior unsecured debentures due 2027. Under the agreement related to its \$300 million 5.125% senior unsecured notes due 2017, the average floating rate paid during 2007 was 4.64 percent. Under the agreement related to its \$100 million 7.375% senior unsecured debentures due 2027, the average floating rate paid during 2007 was 6.73 percent.

Prior to 2007, the Company had entered into interest rate swap agreements relating to its \$385 million 6.5% senior unsecured notes due 2012 and its \$350 million 5.25% senior unsecured notes due 2014. Under each of these interest rate swap agreements, the Company pays the London InterBank Offered Rate (LIBOR) plus a margin every six months on the notional amount of the debt, and receives payments based on the fixed stated rate of the notes every six months until the date the notes become due. Under the agreement related to its \$385 million 6.5% senior unsecured notes due 2012, the average floating rate paid during 2007 is estimated to be 7.31 percent based on actual and forward rates at December 31, 2007. Under the agreement related to its \$350 million 5.25% senior unsecured notes due 2014, the average floating rate paid during 2007 was 6.02 percent.

The primary objective for the Company's use of interest rate hedges is to reduce the volatility of net interest income by better matching the repricing of its assets and liabilities. The Company's interest rate swap agreements qualify as fair value hedges, as defined by SFAS 133. The fair values of the interest rate swap agreements, which are adjusted regularly, are recorded in the Consolidated Balance Sheet, 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 December 31, 2007, was an asset of approximately \$16 million and is recorded in "Other deferred liabilities" in the Consolidated Balance Sheet. In accordance with fair value hedging, the offsetting entry is an adjustment to increase the carrying value of long-term debt. See Note 7.

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 its 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 December 31, 2007, the Company had agreements with nine 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 December 31, 2007, the Company held \$2.0 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 and cash flows as of and for a particular operating period, are included in "Accrued liabilities" on the Consolidated Balance Sheet and are included as "Operating cash flows" in the Consolidated Statement of Cash Flows.

The carrying amounts and estimated fair values of the Company's long-term debt and fuel contracts at December 31, 2007 were as follows:

	Carrying Value	Estimated Fair Value (In millions)
French Credit Agreements due 2012	\$ 32	\$ 32
6 <sup>1</sup> / <sub>2</sub> % Notes due 2012	386	402
5 <sup>1</sup> / <sub>4</sub> % Notes due 2014	352	342
5 <sup>3</sup> / <sub>4</sub> % Notes due 2016	300	295
5 <sup>1</sup> / <sub>8</sub> % Notes due 2017	311	291
French Credit Agreements due 2017	94	94
Pass Through Certificates	480	487
7 <sup>3</sup> / <sub>8</sub> % Debentures due 2027	103	105
Fuel contracts	2,387	2,387

The estimated fair values of the Company's publicly held long-term debt were based on quoted market prices. The carrying values of all other financial instruments approximate their fair value.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

11. Comprehensive Income

Comprehensive income includes changes in the fair value of certain financial derivative instruments, which qualify for hedge accounting, unrealized gains and losses on certain investments, and adjustments to recognize the funded status of the Company's postretirement obligations. See Note 14 for further information on Employee retirement plans. Comprehensive income totaled \$1,304 million, \$189 million, and \$959 million for 2007, 2006, and 2005, respectively. The differences between "Net income" and "Comprehensive income" for these years are as follows:

	2007	2006	2005
	(In millions)		
<b>Net income</b>	<b>\$ 645</b>	<b>\$ 499</b>	<b>\$ 484</b>
Unrealized gain (loss) on derivative instruments, net of deferred taxes of \$408, (\$201) and \$300	636	(306)	474
Other, net of deferred taxes of \$14, (\$2) and \$1	23	(4)	1
Total other comprehensive income (loss)	659	(310)	475
<b>Comprehensive income</b>	<b>\$ 1,304</b>	<b>\$ 189</b>	<b>\$ 959</b>

A rollforward of the amounts included in "Accumulated other comprehensive income (loss)", net of taxes for 2007, 2006, and 2005, is shown below:

	Fuel Hedge Derivatives	Other	Accumulated Other Comprehensive Income (Loss)
	(In millions)		
Balance at December 31, 2005	\$ 890	\$ 2	\$ 892
2006 changes in fair value	52	(4)	48
Reclassification to earnings	(358)	—	(358)
Balance at December 31, 2006	584	(2)	582
2007 changes in fair value	1,039	23	1,062
Reclassification to earnings	(403)	—	(403)
<b>Balance at December 31, 2007</b>	<b>\$ 1,220</b>	<b>\$ 21</b>	<b>\$ 1,241</b>

12. Common Stock

The Company has one class of capital stock, its common stock. Holders of shares of common stock are entitled to receive dividends when and if declared by the Board of Directors and are entitled to one vote per share on all matters submitted to a vote of the shareholders. At December 31, 2007, the Company had 82 million shares of common stock reserved for issuance pursuant to Employee stock benefit plans (of which 32 million shares had not been granted.)

In January 2004, the Company's Board of Directors authorized the repurchase of up to \$300 million of the Company's common stock, utilizing proceeds from the exercise of Employee stock options. Repurchases were 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 2005, the Company completed this program. In total, the Company repurchased approximately 21 million of its common shares during the course of the program.

In 2006, the Company's Board of Directors authorized three separate programs for the repurchase of up to a total of \$1.0 billion of the Company's common stock — \$300 million authorized in January 2006, \$300 million authorized in May 2006, and \$400 million authorized in November 2006. Repurchases were made in accordance with applicable securities laws in the open market or in private transactions from time to time, depending on market conditions. These programs, which were completed during first quarter 2007, resulted in the repurchase of a total of approximately 63 million shares.

In 2007, the Company's Board of Directors authorized two separate programs for the repurchase of up to a total of \$800 million of the Company's common stock — \$300 million authorized in March 2007, and \$500 million authorized in May 2007. Repurchases were made in

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

accordance with applicable securities laws in the open market or in private transactions from time to time, depending on market conditions. These programs, which were completed during third quarter 2007, resulted in the repurchase of a total of approximately 53 million shares.

During January 2008, the Company's Board of Directors authorized an additional program for the repurchase of up to \$500 million of the Company's Common Stock. Repurchases will be made in accordance with applicable securities laws in the open market or in private transactions from time to time, depending on market conditions.

**13. Stock Plans**

*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 the Executive Chairman of the Company. 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 eliminated the use of APB 25 and the intrinsic value method of accounting, and requires recognition of 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 were retrospectively adjusted in first quarter 2006 utilizing the pro forma disclosures in those prior financial statements, except as noted. The Consolidated Statement of Income for the years ended December 31, 2007, 2006, and 2005 reflects share-based compensation cost of \$37 million, \$80 million, and \$80 million, respectively. The total tax benefit recognized from share-based compensation arrangements for the years ended December 31, 2007, 2006, and 2005, was \$11 million, \$27 million, and \$25 million, respectively. As a result of the SFAS 123R retroactive application, for the year ended December 31, 2005, net income was reduced by \$55 million, net income per share, basic was reduced by \$.08, and net income per share, diluted was reduced by \$.06.

*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. 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 no less than 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 5 million shares of the Company's Common Stock as of December 31, 2007. The Company also has plans related to past employment agreements with its current Executive Chairman. As of December 31, 2007, there were 556,000 options outstanding under these plans, all of which were fully vested. Although the Company does not have a formal policy, 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 generally 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, Southwest recognizes 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

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 years:

	2007	2006	2005
Weighted-average risk-free interest rate	3.7%	4.6%	4.1%
Expected life of option (years)	4.9	5.0	4.7
Expected stock volatility	25.7%	26.0%	26.2%
Expected dividend yield	0.09%	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 2007 and 2006, 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 2007 and 2006 stock option grants, the Company utilized expected volatility based on the expected life of the option, but within a range of 24 percent to 27 percent. Prior to 2006, the Company relied exclusively on historical volatility as an input for determining the estimated fair value of stock options. 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 .50 percent to 5.37 percent for the year ended December 31, 2007, from 4.26 percent to 5.24 percent for 2006, and from 3.37 percent to 4.47 percent for 2005.

The fair value of options granted under the fixed option plans during the year ended December 31, 2007, ranged from \$0.67 to \$6.33, with a weighted-average fair value of \$4.28. The fair value of options granted under the fixed option plans during 2006 ranged from \$2.48 to \$6.99, with a weighted-average fair value of \$5.47. 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 \$4.49.

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, 2004	120,703	\$ 10.98		
Granted	1,697	14.91		
Exercised	(14,739)	6.13		
Surrendered	(2,417)	13.89		
Outstanding December 31, 2005	105,244	\$ 11.65		
Granted	1,025	16.64		
Exercised	(24,632)	7.91		
Surrendered	(1,427)	14.25		
Outstanding December 31, 2006	80,210	\$ 12.83		
Granted	751	14.89		
Exercised	(14,145)	7.17		
Surrendered	(3,440)	16.11		
Outstanding December 31, 2007	63,376	\$ 13.93	3.8	\$ 2
Vested or expected to vest at December 31, 2007	63,254	\$ 13.93	3.8	\$ 2
Exercisable at December 31, 2007	62,442	\$ 13.92	3.8	\$ 2

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

	Other Employee Plans			
	Options (000)	Wtd. Average Exercise Price	Wtd. Average Remaining Contractual Term	Aggregate Intrinsic Value (Millions)
Outstanding December 31, 2004	34,221	\$ 12.94		
Granted	6,662	15.60		
Exercised	(3,800)	7.09		
Surrendered	(1,263)	15.60		
Outstanding December 31, 2005	35,820	\$ 13.96		
Granted	2,831	17.52		
Exercised	(5,015)	9.57		
Surrendered	(1,442)	15.93		
Outstanding December 31, 2006	32,194	\$ 14.87		
Granted	293	16.35		
Exercised	(2,506)	8.45		
Surrendered	(1,454)	16.49		
Outstanding December 31, 2007	28,527	\$ 15.37	4.9	\$ 8
Vested or expected to vest at December 31, 2007	28,407	\$ 15.36	4.9	\$ 7
Exercisable at December 31, 2007	20,777	\$ 15.29	4.6	\$ 6

The total aggregate intrinsic value of options exercised during the years ended December 31, 2007, 2006, and 2005, was \$137 million, \$262 million, and \$179 million, respectively. The total fair value of shares vesting during the years ended December 31, 2007, 2006, and 2005, was \$64 million, \$112 million, and \$96 million, respectively. As of December 31, 2007, there was \$37 million of total unrecognized compensation cost related to share-based compensation arrangements, which is expected to be recognized over a weighted-average period of 2.25 years. The total recognition period for the remaining unrecognized compensation cost is approximately eight years; however, the majority of this cost will be recognized over the next two years, in accordance with vesting provisions.

**Employee Stock Purchase Plan**

Under the amended 1991 Employee Stock Purchase Plan (ESPP), which has been approved by shareholders, the Company is authorized to issue up to a remaining balance of 6.5 million shares of Common Stock to Employees of the Company. These shares may be issued at a price equal to 90 percent of the market value at the end of each monthly purchase period. Common Stock purchases are paid for through periodic payroll deductions. For the years ended December 31, 2007, 2006, and 2005, participants under the plan purchased 1.3 million shares, 1.2 million shares, and 1.5 million shares at average prices of \$13.30, \$14.86, and \$13.19, respectively. The weighted-average fair value of each purchase right under the ESPP granted for the years ended December 31, 2007, 2006, and 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 \$1.48, \$1.65, and \$1.47, respectively.

**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 grants are made out of one of the Company's plans covering Employees not subject to collective bargaining agreements (other Employee plans). Stock option grants to the Board become exercisable over a period of three 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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

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 granted 750 Performance Shares to each non-Employee Director who has served since the previous Annual Meeting. Effective beginning with the 2007 Annual Meeting, the plan was amended to increase the annual number of Performance Shares to be granted to 1,000. 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 former 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 December 31, 2007, which is not material to the Company, is included in Accrued liabilities in the accompanying 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 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 from year to year is subject to variability.

**14. Employee Retirement Plans**

**Defined Contribution Plans**

The Company has defined contribution plans covering substantially all Southwest Employees. The Southwest Airlines Co. Profit Sharing Plan (Profit Sharing Plan) is a money purchase defined contribution plan and Employee stock purchase plan. However, the Profit Sharing Plan was amended as of January 1, 2008, and is now characterized as simply a Profit Sharing Plan. The Company contributes 15 percent of its eligible pre-tax profits, as defined, to the Profit Sharing Plan on an annual basis. No Employee contributions to the Profit Sharing Plan are allowed.

The Company also sponsors Employee savings plans under section 401(k) of the Internal Revenue Code, which include Company matching contributions. The 401(k) plans cover substantially all Employees. Contributions under all defined contribution plans are primarily based on Employee compensation and performance of the Company.

Company contributions to all retirement plans expensed in 2007, 2006, and 2005 were \$279 million, \$301 million, and \$264 million, respectively.

**Postretirement Benefit Plans**

The Company provides postretirement benefits to qualified retirees in the form of medical and dental coverage. Employees must meet minimum levels of service and age requirements as set forth by the Company, or as specified in collective bargaining agreements with specific workgroups. Employees meeting these requirements, as defined, may use accrued unused sick time to pay for medical and dental premiums from the age of retirement until age 65.

The following table shows the change in the Company's accumulated postretirement benefit obligation (APBO) for the years ended December 31, 2007 and 2006:

	2007	(In millions)	2006
APBO at beginning of period	\$ 111		\$ 94
Service cost	16		15
Interest cost	6		5
Benefits paid	(6)		(5)
Actuarial (gain) loss	(39)		2
Plan amendments	—		—
APBO at end of period	<u>\$ 88</u>		<u>\$ 111</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The assumed healthcare cost trend rates have a significant effect on the amounts reported for the Company's plan. A one-percent change in all healthcare cost trend rates used in measuring the APBO at December 31, 2007, would have the following effects:

	<u>1% Increase</u>	(In millions)	<u>1% Decrease</u>
Increase (decrease) in total service and interest costs	\$ 2		\$(2)
Increase (decrease) in the APBO	\$ 7		\$(6)

The Company's plans are unfunded, and benefits are paid as they become due. For 2007, both benefits paid and Company contributions to the plans were each \$6 million. For 2006, both benefits paid and Company contributions to the plans were each \$5 million. Estimated future benefit payments expected to be paid for each of the next five years are \$6 million in 2008, \$7 million in 2009, \$8 million in 2010, \$9 million in 2011, \$10 million in 2012, and \$80 million for the next five years thereafter.

On December 31, 2006, the Company adopted the recognition and disclosure provisions of SFAS 158. SFAS 158 requires the Company to recognize the funded status (i.e., the difference between the fair value of plan assets and the projected benefit obligations) of its benefit plans in the Consolidated Balance Sheet, with a corresponding adjustment to accumulated other comprehensive income, net of tax. The following table reconciles the funded status of the plan to the Company's accrued postretirement benefit cost recognized in "Other deferred liabilities" on the Company's Consolidated Balance Sheet at December 31, 2007 and 2006.

	<u>2007</u>	(In millions)	<u>2006</u>
Funded status	\$ (88)		\$ (111)
Unrecognized net actuarial (gain) loss	(31)		7
Unrecognized prior service cost	3		4
Accumulated other comprehensive income (loss)	28		(11)
Cost recognized on Consolidated Balance Sheet	<u>\$ (88)</u>		<u>\$ (111)</u>

During 2007, the Company recorded a \$31 million actuarial gain as a decrease to the recognized obligation with the offset to accumulated other comprehensive income. This actuarial gain is included above and resulted from Congress' passage of a law to increase the mandatory retirement age for U.S. commercial airline pilots from 60 to 65, effective immediately. Therefore, since the Company projects that some of its Pilots will now work past age 60, this assumption resulted in a decrease to the Company's projected future postretirement obligation.

The Company's periodic postretirement benefit cost for the years ended December 31, 2007, 2006, and 2005, included the following:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
	(In millions)		
Service cost	\$ 16	\$ 15	\$ 12
Interest cost	6	5	4
Amortization of prior service cost	2	2	2
Recognized actuarial loss	—	(1)	—
Net periodic postretirement benefit cost	<u>\$ 24</u>	<u>\$ 21</u>	<u>\$ 18</u>

Unrecognized prior service cost is expensed using a straight-line amortization of the cost over the average future service of Employees expected to receive benefits under the plan. The Company used the following actuarial assumptions to account for its postretirement benefit plans at December 31:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Wtd-average discount rate	5.75%	5.50%	5.25%
Assumed healthcare cost trend rate(1)	8.00%	8.50%	8.50%

(1) The assumed healthcare cost trend rate is assumed to decline to 7.50% for 2008, then decline gradually to 5% by 2014 and remain level thereafter.

The selection of a discount rate is made annually and is selected by the Company based upon comparison of the expected cash flows associated with the Company's future payments under its postretirement obligations to a hypothetical bond portfolio created using high quality bonds that closely match those expected cash flows. The assumed healthcare trend rate is also reviewed at least annually and is determined based upon both historical experience with the Company's healthcare benefits paid and expectations of how those trends may or may not change in future years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

15. Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The components of deferred tax assets and liabilities at December 31, 2007 and 2006, are as follows:

	2007	2006
	(In millions)	
<b>DEFERRED TAX LIABILITIES:</b>		
Accelerated depreciation	\$ 2,612	\$ 2,405
Fuel hedges	884	363
Other	19	1
Total deferred tax liabilities	<u>3,515</u>	<u>2,769</u>
<b>DEFERRED TAX ASSETS:</b>		
Deferred gains from sale and leaseback of aircraft	65	70
Capital and operating leases	58	65
Accrued employee benefits	187	160
Stock-based compensation	110	122
State taxes	75	55
Business partner income	78	37
Net operating loss carry forward	—	22
Other	37	56
Total deferred tax assets	<u>610</u>	<u>587</u>
Net deferred tax liability	<u>\$ 2,905</u>	<u>\$ 2,182</u>

The provision for income taxes is composed of the following:

	2007	2006	2005
	(In millions)		
<b>CURRENT:</b>			
Federal	\$ 108	\$ 64	\$ 43
State	9	15	7
Total current	<u>117</u>	<u>79</u>	<u>50</u>
<b>DEFERRED:</b>			
Federal	246	220	231
State	50	(8)	14
Total deferred	<u>296</u>	<u>212</u>	<u>245</u>
	<u>\$ 413</u>	<u>\$ 291</u>	<u>\$ 295</u>

For the year 2004, Southwest had a tax net operating loss of \$616 million for federal income tax purposes. The Company carried a portion of this net operating loss back to prior periods, resulting in a \$35 million refund of federal taxes previously paid. This refund was received during 2005. The Company applied a portion of this 2004 net operating loss to the 2005 and 2006 tax years, resulting in the payment of no regular federal income taxes for these years. The remaining portion of the Company's federal net operating loss was utilized during 2007.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The effective tax rate on income before income taxes differed from the federal income tax statutory rate for the following reasons:

	2007	2006 (In millions)	2005
Tax at statutory U.S. tax rates	\$ 370	\$ 276	\$ 274
Non deductible items	6	10	8
State income taxes, net of federal benefit	38	4	14
Other, net	(1)	1	(1)
Total income tax provision	<u>\$ 413</u>	<u>\$ 291</u>	<u>\$ 295</u>

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

The Company's policy for recording interest and penalties associated with audits is to record such items as a component of income before taxes. Penalties are recorded in "Other (gains) losses, net," and interest paid or received is recorded in interest expense or interest income, respectively, in the statement of income. For the year ended December 31, 2007, the Company recorded approximately \$1 million in interest income related to the settlement of audits for certain prior periods.

**16. Net Income Per Share**

The following table sets forth the computation of net income per share, basic and diluted:

	2007	2006	2005
	(In millions, except per share amounts)		
Net income	\$ 645	\$ 499	\$ 484
Weighted-average shares outstanding, basic	757	795	789
Dilutive effect of Employee stock options	11	29	17
Adjusted weighted-average shares outstanding, diluted	768	824	806
Net income per share, basic	<u>\$ .85</u>	<u>\$ .63</u>	<u>\$ .61</u>
Net income per share, diluted	<u>\$ .84</u>	<u>\$ .61</u>	<u>\$ .60</u>

The Company has excluded 49 million, 20 million, and 12 million shares from its calculations of net income per share, diluted, in 2007, 2006, and 2005, respectively, as they represent antidilutive stock options for the respective periods presented.

**17. 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 IRS. The IRS regularly examines the Company's federal

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

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.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

THE BOARD OF DIRECTORS AND SHAREHOLDERS  
SOUTHWEST AIRLINES CO.

We have audited the accompanying consolidated balance sheets of Southwest Airlines Co. as of December 31, 2007 and 2006, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Southwest Airlines Co. at December 31, 2007 and 2006, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Southwest Airlines Co.'s internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated January 31, 2008 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Dallas, Texas  
January 31, 2008

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

THE BOARD OF DIRECTORS AND SHAREHOLDERS  
SOUTHWEST AIRLINES CO.

We have audited Southwest Airlines Co.'s internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Southwest Airlines Co.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying "Management's Annual Report on Internal Control Over Financial Reporting". Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Southwest Airlines Co. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Southwest Airlines Co. as of December 31, 2007 and 2006, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2007 of Southwest Airlines Co. and our report dated January 31, 2008 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Dallas, Texas  
January 31, 2008

**QUARTERLY FINANCIAL DATA**  
(Unaudited)

	Three Months Ended			
	March 31	June 30	Sept. 30	Dec. 31
	(In millions except per share amounts)			
<b>2007</b>				
Operating revenues	\$ 2,198	\$ 2,583	\$ 2,588	\$ 2,492
Operating income	84	328	251	126
Income before income taxes	149	447	277	183
Net income	93	278	162	111
Net income per share, basic	.12	.36	.22	.15
Net income per share, diluted	.12	.36	.22	.15
	March 31	June 30	Sept. 30	Dec. 31
<b>2006</b>				
Operating revenues	\$ 2,019	\$ 2,449	\$ 2,342	\$ 2,276
Operating income	98	402	261	174
Income before income taxes	96	515	78	101
Net income	61	333	48	57
Net income per share, basic	.08	.42	.06	.07
Net income per share, diluted	.07	.40	.06	.07

**Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure**

None.

**Item 9A. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures.* The Company maintains disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act) designed to provide reasonable assurance that the information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms. These include controls and procedures designed to ensure that this information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Management, with the participation of the Chief Executive and Chief Financial Officers, evaluated the effectiveness of the Company's disclosure controls and procedures as of December 31, 2007. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures were effective as of December 31, 2007 at the reasonable assurance level.

*Management's Annual Report on Internal Control over Financial Reporting.* Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act). The Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes of accounting principles generally accepted in the United States.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance of achieving their control objectives.

Management, with the participation of the Chief Executive and Chief Financial Officers, evaluated the effectiveness of the Company's internal control over financial reporting as of December 31, 2007. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control — Integrated Framework. Based on this evaluation, management, with the participation of the Chief Executive and Chief Financial Officers, concluded that, as of December 31, 2007, the Company's internal control over financial reporting was effective.

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Ernst & Young, LLP, the independent registered public accounting firm who audited the Company's consolidated financial statements included in this Form 10-K, has issued a report on the Company's internal control over financial reporting, which is included herein.

*Changes in Internal Control over Financial Reporting.* There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the quarter ended December 31, 2007, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Item 9B. Other Information**

None.

**PART III**

**Item 10. Directors, Executive Officers, and Corporate Governance**

**Directors and Executive Officers**

The information required by this Item 10 regarding the Company's directors will be set forth under the heading "Election of Directors" in the Proxy Statement for the Company's 2008 Annual Meeting of Shareholders and is incorporated herein by reference. The information required by this Item 10 regarding the Company's executive officers is set forth under the heading "Executive Officers of the Registrant" in Part I of this Form 10-K and is incorporated herein by reference.

**Section 16(a) Compliance**

The information required by this Item 10 regarding compliance with Section 16(a) of the Exchange Act will be set forth under the heading "Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy Statement for the Company's 2008 Annual Meeting of Shareholders and is incorporated herein by reference.

**Corporate Governance**

Except as set forth in the following paragraph, the remaining information required by this Item 10 will be set forth under the heading "Corporate Governance" in the Proxy Statement for the Company's 2008 Annual Meeting of Shareholders and is incorporated herein by reference.

The Company has adopted a Code of Ethics that applies to the Company's principal executive officer, principal financial officer, and principal accounting officer or controller. The Company's Code of Ethics, as well as its Corporate Governance Guidelines and the charters of its Audit, Compensation, and Nominating and Corporate Governance Committees, are available on the Company's website, [www.southwest.com](http://www.southwest.com). Copies of these documents are also available upon request to Investor Relations, Southwest Airlines Co., P.O. Box 36611, Dallas, TX 75235. The Company intends to disclose any amendments to or waivers of its Code of Ethics on behalf of the Company's Chief Executive Officer, Chief Financial Officer, Controller, and persons performing similar functions on the Company's website, at [www.southwest.com](http://www.southwest.com), under the "About Southwest" caption, promptly following the date of any such amendment or waiver.

**Item 11. Executive Compensation**

The information required by this Item 11 will be set forth under the heading "Compensation of Executive Officers" in the Proxy Statement for the Company's 2008 Annual Meeting of Shareholders and is incorporated herein by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

Except as set forth below regarding securities authorized for issuance under equity compensation plans, the information required by this Item 12 will be set forth under the heading "Voting Securities and Principal Shareholders" in the Proxy Statement for the Company's 2008 Annual Meeting of Shareholders and is incorporated herein by reference.

**Securities Authorized for Issuance under Equity Compensation Plans**

The following table provides information as of December 31, 2007, regarding compensation plans (including individual compensation arrangements) under which equity securities of Southwest are authorized for issuance.

Plan Category	Equity Compensation Plan Information		
	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants, and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants, and Rights*	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
	(a)	(b)	(c)
	(In thousands)		(In thousands)
Equity Compensation Plans Approved by Security Holders	23,941	\$ 12.76	5,707
Equity Compensation Plans not Approved by Security Holders	68,517	\$ 15.16	20,011
Total	92,459	\$ 14.54	25,718

\* As adjusted for stock splits.

See Note 13 to the Consolidated Financial Statements for information regarding the material features of the above plans. Each of the above plans provides that the number of shares with respect to which options may be granted, and the number of shares of common stock subject to an outstanding option, shall be proportionately adjusted in the event of a subdivision or consolidation of shares or the payment of a stock dividend on common stock, and the purchase price per share of outstanding options shall be proportionately revised.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

The information required by this Item 13 will be set forth under the heading "Certain Relationships and Related Transactions, and Director Independence" in the Proxy Statement for the Company's 2008 Annual Meeting of Shareholders and is incorporated herein by reference.

**Item 14. Principal Accounting Fees and Services**

The information required by this Item 14 will be set forth under the heading "Relationship with Independent Auditors" in the Proxy Statement for the Company's 2008 Annual Meeting of Shareholders and is incorporated herein by reference.

PART IV

Item 15. *Exhibits and Financial Statement Schedules*

(a) 1. *Financial Statements:*

The financial statements included in Item 8. Financial Statements and Supplementary Data above are filed as part of this annual report.

2. *Financial Statement Schedules:*

There are no financial statement schedules filed as part of this annual report, since the required information is included in the consolidated financial statements, including the notes thereto, or the circumstances requiring inclusion of such schedules are not present.

3. *Exhibits:*

- 3.1 Restated Articles of Incorporation of Southwest (incorporated by reference to Exhibit 4.1 to Southwest's Registration Statement on Form S-3 (File No. 33-52155)); Amendment to Restated Articles of Incorporation of Southwest (incorporated by reference to Exhibit 3.1 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 1996 (File No. 1-7259)); Amendment to Restated Articles of Incorporation of Southwest (incorporated by reference to Exhibit 3.1 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 1998 (File No. 1-7259)); Amendment to Restated Articles of Incorporation of Southwest (incorporated by reference to Exhibit 4.2 to Southwest's Registration Statement on Form S-8 (File No. 333-82735); Amendment to Restated Articles of Incorporation of Southwest (incorporated by reference to Exhibit 3.1 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2001 (File No. 1-7259)); Articles of Amendment to Articles of Incorporation of Southwest (incorporated by reference to Exhibit 3.1 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2007 (File No. 1-7279)).
- 3.2 Amended and Restated Bylaws of Southwest, effective September 20, 2007 (incorporated by reference to Exhibit 3.1 to Southwest's Current Report on Form 8-K dated September 20, 2007).
- 4.1 \$600,000,000 Competitive Advance and Revolving Credit Facility Agreement dated as of April 20, 2004 (incorporated by reference to Exhibit 10.1 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2004 (File No. 1-7259)); First Amendment, dated as of August 9, 2005, to Competitive Advance Revolving Credit Agreement (incorporated by reference to Exhibit 10.1 to Southwest's Current Report on Form 8-K dated August 12, 2005 (File No. 1-7259)).
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- 4.5 Indenture dated as of February 25, 1997, between the Company and U.S. Trust Company of Texas, N.A. (incorporated by reference to Exhibit 4.2 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1996 (File No. 1-7259)).

Southwest is not filing any other instruments evidencing any indebtedness because the total amount of securities authorized under any single such instrument does not exceed 10 percent of its total consolidated assets. Copies of such instruments will be furnished to the Securities and Exchange Commission upon request.

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- 10.1 Purchase Agreement No. 1810, dated January 19, 1994, between The Boeing Company and Southwest (incorporated by reference to Exhibit 10.4 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1993 (File No. 1-7259)); Supplemental Agreement No. 1. (incorporated by reference to Exhibit 10.3 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1996 (File No. 1-7259)); Supplemental Agreements Nos. 2, 3 and 4 (incorporated by reference to Exhibit 10.2 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1997 (File No. 1-7259)); Supplemental Agreements Nos. 5, 6, and 7; (incorporated by reference to Exhibit 10.1 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1998 (File No. 1-7259)); Supplemental Agreements Nos. 8, 9, and 10 (incorporated by reference to Exhibit 10.1 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1999 (File No. 1-7259)); Supplemental Agreements Nos. 11, 12, 13 and 14 (incorporated by reference to Exhibit 10.1 to Southwest's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000 (File No. 1-7259)); Supplemental Agreements Nos. 15, 16, 17, 18 and 19 (incorporated by reference to Exhibit 10.1 to Southwest's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001 (File No. 1-7259)); Supplemental Agreements Nos. 20, 21, 22, 23 and 24 (incorporated by reference to Exhibit 10.3 to Southwest's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002 (File No. 1-7259)); Supplemental Agreements Nos. 25, 26, 27, 28 and 29 to Purchase Agreement No. 1810, dated January 19, 1994, between The Boeing Company and Southwest (incorporated by reference to Exhibit 10.8 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003 (File No. 1-7259)); Supplemental Agreements Nos. 30, 31, 32, and 33 to Purchase Agreement No. 1810, dated January 19, 1993 between The Boeing Company and Southwest; (incorporated by reference to Exhibit 10.1 to Southwest's Annual Report on Form 10-K for the year ended December 31, 2003 (File No. 1-7259)); Supplemental Agreements Nos. 34, 35, 36, 37, and 38 (incorporated by reference to Exhibit 10.3 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2004 (File No. 1-7259)); Supplemental Agreements Nos. 39 and 40 (incorporated by reference to Exhibit 10.6 to Southwest's Quarterly Report on Form 10-Q for the quarter ended September 30, 2004 (File No. 1-7259)); Supplemental Agreement No. 41; Supplemental Agreement Nos. 42, 43 and 44 (incorporated by reference to Exhibit 10.1 to Southwest's Quarterly Report on Form 10-Q for the quarter ended March 31, 2005 (File No. 1-7259)); Supplemental Agreement No. 45 (incorporated by reference to Exhibit 10.1 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2005 (File No. 1-7259)); Supplemental Agreement Nos. 46 and 47 (incorporated by reference to Exhibit 10.1 to Southwest's Quarterly Report on Form 10-Q for the quarter ended March 31, 2005 (File No. 1-7259)); Supplemental Agreement No. 48 (incorporated by reference to Exhibit 10.1 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006 (File No. 1-7259)); Supplemental Agreements Nos. 49 and 50 (incorporated by reference to Exhibit 10.1 to Southwest's Quarterly Report on Form 10-Q for the quarter ended September 30, 2006 (File No. 1-7259)); Supplemental Agreement No. 51 (incorporated by reference to Exhibit 10.1 to Southwest's Annual Report on Form 10-K for the year ended December 31, 2006 (File No. 1-7259)); Supplemental Agreement No. 52 (incorporated by reference to Exhibit 10.1 to Southwest's Quarterly Report on Form 10-Q for the quarter ended March 31, 2007 (File No. 1-7259)); Supplemental Agreement No. 53 (incorporated by reference to Exhibit 10.1 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2007 (File No. 1-7259)); Supplemental Agreement Nos. 54 and 55 (incorporated by reference to Exhibits 10.1 and 10.2, respectively, to Southwest's Quarterly Report on Form 10-Q for the quarter ended September 30, 2007 (File No. 1-7259)); Supplemental Agreement No. 56.
- 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.
- The following exhibits filed under paragraph 10 of Item 601 are the Company's compensation plans and arrangements.
- 10.2 Form of Executive Employment Agreement between Southwest and certain key employees pursuant to Executive Service Recognition Plan (incorporated by reference to Exhibit 28 to Southwest Quarterly Report on Form 10-Q for the quarter ended June 30, 1987 (File No. 1-7259)).
- 10.3 2001 stock option agreements between Southwest and Herbert D. Kelleher (incorporated by reference to Exhibit 10 to Southwest's Quarterly Report on Form 10-Q for the quarter ended March 31, 2001 (File No. 1-7259)).
- 10.4 1991 Incentive Stock Option Plan (incorporated by reference to Exhibit 10.6 to Southwest's Annual Report on Form 10-K for the year ended December 31, 2002 (File No. 1-7259)).
- 10.5 1991 Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 10.7 to Southwest's Annual Report on Form 10-K for the year ended December 31, 2002 (File No. 1-7259)).

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10.6	1991 Employee Stock Purchase Plan as amended March 16, 2006 (incorporated by reference to Exhibit 99.1 to Registration Statement on Form S-8 (File No. 333-139362)).
10.7	Southwest Airlines Co. Profit Sharing Plan.
10.8	Southwest Airlines Co. 401(k) Plan.
10.9	Southwest Airlines Co. 1995 SWAPA Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 10.14 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1994 (File No. 1-7259)).
10.10	1996 Incentive Stock Option Plan (incorporated by reference to Exhibit 10.12 to Southwest's Annual Report on Form 10-K for the year ended December 31, 2002 (File No. 1-7259)).
10.11	1996 Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 10.13 to Southwest's Annual Report on Form 10-K for the year ended December 31, 2002 (File No. 1-7259)).
10.12	Employment Contract dated as of July 15, 2007, between Southwest and Herbert D. Kelleher (incorporated by reference to Exhibit 10.3 to Southwest's Quarterly Report on Form 10-Q for the quarter ended September 30, 2007 (File No. 1-7259)).
10.13	Employment Contract dated as of July 15, 2007, between Southwest and Gary C. Kelly (incorporated by reference to Exhibit 10.4 to Southwest's Quarterly Report on Form 10-Q for the quarter ended September 30, 2007 (File No. 1-7259)).
10.14	Employment Contract dated as of July 15, 2007, between Southwest and Colleen C. Barrett (incorporated by reference to Exhibit 10.5 to Southwest's Quarterly Report on Form 10-Q for the quarter ended September 30, 2007 (File No. 1-7259)).
10.15	Southwest Airlines Co. Severance Plan for Directors.
10.16	Southwest Airlines Co. Outside Director Incentive Plan (incorporated by reference to Exhibit 10.2 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2007 (as amended and restated effective May 16, 2007) (File No. 1-7259)).
10.17	1998 SAEA Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 10.17 to Southwest's Annual Report on Form 10-K for the year ended December 31, 2002 (File No. 1-7259)).
10.18	1999 SWAPIA Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 10.18 to Southwest's Annual Report on Form 10-K for the year ended December 31, 2002 (File No. 1-7259)).
10.19	LUV 2000 Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-8 (File No. 333-53610)).
10.20	2000 Aircraft Appearance Technicians Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-8 (File No. 333-52388)); Amendment No. 1 to 2000 Aircraft Appearance Technicians Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 10.4 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003 (File No. 1-7259)).
10.21	2000 Stock Clerks Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-8 (File No. 333-52390)); Amendment No. 1 to 2000 Stock Clerks Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 10.5 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003 (File No. 1-7259)).
10.22	2000 Flight Simulator Technicians Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-8 (File No. 333-53616)); Amendment No. 1 to 2000 Flight Simulator Technicians Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 10.6 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003 (File No. 1-7259)).
10.23	2002 SWAPA Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-8 (File No. 333-98761)).
10.24	2002 Bonus SWAPA Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-8 (File No. 333-98761)).
10.25	2002 SWAPIA Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 4.2 to Registration Statement on Form S-8 (File No. 333-100862)).
10.26	2002 Mechanics Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 4.2 to Registration Statement on Form S-8 (File No. 333-100862)).

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10.27	2002 Ramp, Operations, Provisioning and Freight Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 10.27 to Southwest's Annual Report on Form 10-K for the year ended December 31, 2002 (File No. 1-7259)).
10.28	2002 Customer Service/Reservations Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 10.28 to Southwest's Annual Report on Form 10-K for the year ended December 31, 2002 (File No. 1-7259)); Amendment No. 1 to 2002 Customer Service/Reservations Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 4.3 to Registration Statement on Form S-8 (File No. 333-104245)).
10.29	2003 Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 10.3 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003 (File No. 1-7259)).
10.30	Southwest Airlines Co. 2007 Equity Incentive Plan (incorporated by reference to Exhibit 99.1 to Southwest's Current Report on Form 8-K dated May 16, 2007 (File No. 1-7259)).
10.31	2007 Equity Incentive Plan Form of Notice of Grant and Terms and Conditions for Stock Option Grants.
10.32	Southwest Airlines Co. 2005 Excess Benefit Plan (incorporated by reference to Exhibit 99.1 to Southwest's Current Report on Form 8-K dated November 15, 2007 (File No. 1-7259)).
14	Code of Ethics (incorporated by reference to Exhibit 14.1 to Southwest's Current Report on Form 8-K dated November 16, 2006 (File No. 1-7259)).
21	Subsidiaries of Southwest (incorporated by reference to Exhibit 22 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1997 (File No. 1-7259)).
23	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.
31.1	Rule 13a-14(a) Certification of Chief Executive Officer.
31.2	Rule 13a-14(a) Certification of Chief Financial Officer.
32	Section 1350 Certification of Chief Executive Officer and Chief Financial Officer.

A copy of each exhibit may be obtained at a price of 15 cents per page, \$10.00 minimum order, by writing to: Investor Relations, Southwest Airlines Co., P.O. Box 36611, Dallas, Texas 75235-1611.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.

February 1, 2008

By: \_\_\_\_\_ /s/ LAURA WRIGHT  
Laura Wright  
Senior Vice President — Finance,  
Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on February 1, 2008 on behalf of the registrant and in the capacities indicated.

<u>Signature</u>	<u>Capacity</u>
/s/ HERBERT D. KELLEHER _____ Herbert D. Kelleher	Executive Chairman of the Board of Directors
/s/ GARY C. KELLY _____ Gary C. Kelly	Chief Executive Officer and Director
/s/ COLLEEN C. BARRETT _____ Colleen C. Barrett	President and Director
/s/ LAURA WRIGHT _____ Laura Wright	Sr. Vice President — Finance and Chief Financial Officer (Chief Financial and Accounting Officer)
/s/ DAVID W. BIEGLER _____ David W. Biegler	Director
/s/ LOUIS CALDERA _____ Louis Caldera	Director
/s/ C. WEBB CROCKETT _____ C. Webb Crockett	Director
/s/ WILLIAM H. CUNNINGHAM _____ William H. Cunningham	Director
/s/ TRAVIS C. JOHNSON _____ Travis C. Johnson	Director
/s/ NANCY LOEFFLER _____ Nancy Loeffler	Director
/s/ JOHN T. MONTFORD _____ John T. Montford	Director

**INDEX TO THE EXHIBITS**

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10.11	1996 Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 10.13 to Southwest's Annual Report on Form 10-K for the year ended December 31, 2002 (File No. 1-7259)).
10.12	Employment Contract dated as of July 15, 2007, between Southwest and Herbert D. Kelleher (incorporated by reference to Exhibit 10.3 to Southwest's Quarterly Report on Form 10-Q for the quarter ended September 30, 2007 (File No. 1-7259)).
10.13	Employment Contract dated as of July 15, 2007, between Southwest and Gary C. Kelly (incorporated by reference to Exhibit 10.4 to Southwest's Quarterly Report on Form 10-Q for the quarter ended September 30, 2007 (File No. 1-7259)).
10.14	Employment Contract dated as of July 15, 2007, between Southwest and Colleen C. Barrett (incorporated by reference to Exhibit 10.5 to Southwest's Quarterly Report on Form 10-Q for the quarter ended September 30, 2007 (File No. 1-7259)).
10.15	Southwest Airlines Co. Severance Plan for Directors.
10.16	Southwest Airlines Co. Outside Director Incentive Plan (incorporated by reference to Exhibit 10.2 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2007 (as amended and restated effective May 16, 2007) (File No. 1-7259)).
10.17	1998 SAEA Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 10.17 to Southwest's Annual Report on Form 10-K for the year ended December 31, 2002 (File No. 1-7259)).
10.18	1999 SWAPIA Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 10.18 to Southwest's Annual Report on Form 10-K for the year ended December 31, 2002 (File No. 1-7259)).
10.19	LUV 2000 Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-8 (File No. 333-53610)).
10.20	2000 Aircraft Appearance Technicians Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-8 (File No. 333-52388)); Amendment No. 1 to 2000 Aircraft Appearance Technicians Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 10.4 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003 (File No. 1-7259)).
10.21	2000 Stock Clerks Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-8 (File No. 333-52390)); Amendment No. 1 to 2000 Stock Clerks Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 10.5 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003 (File No. 1-7259)).
10.22	2000 Flight Simulator Technicians Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-8 (File No. 333-53616)); Amendment No. 1 to 2000 Flight Simulator Technicians Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 10.6 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003 (File No. 1-7259)).
10.23	2002 SWAPA Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-8 (File No. 333-98761)).
10.24	2002 Bonus SWAPA Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-8 (File No. 333-98761)).
10.25	2002 SWAPIA Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 4.2 to Registration Statement on Form S-8 (File No. 333-100862)).
10.26	2002 Mechanics Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 4.2 to Registration Statement on Form S-8 (File No. 333-100862)).

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10.27	2002 Ramp, Operations, Provisioning and Freight Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 10.27 to Southwest's Annual Report on Form 10-K for the year ended December 31, 2002 (File No. 1-7259)).
10.28	2002 Customer Service/Reservations Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 10.28 to Southwest's Annual Report on Form 10-K for the year ended December 31, 2002 (File No. 1-7259)); Amendment No. 1 to 2002 Customer Service/Reservations Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 4.3 to Registration Statement on Form S-8 (File No. 333-104245)).
10.29	2003 Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 10.3 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003 (File No. 1-7259)).
10.30	Southwest Airlines Co. 2007 Equity Incentive Plan (incorporated by reference to Exhibit 99.1 to Southwest's Current Report on Form 8-K dated May 16, 2007 (File No. 1-7259)).
10.31	2007 Equity Incentive Plan Form of Notice of Grant and Terms and Conditions for Stock Option Grants.
10.32	Southwest Airlines Co. 2005 Excess Benefit Plan (incorporated by reference to Exhibit 99.1 to Southwest's Current Report on Form 8-K dated November 15, 2007 (File No. 1-7259)).
14	Code of Ethics (incorporated by reference to Exhibit 14.1 to Southwest's Current Report on Form 8-K dated November 16, 2006 (File No. 1-7259)).
21	Subsidiaries of Southwest (incorporated by reference to Exhibit 22 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1997 (File No. 1-7259)).
23	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.
31.1	Rule 13a-14(a) Certification of Chief Executive Officer.
31.2	Rule 13a-14(a) Certification of Chief Financial Officer.
32	Section 1350 Certification of Chief Executive Officer and Chief Financial Officer.

A copy of each exhibit may be obtained at a price of 15 cents per page, \$10.00 minimum order, by writing to: Investor Relations, Southwest Airlines Co., P.O. Box 36611, Dallas, Texas 75235-1611.

Supplemental Agreement No. 56

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 December 19, 2007, by and between THE BOEING COMPANY, a Delaware corporation with principal offices in Seattle, Washington, (Boeing) and SOUTHWEST AIRLINES CO., a Texas corporation with principal offices in Dallas, Texas (Buyer);

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

WHEREAS, Buyer has agreed to exercise two (2) April 2009 Option Aircraft as Block T-W-2 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-56-1

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3. Table 2 is deleted in its entirety and replaced by a new Table 2 which is attached hereto and is incorporated into the Agreement by this reference.

4. All references in the Letter Agreements associated with Purchase Agreement No. 1810 shall be deemed to refer to the purchase by Buyer of four hundred two (402) Model 737-7H4 Aircraft, eighty-four (84) 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.

5. The Advance Payment due upon signing assuming execution of this Supplemental Agreement on or before December 31, 2007 is:

\*\*\*for two (2) April 2009 Block T-W-2 Aircraft

Buyer will pay the \*\*\* directly to Boeing on or before December 31, 2007.

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  
Its: Attorney-In-Fact

By: /s/ Laura Wright  
Its: SVP Finance & CFO

P.A. No. 1810  
K/SWA

SA-56-2

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

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

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

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

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

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

**Firm Aircraft contracted to deliver in July 2008 forward at the signing of SA47 —**

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

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

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

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

<u>Delivery Date</u>	<u>Number of Aircraft</u>	<u>Aircraft Block</u>	<u>Escalation Estimate Adv Payment Base Price Per A/P</u>	<u>Serial Number</u>
Sep-2004	1	K-W	***	
Oct-2004	4	K-W	***	
Oct-1999	1	L	***	
Nov-1999	2	L	***	
Dec-1999	1	L	***	
Jun-2000	3	L	***	
Jul-2000	3	L	***	
Sep-2000	1	L	***	
Oct-2000	1	L	***	
Nov-2000	4	L	***	
Dec-2000	1	L	***	
Jan-2001	1	L	***	
Feb-2001	1	L	***	
Jul-2001	1	L	***	
Sep-2001	1	L	***	
Oct-2001	1	L	***	
Mar-2003	2	L	***	
Jul-2003	1	L	***	
Aug-2003	2	L	***	
Nov-2001	1	T	***	
Feb-2002	1	T	***	
Jan-2004	2	T	***	
Feb-2004	1	T	***	
Apr-2004	3	T	***	
May-2004	1	T	***	
Jun-2004	6	T	***	
Jul-2004	2	T	***	
Aug-2004	6	T-W	***	
Sep-2004	4	T-W	***	
Oct-2004	0	T-W	***	
Nov-2004	3	T-W	***	
Dec-2004	3	T-W	***	
Jan-2005	5	T-W	***	
Feb-2005	3	T-W	***	
Mar-2005	4	T-W	***	
Apr-2005	4	T-W	***	
May-2005	2	T-W	***	
Jun-2005	4	T-W	***	
Jul-2005	2	T-W	***	
Aug-2005	2	T-W	***	
Sep-2005	3	T-W	***	
Oct-2005	2	T-W	***	
Nov-2005	2	T-W	***	
Dec-2005	1	T-W	***	
Jan-2006	1	T-W	***	
Feb-2006	4	T-W	***	
Mar-2006	3	T-W	***	

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

<u>Delivery Date</u>	<u>Number of Aircraft</u>	<u>Aircraft Block</u>	<u>Escalation Estimate Adv Payment Base Price Per A/P</u>	<u>Serial Number</u>
Apr-2006	2	T-W	***	
May-2006	5	T-W-1	***	
Jun-2006	5	T-W-1	***	
Jul-2006	3	T-W-1	***	
Aug-2006	3	T-W-1	***	
Sep-2006	3	T-W-1	***	
Oct-2006	1	T-W-1	***	
Nov-2006	2	T-W-1	***	
Dec-2006	2	T-W-1	***	
Jan-2007	2	T-W-1	***	
Feb-2007	3	T-W-1	***	
Mar-2007	2	T-W-1	***	
Apr-2007	3	T-W-1	***	
May-2007	3	T-W-1	***	
Jun-2007	2	T-W-1	***	
Jun-2007	1	T-W-1a	***	36528
Jul-2007	2	T-W-1	***	
Jul-2007	1	T-W-1a	***	36610
Aug-2007	2	T-W-1	***	
Aug-2007	3	T-W-1a	***	36611, 36632 & 36633
Sep-2007	2	T-W-1	***	
Sep-2007	1	T-W-1a	***	36612
Oct-2007	3	T-W-1	***	
Oct-2007	1	T-W-1a	***	36613
Nov-2007	1	T-W-1	***	
Nov-2007	1	T-W-1a	***	36614
Dec-2007	2	T-W-1	***	
Dec-2007	1	T-W-1a	***	36615
Jan-2008	1	T-W-1	***	
Jan-2008	2	T-W-1a	***	36616 & 36617
Jan-2008	1	T-W-2	***	36887
Feb-2008	1	T-W-1	***	
Feb-2008	3	T-W-1a	***	36618, 36619 & 36620
Mar-2008	1	T-W-1	***	
Mar-2008	2	T-W-1a	***	36621 & 36622
Mar-2008	1	T-W-2	***	36888
Apr-2008	1	T-W-1	***	
Apr-2008	2	T-W-1a	***	36623 & 36624
May-2008	1	T-W-1	***	
May-2008	2	T-W-1a	***	36625 & 36626
Jun-2008	1	T-W-1	***	
Jun-2008	2	T-W-1a	***	36627 & 36628
Jul-2008	2	T-W-2a	***	
Jul-2008	2	T-W-2	***	36889 & 36890
Aug-2008	1	T-W-2a	***	
Oct-2008	1	T-W-2a	***	

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

<u>Delivery Date</u>	<u>Number of Aircraft</u>	<u>Aircraft Block</u>	<u>Escalation Estimate Adv Payment Base Price Per A/P</u>	<u>Serial Number</u>
Nov-2008	1	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	***	
<b>Apr-2009</b>	<b>2</b>	<b>T-W-2a</b>	<b>***</b>	<b>36899 &amp; 36900</b>
May-2009	2	T-W-2a	***	
Jun-2009	2	T-W-2a	***	
Jul-2009	2	T-W-2a	***	
Aug-2009	1	T-W-2a	***	
Sep-2009	1	T-W-2a	***	
Oct-2009	1	T-W-2a	***	
Nov-2009	1	T-W-2a	***	
Dec-2009	1	T-W-2a	***	
Jan-2010	1	T-W-2a	***	
Feb-2010	1	T-W-2a	***	
Mar-2010	1	T-W-2a	***	
Apr-2010	1	T-W-2a	***	
May-2010	1	T-W-2a	***	
Jun-2010	1	T-W-2a	***	
Jul-2010	1	T-W-2a	***	
Aug-2010	1	T-W-2a	***	
Sep-2010	1	T-W-2a	***	
Oct-2010	1	T-W-2a	***	
Jan-2011	1	T-W-2a	***	
Feb-2011	1	T-W-2a	***	
Mar-2011	1	T-W-2a	***	
Apr-2011	1	T-W-2a	***	
May-2011	1	T-W-2a	***	
Jun-2011	1	T-W-2a	***	
Jul-2011	1	T-W-2a	***	
Aug-2011	1	T-W-2a	***	
Sep-2011	1	T-W-2a	***	
Oct-2011	1	T-W-2a	***	
Jan-2012	1	T-W-2a	***	
Feb-2012	1	T-W-2a	***	
Mar-2012	1	T-W-2a	***	
Apr-2012	1	T-W-2a	***	
May-2012	1	T-W-2a	***	
Jun-2012	1	T-W-2a	***	
Jul-2012	1	T-W-2a	***	
Aug-2012	1	T-W-2a	***	
Sep-2012	1	T-W-2a	***	
Oct-2012	1	T-W-2a	***	
Jan-2013	1	T-W-2	***	36891

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

<b>Delivery Date</b>	<b>Number of Aircraft</b>	<b>Aircraft Block</b>	<b>Escalation Estimate Adv Payment Base Price Per A/P</b>	<b>Serial Number</b>
Jan-2013	1	T-W-2a	***	
Feb-2013	1	T-W-2a	***	
Mar-2013	1	T-W-2a	***	
Mar-2013	1	T-W-2	***	
Apr-2013	1	T-W-2	***	
May-2013	1	T-W-2	***	
Jun-2013	2	T-W-2	***	
Jul-2013	1	T-W-2	***	
Aug-2013	2	T-W-2	***	
Sep-2013	2	T-W-2	***	
Oct-2013	2	T-W-2	***	
Nov-2013	1	T-W-2	***	
Dec-2013	2	T-W-2	***	
Jan-2014	1	T-W-2	***	
Feb-2014	1	T-W-2	***	
Mar-2014	1	T-W-2	***	
Apr-2014	1	T-W-2	***	
May-2014	1	T-W-2	***	
Jun-2014	1	T-W-2	***	
Jul-2014	1	T-W-2	***	
Aug-2014	1	T-W-2	***	
Sep-2014	1	T-W-2	***	
Oct-2014	1	T-W-2	***	

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

*Price Description of Option Aircraft:*

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

*Delivery of Purchase Right Aircraft:*

**Quantity 54**

*Delivery Period of Purchase Right Aircraft:*

**Complete delivery not later than Dec. 31, 2014**

*Condition of Offer for Purchase Right Aircraft:*

**Subject to Available Position**

**Remaining Option Aircraft:**

**84**

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

<b>Aircraft Delivery Mo. &amp; Yr.</b>	<b>Number of Option Aircraft</b>	<b>Option Aircraft Block</b>	<b>Adv Payment Base Price Per Option Aircraft</b>	<b>Option Exercise</b>
May-2009	1	U-W-1	***	January 1, 2008
Jun-2009	1	U-W-1	***	February 1, 2008
Jul-2009	2	U-W-1	***	March 3, 2008
Aug-2009	1	U-W-1	***	April 1, 2008
Oct-2009	1	U-W-1	***	June 2, 2008
Nov-2009	1	U-W-1	***	July 1, 2008
Dec-2009	1	U-W-1	***	August 1, 2008
Jan-2010	1	U-W-1	***	September 1, 2008
Feb-2010	1	U-W-1	***	October 1, 2008
Mar-2010	1	U-W-1	***	November 3, 2008
Apr-2010	1	U-W-1	***	December 1, 2008
May-2010	2	U-W-1	***	January 1, 2009
Jun-2010	3	U-W-1	***	February 2, 2009
Jul-2010	2	U-W-1	***	March 2, 2009
Aug-2010	2	U-W-1	***	April 1, 2009
Sep-2010	2	U-W-1	***	May 1, 2009
Oct-2010	3	U-W-1	***	June 1, 2009
Nov-2010	3	U-W-1	***	July 1, 2009
Dec-2010	3	U-W-1	***	August 3, 2009
Jan-2011	1	U-W-1	***	September 1, 2009
Feb-2011	2	U-W-1	***	October 1, 2009
Mar-2011	1	U-W-1	***	November 2, 2009
Apr-2011	1	U-W-1	***	December 1, 2009
May-2011	2	U-W-1	***	January 1, 2010
Jun-2011	2	U-W-1	***	February 1, 2010
Jul-2011	2	U-W-1	***	March 1, 2010
Aug-2011	2	U-W-1	***	April 1, 2010
Sep-2011	2	U-W-1	***	May 3, 2010
Oct-2011	2	U-W-1	***	June 1, 2010
Nov-2011	3	U-W-1	***	July 1, 2010
Dec-2011	2	U-W-1	***	August 2, 2010
Jan-2012	3	U-W-1	***	September 1, 2010
Feb-2012	3	U-W-1	***	October 1, 2010
Mar-2012	2	U-W-1	***	November 1, 2010
Apr-2012	3	U-W-1	***	December 1, 2010
May-2012	3	U-W-1	***	January 3, 2011
Jun-2012	3	U-W-1	***	February 1, 2011
Jul-2012	2	U-W-1	***	March 1, 2011
Aug-2012	2	U-W-1	***	April 1, 2011
Sep-2012	2	U-W-1	***	May 2, 2011
Oct-2012	2	U-W-1	***	June 1, 2011
Nov-2012	3	U-W-1	***	July 1, 2011
Dec-2012	2	U-W-1	***	August 1, 2011
Total	84			

SOUTHWEST AIRLINES CO.  
PROFITSHARING PLAN

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**SOUTHWEST AIRLINES CO.  
PROFITSHARING PLAN**

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SOUTHWEST AIRLINES CO.  
PROFITSHARING PLAN

**PREAMBLE**

WHEREAS, SOUTHWEST AIRLINES CO., a corporation formed under the laws of the State of Texas (the "Company") has previously adopted a plan and trust designated as the Southwest Airlines Co. ProfitSharing Plan (the "Prior Plan"), effective January 1, 1973, which was subsequently amended and restated in its entirety, effective January 1, 1986, again amended and restated in its entirety, effective January 1, 1991, and again amended and restated in its entirety, effective January 1, 1996, as amended from time to time thereafter;

WHEREAS, the Company now desires to continue the plan by again amending and restating the Prior Plan to implement certain provisions of, and for compliance with, the Pension Protection Act of 2006, to incorporate amendments that have previously been made to the plan, to change the designation of the plan from an employee stock ownership plan and a money purchase defined contribution plan to a profit sharing plan, and to reflect certain other operational and administrative practices;

NOW, THEREFORE, in consideration of the premises and to carry out the purposes and intent as set forth above, the Prior Plan is hereby restated and amended in its entirety, superseded and replaced by this plan (hereinafter referred to as the "Plan"), effective January 1, 2008, except as otherwise specifically provided herein. There will be no gap or lapse in time or effect between such plans, and the existence of a qualified plan and trust shall be continuous and uninterrupted.

The terms and conditions of this restated Plan are as follows:

**ARTICLE I  
PURPOSE**

The purpose of this Plan is to reward Employees of the Company for their loyal and faithful service, to provide the Employees with a retirement benefit, and to provide funds for their beneficiaries in the event of death or disability. The benefits provided by this Plan will be paid from a Trust Fund established by the Company and will be in addition to the benefits Employees are entitled to receive under any other programs of the Company and under the Social Security Act.

This Plan and the separate related Trust forming a part hereof are established and shall be maintained for the exclusive benefit of the Members hereunder and their Beneficiaries. No part of the Trust Fund can ever revert to the Company, except as hereinafter provided, or be used for or diverted to purposes other than the exclusive benefit of the Members of this Plan and their Beneficiaries.

**ARTICLE II**  
**DEFINITIONS AND CONSTRUCTION**

2.1 Definitions. Where the following words and phrases appear in this Plan, they shall have the respective meanings set forth below, unless their context clearly indicates to the contrary:

(a) Affiliate. A member of a controlled group of corporations (as defined in Section 414(b) of the Code), a group of trades or businesses (whether or not incorporated) which are under common control (as defined in Section 414(c) of the Code), or an affiliated service group (as defined in Section 414(m) of the Code) of which the Company is a member, or any entity otherwise required to be aggregated with the Company pursuant to Section 414(o) of the Code and the regulations issued thereunder.

(b) Allocation Date. The date on which Company Contributions and forfeitures are to be allocated, such date to be the last day of each Plan Year.

(c) Annual Compensation. The total amounts paid by the Company or any Eligible Affiliate to an Employee as remuneration for personal services rendered during each Plan Year, including expense allowances (to the extent includible in the gross income of the Employee) and any amounts not includible in the gross income of the Employee pursuant to Sections 402(e)(3), 125(a), or 132(f)(4) of the Code, but excluding (1) director's fees; (2) expense reimbursements and nontaxable expense allowances; (3) prizes and awards; (4) expatriate bonuses; (5) items of imputed income; (6) contributions made by the Company under this Plan or any other employee benefit plan or program it maintains, such as group insurance, hospitalization or like benefits; (7) amounts realized or recognized from qualified or nonqualified stock options or when restricted stock or property held by the Employee either becomes freely transferable or is no longer subject to a substantial risk of forfeiture; (8) Company contributions to a plan of deferred compensation that are not included in the Employee's gross income for the taxable year in which contributed, or any distributions from a deferred compensation plan; (9) amounts, if any, paid to an Employee in lieu of a Company Contribution to this Plan in the event that such Company Contribution would constitute an annual addition, as defined in Section 415(c)(2) of the Code, in excess of the limitations under Section 415(c) of the Code; and (10) severance payments. For purposes of this Section 2.1(c), severance payments include severance pay, unfunded nonqualified deferred compensation benefits and parachute payments made after an Employee's severance from employment, but shall not include amounts attributable to payments made within 2½ months following severance from employment that, absent a severance from employment, would have been paid to the Employee for services rendered prior to the severance from employment and for accrued bona fide sick, vacation, or other leave (to the extent the Employee would have been able to use the leave if employment had continued). Annual Compensation shall include amounts otherwise includible, as provided above, which are paid by the Company or an Eligible Affiliate to the Employee through another person, pursuant to the common paymaster provisions of Section 3121(s) and 3306(p) of the Code.

The Annual Compensation of each Member or former Member taken into account under the Plan for any Plan Year shall not exceed \$230,000, as adjusted by the Secretary of the Treasury for increases in the cost of living at the time and in the manner set forth in Section 401(a)(17)(B) of the Code. If a Plan Year consists of fewer than twelve (12) months, then the dollar limitation in the preceding sentence will be multiplied by a fraction, the numerator of which is the number of months in the Plan Year, and the denominator of which is twelve (12). Furthermore, for purposes of an allocation under the Plan based on Annual Compensation, Annual Compensation shall only include amounts attributable to the period an Employee is a Member of the Plan.

- (d) Beneficiary. A person designated by a Member or former Member to receive benefits hereunder upon the death of such Member or former Member.
- (e) Break in Service. An Employee shall have a Break in Service for each Plan Year in which he completes less than 501 Hours of Service with the Company or an Eligible Affiliate unless he is on a leave of absence authorized by the Company or an Eligible Affiliate in accordance with its leave policy.
- (f) Code. The Internal Revenue Code of 1986, as amended.
- (g) Committee. The persons who may be appointed to administer the Plan in accordance with Article XIII.
- (h) Common Stock. The common stock of the Company.
- (i) Company. Southwest Airlines Co., or its successor or successors.
- (j) Company Contributions. Contributions that are made by the Company for each Plan Year pursuant to the provisions of Section 4.1 hereof.
- (k) Deductible Contributions. A Member's voluntary contributions, if any, to the Plan, made prior to January 1, 1987 and deductible by such Member for federal income tax purposes in accordance with Section 219 of the Internal Revenue Code, as then in effect.
- (l) Deductible Contribution Account. A separate subaccount to which is credited a Member's Deductible Contributions, if any, and any earnings attributable thereto, adjusted to reflect any withdrawals, distributions or investment losses attributable thereto.
- (m) Disability. A physical or mental condition that, in the judgment of the Committee, totally and presumably permanently prevents the Employee from engaging in any substantial gainful employment with the Company or an Eligible Affiliate. A determination of Disability shall be based upon competent medical evidence satisfactory to the Committee. The Committee shall apply the rules with respect to Disability uniformly and consistently to all Employees in similar circumstances.

(n) Effective Date. January 1, 2008, except as otherwise specifically provided herein.

(o) Employee. Any person who is receiving remuneration for personal services rendered to the Company or any Eligible Affiliate, or who would be receiving such remuneration except for an authorized leave of absence; provided, however, that any individual whose conditions of employment are governed by a collective bargaining agreement between the Company and a labor union shall not be considered an Employee unless the collective bargaining agreement provides for coverage of such individual under the Plan. In no event shall any individual employed by any Affiliate or subsidiary of the Company be considered an Employee unless such Affiliate or subsidiary has specifically been designated by the Company as an Eligible Affiliate. Notwithstanding the foregoing, individuals whose conditions of employment are governed by a collective bargaining agreement that does not provide for coverage of such individual under the Plan shall nonetheless be deemed to be an Employee for purposes of crediting service pursuant to the provisions of subsections 2.1(t), (gg) and (kk) hereunder.

The term "Employee" shall also include any "leased employee," as such term is defined below, deemed to be an employee of an Employer or any Affiliate as provided in Sections 414(n) or (o) of the Code. The term "leased employee" means any person (other than an employee of the recipient) who, pursuant to an agreement between the recipient and any other person ("leasing organization"), has performed services for the recipient (or for the recipient and related persons determined in accordance with Section 414(n)(6) of the Code) on a substantially full-time basis for a period of at least one year, and such services are performed under primary direction or control by the recipient. Contributions or benefits provided by the leasing organization that are attributable to services performed for the recipient shall be treated as provided by the recipient. Notwithstanding the foregoing, a leased employee shall not be considered an employee of the recipient if: (i) such employee is covered by a money purchase pension plan that provides: (1) a nonintegrated employer contribution rate of at least ten percent (10%) of compensation, as defined in Section 415(c)(3) of the Code, but including amounts contributed pursuant to a salary reduction agreement that are excludable from the employee's gross income under Section 125, Section 402(e)(3), Section 402(h)(1)(B), or Section 403(b) of the Code, immediate vesting; and (ii) leased employees do not constitute more than twenty percent (20%) of the recipient's nonhighly compensated work force.

(p) Employer Savings Account. A separate subaccount to which is credited a Member's Company Contributions and forfeitures, if any, and any earnings attributable thereto, adjusted to reflect any withdrawals, distributions or investment losses attributable thereto.

(q) Entry Date. January 1st of each year.

(r) ERISA. The Employee Retirement Income Security Act of 1974, as amended.

(s) Fund or Trust Fund. All assets of whatsoever kind or nature held from time to time by the Trustee in the Trust forming a part of this Plan, without distinction as to income and principal and without regard to source, e.g., allocations, Company contributions, earnings, forfeitures or gifts.

(t) Hour of Service. An Hour of Service shall include all hours for which pay is received or for which an Employee is entitled to payment, whether worked or not, plus service credit on the basis of the number of his regularly scheduled working hours for any other period of absence for which the Employee is paid or entitled to payment and that is authorized by the Company in accordance with its uniform leave policy for vacation, holiday, sick leave, illness, Disability, layoff, military service or civic duty. In no event shall credit for the number of Hours of Service attributable to a single continuous period for which no duties are performed exceed 501. Service credit shall also be given for each other leave of absence authorized by the Company for which the Employee is paid or entitled to payment.

Hours of Service shall be computed on an equivalency basis, whereby for each month during which an Employee would be credited with at least one Hour of Service (or, in the case of flight attendants or pilots, one trip), such Employee shall be credited with one hundred ninety (190) Hours of Service.

These hours must be credited to Employees in the computation period during which the duties were performed, or, if no duties were performed, during which the applicable period of absence occurred, and not when paid, if different. Credit must also be given, without duplicating any hours described above, for each hour for which back pay, irrespective of mitigation of damages, has been awarded or agreed to by the Company or any Eligible Affiliate. These hours must be credited in the computation period or periods to which the award or agreement pertains rather than that in which the payment, award or agreement was made.

In determining the number of Hours of Service to be credited to an Employee in the case of a payment which is made or due to an Employee under the provisions of the paragraphs above, the Committee shall apply the rules set forth in Department of Labor Regulations 2530.200b-2(b) and (c), which rules are incorporated into and made a part of this Plan by reference.

For purposes of determining whether an Employee has incurred a Break in Service as defined in Section 2.1(e), the Committee shall credit an Employee with Hours of Service during absence from work for maternity or paternity reasons which would otherwise have been credited to such Employee but for such absence. For purposes of this Plan, an Employee shall be deemed to be on maternity or paternity leave if the Employee's absence from work is (1) by reason of the pregnancy of the Employee, (2) by reason of the birth of a child of the Employee, (3) by reason of the placement of a child with the Employee in connection with the adoption of such child by the Employee, or (4) for purposes of caring for such child for a period beginning immediately following such birth or placement. The Hours of Service credited under this paragraph shall be limited to the lesser of (1) the number necessary to prevent the Employee from incurring a Break

in Service or (2) 501 Hours of Service. Hours of Service credited under this paragraph shall be credited in the Plan Year in which the absence begins, but if the Employee does not need those Hours of Service to prevent a Break in Service in the Plan Year in which the absence began, then they shall be credited in the immediately following Plan Year.

(u) Individual Account. The account or record maintained by the Committee showing the monetary value of the individual interest in the Trust Fund of each Member, former Member and Beneficiary.

(v) Investment Managers. The qualified and acting Investment Managers, as defined in ERISA, who under this Plan may be appointed by the Company to invest and manage Plan assets as fiduciaries.

(w) Member. An Employee who has met the eligibility requirements for participation in this Plan, as set forth in Article III hereof.

(x) Named Fiduciary. The Committee shall be the Named Fiduciary designated to manage the operation and administration of the Plan.

(y) Nondeductible Contributions. A Member's voluntary contributions, if any, to the Plan, made prior to January 1, 1987, which are not deductible by such Member for federal income tax purposes.

(z) Nondeductible Contribution Account. A separate subaccount to which is credited a Member's Nondeductible Contributions, if any, and any earnings attributable thereto, adjusted to reflect any withdrawals, distributions or investment losses attributable thereto.

(aa) Normal Retirement Date. The date on which a Member attains the age of fifty-nine and one-half (59½) years.

(bb) Plan. Southwest Airlines Co. ProfitSharing Plan, as amended from time to time.

(cc) Plan Administrator. Such person or persons as designated by the Committee, which shall be the Committee unless and until it designates such other person or persons.

(dd) Plan Year. The annual period beginning January 1st and ending December 31st, both dates inclusive of each year.

(ee) Prior Plan. The Southwest Airlines Co. ProfitSharing Plan, effective January 1, 1973, as heretofore amended and restated from time to time.

(ff) Retirement. Separation from service after a Member has reached his Normal Retirement Date. Retirement shall be considered as commencing on the day immediately following a Member's last day of service.

(gg) Service. A period or periods of employment by an Employee used in determining eligibility for Plan participation or in determining the amount of benefits. If the Company is a member of a controlled group of corporations (as defined in Section 414(b) of the Code), is one of a group of trades or businesses (whether or not incorporated) which are under common control (as defined in Section 414(c) of the Code), is a member of an affiliated service group (as defined in Section 414(m) of the Code) or is otherwise required to be aggregated with any entity pursuant to Section 414(o) of the Code and the regulations issued thereunder, then Service shall include any employment with any such Affiliate from and after the date such entity becomes an Affiliate, including Service prior to the Effective Date.

(hh) Trust. Southwest Airlines Co. ProfitSharing Trust, as amended from time to time, the Trust established to hold and invest contributions made under the Plan and Prior Plan for the exclusive benefit of the Members included in the Plan from which the benefits will be distributed.

(ii) Trustee. The qualified and acting Trustee under the Trust, who shall be the fiduciary designated to invest and manage the Plan assets, other than those which may be managed exclusively by an Investment Manager, and to operate and administer the Trust Fund.

(jj) Valuation Date. Each business day on which the financial markets are open for trading activity.

(kk) Vesting Service. Vesting Service is the period of employment used in determining eligibility for benefits. A year of Vesting Service shall be granted for each Plan Year in which an Employee has completed 1,000 or more Hours of Service with the Company or an Affiliate, subject to the following exceptions:

(i) Vesting Service prior to January 1, 1973 shall be excluded.

(ii) Vesting Service completed after December 31, 1972 and prior to January 1, 1976 shall be excluded if such service would have been disregarded under the break in service rules of the Prior Plan, as then in effect. For this purpose, break in service rules are those rules which result in the loss of prior vesting because of service termination or failure to complete a required period of service within a specified time.

(iii) In the case of an Employee who has a Break in Service, his years of Vesting Service before such Break in Service shall not be taken into account until he has completed a year of Vesting Service following his reemployment. Prior to January 1, 1985, in the case of an Employee who has any Break in Service, all years of Vesting Service incurred after such Break shall be disregarded for purposes of measuring years of Vesting Service before such Break. However, effective January 1, 1985, and thereafter, in the case of an Employee who has five (5) or more consecutive Breaks in Service, all years of

Vesting Service incurred after such Breaks in Service will be disregarded for purposes of measuring years of Vesting Service before such Breaks in Service.

(II) Eligible Affiliate. An Affiliate, the employees of which the Company has specifically designated as being eligible to participate in the Plan.

2.2 Construction. The masculine gender, where appearing in the Plan, shall be deemed to include the feminine gender, unless the context clearly indicates to the contrary. The words "hereof," "herein," "hereunder," and other similar compounds of the word "here" shall mean and refer to the entire Plan, not to any particular provision or section. The Plan and Trust shall each form a part of the other by reference and terms shall be used therein interchangeably.

### ARTICLE III ELIGIBILITY AND PARTICIPATION

3.1 Eligibility Requirements. Every Employee who was a Member in the Prior Plan on the day before the Effective Date shall continue to be a Member in the Plan. Except as otherwise provided herein, every other Employee shall become a Member in the Plan as of the first Entry Date concurrent with or next following his employment commencement date or the date on which his employer became an Eligible Affiliate, whichever is later. The employment commencement date is the first day for which an Employee is entitled to be credited hereunder with an Hour of Service. Notwithstanding the foregoing, non-resident aliens who receive no earned income from the Company that constitutes income from sources within the United States shall not be eligible to participate in the Plan. Furthermore, "leased employees" (as such term is defined in Section 2.1(o) hereof) and Employees classified by the Company as interns shall not be eligible to participate in the Plan. A person who is not treated as an Employee on the Company's books and records (such as a person who as a matter of practice is treated by the Company as an independent contractor, but who is later determined to be an Employee as a matter of fact) shall not be an eligible Employee during any part of a Plan Year in which such person was not treated as an Employee, despite any retroactive recharacterization.

3.2 Notification of Eligibility. The Committee shall notify in writing each Employee of the qualifications for eligibility and shall furnish each Employee a copy of such explanation of the Plan as the Committee shall provide for that purpose.

3.3 Reentry of Prior Members. An Employee who terminates employment after becoming a Member hereunder shall be eligible to participate immediately upon his completion of one Hour of Service following his reemployment by the Company or an Eligible Affiliate. An Employee who terminates employment after satisfying the requirements of Section 3.1 hereof, but prior to the first Entry Date following the satisfaction of such requirements, shall be eligible to participate immediately upon his completion of one Hour of Service following his reemployment by the Company or an Eligible Affiliate, or, if later, the first Entry Date following the satisfaction of such requirements.

**ARTICLE IV  
CONTRIBUTIONS**

4.1 Company Contributions. The Company may, for each of its taxable years, contribute to the Trust Fund such profit sharing contribution, if any, as the Company shall determine by resolution of its board of directors. The amount of the profit sharing contribution, if any, shall be determined in the sole and absolute discretion of the board of directors of the Company; provided, however, that in the absence of any action of the board of directors to the contrary, the amount of the profit sharing contribution shall be an amount equal to 15% of ANP, reduced by the contribution made to the Southwest Airlines Co. 2005 Deferred Compensation Plan for Pilots for such Plan Year pursuant to section 3.2 of such plan.

For purposes of the foregoing, "ANP" is the operating profit of the Company for such Plan Year. As used herein, the term "operating profit" of the Company for any Plan Year shall mean its income for such Plan Year before income taxes, derived in accordance with generally accepted accounting principles, and as set forth in the Company's audited statement of income included in the annual report to shareholders, before provision for any contribution to this Plan, excluding (1) nonoperating or non-recurring gains or losses not arising from the Company's usual business operations, including those gains or losses recognized under Statement of Financial Accounting Standards No. 133 that are factored into the Company's presentation of "economic" results and gains or losses from the sale or exchange of capital assets, as set forth in the Company's audited statement of income or disclosed in the notes thereto, and (2) profits or losses incurred by TranStar or any separately definable division of the Company; provided, however, that notwithstanding the foregoing, profits and losses incurred by Morris Air Corporation shall be taken into account for Plan Years beginning after December 31, 1993.

The contribution shall be made either (1) in cash, (2) in Common Stock having a fair market value equal to the amount of the contribution, or (3) in cash and Common Stock having an aggregate fair market value equal to the amount of the contribution. The fair market value of any Common Stock contributed shall be based on the mean of the reported high and low sales prices of Common Stock on the New York Stock Exchange-Composite Tape on the day of the contribution to the Plan; except however, if the Company acquires Common Stock on the open market and contributes it to the Plan immediately following the settlement date, then the fair market value of the contribution shall be equal to the cost paid by the Company for the Common Stock, including commissions and other expenses which the Trustee would incur in the acquisition of Common Stock if the Trustee acquired the Common Stock directly. Any portion of the contribution made in Common Stock may be made in the form of authorized but unissued shares or shares previously issued and reacquired by the Company.

Company Contributions shall be added to and become a part of the Trust Fund, and, as of each Allocation Date, shall be credited to the Individual Accounts of the Members, as provided in Section 6.1 hereof.

**ARTICLE V  
ADJUSTMENT OF INDIVIDUAL ACCOUNTS**

5.1 Individual Accounts. The Committee shall establish an Individual Account for each Member showing the monetary value of the individual interest in the Trust Fund of each Employee, former Employee and Beneficiary. The Individual Account of each Member shall be composed of an Employer Savings Account, to which Company Contributions and forfeitures, if any, shall be credited. In addition, if a Member was at any time prior to the Effective Date a member of the Prior Plan who, prior to January 1, 1987, made voluntary Deductible Contributions or Nondeductible Contributions, his Individual Account shall include a Deductible Contribution Account and/or Nondeductible Contribution Account, as applicable. Such accounts are primarily for accounting purposes and do not require a segregation of the Trust Fund, except as otherwise provided herein.

5.2 Method of Adjustment. As of each Valuation Date, before any restoration of accounts as required pursuant to Section 15.3 hereof and before taking into account the contributions of the Company and forfeitures for the period since the last preceding Valuation Date, the Committee or the Trustee, as directed by the Committee, shall value the assets of each investment fund and adjust the Individual Accounts of all Members who have elected to participate in such investment fund as follows.

(a) The Committee shall determine the market value of the investment fund, including the effect of expenses of administration and other charges against such investment fund since the last Valuation Date.

(b) The Committee shall determine the total aggregate value of all Individual Accounts participating in the investment fund as shown in its records as of the prior Valuation Date. The Individual Account balances of Employees, former Employees and Beneficiaries shall be reduced by any amounts paid to them from the investment fund since the last Valuation Date.

(c) The Committee shall then adjust the value of each Individual Account participating in the investment fund by crediting each Individual Account with its proportion of the difference between (a) and (b) if (a) is the larger or charging it with its proportion of the difference between (a) and (b) if (b) is larger; the proportion to be so credited or charged to each Individual Account shall be calculated by multiplying the difference between (a) and (b) by a fraction, the numerator of which is the then value of said Individual Account and the denominator of which is the then aggregate value of all Individual Accounts participating in such investment fund.

**ARTICLE VI  
ALLOCATIONS**

6.1 Company Contribution. As of each Allocation Date, but after any adjustment of Individual Accounts, as provided in Section 5.2, and other applicable provisions herein, the Committee shall credit the Company Contribution, as described in Section 4.1 hereof, for the Plan Year ending with said Allocation Date to the Individual Accounts of all Members and

former Members, except those Members and former Members who failed to complete at least 1,000 Hours of Service during such Plan Year. The amount of the annual Company Contribution allocated to the Individual Account of each eligible Member or former Member shall be in the proportion that his Annual Compensation during the applicable Plan Year bears to the total Annual Compensation of all eligible Members and former Members during the applicable Plan Year.

**6.2 Allocation of Forfeitures.** If a Member or former Member forfeits a portion of his Individual Account as provided in Section 10.3 hereof, then said forfeited amount shall be used first to restore the Individual Accounts of rehired Members, as required under Section 15.3 hereof, and next to reduce Company Contributions made in accordance with Section 18.11 hereof for Plan Years prior to the Plan Year in which a Member returns from qualified military service, as well as any such Company Contributions outstanding as of the effective date hereof. Any remaining forfeitures shall be allocated as soon as practicable following the Plan Year in which said forfeiture occurs among the Individual Accounts of the Members and former Members who are eligible to have a Company contribution credited on their behalf for such Plan Year, as set forth in Section 6.1 hereof. The amount of the forfeiture allocated under this Section 6.2 to the Individual Account of such Member or former Member shall be in the proportion that his Annual Compensation for such Plan Year bears to the total Annual Compensation for such Plan Year of all such Members and former Members.

If a Member or former Member who does not have any nonforfeitable right to his Individual Account terminates his employment and thereby forfeits his Individual Account, then in the event such Member or former Member is reemployed before he has incurred five (5) or more consecutive Breaks in Service, his Individual Account that was forfeited shall be restored by the Company at the time of his reemployment.

**6.3 Notification to Members.** At least annually, the Committee shall advise each Member, former Member and Beneficiary for whom an Individual Account is held hereunder of the then balance in such account.

**6.4 Maximum Annual Addition to Account or Benefit.**

(a) **Limitations.** If the Employer maintains this Plan and one or more other qualified defined contribution plans, the Annual Additions (as defined in subsection (b) below) allocated under this Plan to any Member's Individual Account shall be limited in accordance with the allocation provisions of this subsection 6.4(a).

The amount of the Annual Additions that may be allocated under this Plan to the Individual Account of any Member as of any Allocation Date, together with Annual Additions allocated on behalf of any such Member under any other defined contribution plan of the Employer for the Limitation Year (as defined in subsection (b) below) in which such Allocation Date occurs, shall not exceed the Maximum Permissible DC Amount (as defined in subsection (b) below), based upon Annual Compensation up to such Allocation Date for such Limitation Year.

If the Annual Additions allocated on behalf of a Member or former Member under this Plan and any other defined contribution plan of the Employer are to be reduced as of any Allocation Date as a result of exceeding the limitations described in the next preceding two paragraphs, such reduction shall be, to the extent required, effected by first reducing the Annual Additions to be allocated on behalf of such Member or former Member under this Plan as of such Allocation Date.

If as a result of the first three paragraphs of this subsection 6.4(a) the allocation of Annual Additions under this Plan is to be reduced, such reduction shall be allocated to a suspense account as of such Allocation Date and held therein until the next succeeding Allocation Date on which Company Contributions and forfeitures could be allocated under the provisions of the Plan, at which time such reduction shall be allocated and reallocated to the Individual Accounts of Members hereunder (in accordance with the provisions of Section 6.1 hereof and subject to the limitations of this Section 6.4) before any Company Contributions may be made to the Plan for the limitation year ending on such Allocation Date. In the event of termination of the Plan, the suspense account shall revert to the Company to the extent it may not be allocated to any Individual Account. If a suspense account is in existence at any time during a Limitation Year pursuant to this Section, it will not participate in the allocation of the Trust Fund's investment gains and losses.

(b) Definitions Applicable to Section 6.4. For purposes of Section 6.4, the following definitions shall apply:

(i) Annual Additions. Annual Additions are the sum of the following amounts allocated on behalf of a Member or former Member for a Limitation Year:

(1) all Employer contributions;

(2) forfeitures, if any;

(3) all Employee contributions; and

(4) amounts allocated after March 31, 1984, to an individual medical benefit account, as defined in Code Section 415(1)(2) that is part of a pension or annuity plan maintained by the Employer, and amounts derived from contributions paid or accrued after December 31, 1985, in taxable years ending after such date, that are attributable to post-retirement medical benefits allocated to the separate account of a key employee (as defined in Code Section 419(d)(3)) under a welfare benefit plan (as defined in Code Section 419(e) maintained by the Employer.

The Annual Additions for any Limitation Year beginning before January 1, 1987, shall not be recomputed to treat all Employee Contributions as Annual Additions.

(ii) Employer. Employer shall mean, in addition to the Company (as defined in Section 2.1(i) hereof, all members of a controlled group of corporations (as defined in Section 414(b) of the Code as modified by Section 415(h)), all commonly controlled trades or businesses (as defined in Section 414(c) as modified by Section 415(h)) or affiliated service groups (as defined in Section 414(m)) of which the Company is a part, and any other entity required to be aggregated with the Company pursuant to regulations under Section 414(o) of the Code.

(iii) Limitation Year. The Limitation Year shall be the twelve (12) consecutive month period ending on the last day of December or any other twelve (12) consecutive month period for all qualified plans of the Company pursuant to a written resolution the Company adopts.

(iv) Maximum Permissible DC Amount. The Maximum Permissible DC Amount for a given Limitation Year is equal to the lesser of (i) 100% of compensation or (ii) \$46,000, as adjusted for increases in the cost-of-living under Section 415(d) of the Code. For purposes of this subparagraph (iv), compensation shall mean compensation as defined in Section 3401(a) of the Code and all other payments of compensation to an Employee by the Company (in the course of the Company's trade or business) for which the Company is required to furnish the Employee a written statement under Sections 6041(d), 6051(a)(3), and 6052 of the Code without regard to any rules under Section 3401(a) that limit the remuneration included in wages based on the nature or location of the employment or the services performed, together with any amounts not includable in the gross income of an Employee pursuant to Sections 125, 132(f)(4), 402(e)(3), 403(b), 457, or 402(h)(1)(B) of the Code applicable to such Limitation Year. If a short Limitation Year is created because of an amendment changing the Limitation Year to a different twelve (12) consecutive month period, the dollar limitation referred to above is multiplied by a fraction, the numerator of which is equal to the number of months in the short Limitation Year and the denominator of which is twelve. The compensation limit referred to in this subparagraph (iv) shall not apply to any contribution for medical benefits after separation from service (within the meaning of section 401(h) or section 419A(f)(2) of the Code) that is otherwise treated as an Annual Addition hereunder.

## **ARTICLE VII RETIREMENT**

7.1 Normal or Late Retirement. A Member, upon reaching his Normal Retirement Date for the purposes of this Plan, shall be one hundred percent (100%) vested in his Individual Account, and such amount contained therein shall be nonforfeitable. If a Member continues in the service of the Company beyond his Normal Retirement Date, he shall continue to participate in the Plan.

7.2 Benefit. Upon Retirement (whether normal or late Retirement in accordance with Section 7.1), a Member shall be entitled to the entire amount to the credit of his Individual Account as of the Valuation Date concurrent with or next following his date of Retirement, including his portion, if any, of Company Contributions and forfeitures allocated after his date of Retirement, adjusted for earnings and losses, if any, that accrue to the Valuation Date immediately preceding the date of distribution, if later. Upon his Retirement under this Article VII, a Member shall receive the benefits to which he is entitled at the time and in the manner provided in Article XV hereof.

## **ARTICLE VIII DEATH**

8.1 Death of Member. Upon the death of a Member while employed by the Company, such Member's Individual Account shall thereupon become one hundred percent (100%) vested, and the amount contained therein shall be nonforfeitable.

8.2 Designation of Beneficiary. Each Member and former Member may, from time to time, designate one or more Beneficiaries and alternate Beneficiaries to receive benefits pursuant to this Article in the event of the death of such Member or former Member. Such designation shall be made in writing upon a form provided by the Committee and shall only be effective when filed with the Committee. The last such designation filed with the Committee shall control.

If a Member is married, his spouse shall automatically be designated his Beneficiary; provided, however, a Beneficiary other than his spouse may be designated if (1) his spouse consents in writing to such designation, the consent acknowledges the effect of such designation and the designation is witnessed by a member of the Committee or a notary public, or (2) it is established to the satisfaction of the Committee that there is sufficient reason why the consent may not be obtained. Notwithstanding the foregoing, divorce after the filing of a designation or designations that name the spouse as beneficiary shall be deemed to revoke such designation or designations if written notice of such divorce is received by the Committee before payment has been made in accordance with the existing designation or designations on file with the Committee.

8.3 Benefit. Subject to the requirements of Section 18.10 hereof, upon the death of a Member or former Member, his designated Beneficiary shall be entitled to the entire amount to the credit of his Individual Account as of the Valuation Date concurrent with or next following his date of death, including his portion, if any, of Company Contributions and forfeitures allocated after the date of his death, adjusted for earnings and losses, if any, that accrue to the Valuation Date immediately preceding the date of distribution, if later. Payment shall be made at the time and in the manner provided in Article XV hereof.

8.4 No Beneficiary. If a Member or former Member dies without a designated Beneficiary surviving him, or if all his Beneficiaries die before receiving the payment to which they are entitled, then any amounts to which such Member, former Member or Beneficiary is entitled hereunder shall be paid to his estate.

For the purpose of this Plan, the production of a certified copy of the death certificate of any Employee or other person shall be sufficient evidence of death, and the Committee shall be fully protected in relying thereon. In the absence of such proof, the Committee may rely upon such other evidence of death as it deems necessary or advisable.

**ARTICLE IX  
DISABILITY**

9.1 Disability. If a Member's employment with the Company terminates as a result of his Disability, such Participant's Individual Account shall thereupon become one hundred percent (100%) vested, and the amount contained therein shall be nonforfeitable.

9.2 Benefit. In the event of the Disability of a Member or former Member, he shall be entitled to the entire amount to the credit of his Individual Account as of the Valuation Date concurrent with or next following the date on which his termination of employment occurs as a result of his Disability, including his portion, if any, of Company Contributions and forfeitures allocated after the date of his termination of employment, adjusted for earnings and losses, if any, that accrue to the Valuation Date immediately preceding the date of distribution, if later. Payments shall be made at the time and in the manner provided in Article XV hereof.

**ARTICLE X  
TERMINATION OF EMPLOYMENT AND FORFEITURES**

10.1 Eligibility and Benefits. If a Member's employment with the Company and all Eligible Affiliates shall terminate for any reason other than his Retirement Under Article VII, death under Article VIII, or Disability under Article IX, such Member shall be entitled to all of his Nondeductible Contribution Account and Deductible Contribution Account and to a percentage of the amount in his Employer Savings Account as of the Valuation Date concurrent with or next following the date on which his termination of employment occurs, including his portion, if any, of Company Contributions and forfeitures allocated after the date of his termination of employment, adjusted for earnings and losses, if any, that accrue to the Valuation Date immediately preceding the date of distribution, if later. The percentage of a Member's Employer Savings Account to which he is entitled shall be determined in accordance with the following schedule:

<u>Completed Years of Vesting Service</u>	<u>Percentage Payable</u>
Less than 5 years	0%
5 years or more	100%

Notwithstanding the foregoing, effective with respect to contributions allocated for Plan Years beginning on and after January 1, 2007, the percentage of a Member's Employer Savings Account to which he is entitled shall be determined in accordance with the following schedule:

Completed Years of Vesting Service	Percentage Payable
Less than 1 year	0%
1 year but less than 2 years	20%
2 years but less than 3 years	40%
3 years but less than 4 years	60%
4 years but less than 5 years	80%
5 years or more	100%

The provisions of this Section shall be subject to the provisions of Section 17.3 hereof, which shall be given full effect.

10.2 Time of Payment. The amount to which a Member shall be entitled under Section 10.1 shall be paid to him at the time and in the manner provided in Article XV hereof.

10.3 Forfeitures. A Member to whom Section 10.1 is applicable shall forfeit that portion of the amount in his Individual Account to which he is not entitled under Section 10.1 and the amount thus forfeited shall remain in the Trust Fund and shall be allocated pursuant to the provisions of Section 6.2. A Member who does not have any nonforfeitable right to his Individual Account shall be deemed to have received a cashout distribution pursuant to Section 15.3 hereof, and shall forfeit the amount in such Individual Account in the Plan Year in which his termination of employment occurs.

10.4 Forfeiture for Cause. In the event a Member who has not completed at least three (3) years of Vesting Service is discharged due to his dishonest or criminal act (proven by conclusive evidence to the unanimous satisfaction of the Committee) or due to embezzlement, fraud, or dishonesty against and damaging to the Company whereby the reasons for such discharge are confirmed by resolution of the board of directors or other governing authority of the Company, the entire amount credited to the benefit of such Member in his Employer Savings Account shall be forfeited and neither he nor his Beneficiary shall be entitled to any benefit hereunder with respect to such amounts. Likewise, any amounts credited to, but not distributed from, the Employer Savings Account of a former Member who has not completed at least three (3) years of Vesting Service shall be forfeited upon the discovery of any embezzlement, fraud or dishonesty of such former Member against and damaging to the Company. Notwithstanding the foregoing, in the event the Plan is top heavy for any Plan Year pursuant to Section 19.2 hereof, the provisions of Section 10.1 shall supersede this Section 10.4 and shall be controlling for all purposes hereunder.

## ARTICLE XI WITHDRAWALS

11.1 Withdrawals.

(a) Nondeductible and Deductible Contribution Accounts. Effective as of any Valuation Date, a Member may, upon prior written notice to the Committee within the time period established by the Committee for such elections, elect to withdraw from his Nondeductible and Deductible Contribution Accounts any or all of the balance thereof, as of such Valuation Date. If a Member timely elects such a withdrawal, distribution shall be made as soon as practicable following such Valuation Date.

(b) Employer Savings Account. Subject to the requirements of Section 18.10 hereof, a Member who has reached his Normal Retirement Date may elect in writing, within the time period established by the Committee for such elections, to withdraw all or any portion of his vested interest in his Employer Savings Account. No more than one such withdrawal may be made by the Member during any Plan Year. The amount available for withdrawal shall be determined as of the Valuation Date next following the date on which the Committee receives the Member's withdrawal election, and the withdrawal amount shall be distributed to the Member as soon as practicable thereafter.

## ARTICLE XII INVESTMENT OF THE TRUST FUND

### 12.1 Member Direction of Investment.

(a) Investment of Contributions. Each Member shall have the right, within the guidelines established by the Committee, to direct the Committee to instruct the Trustee to invest any whole percentage, up to one hundred percent (100%), of such Member's current Company Contributions and forfeitures in one or more of such investment media as the Committee may designate from time to time. The Committee shall direct the Trustee or, if applicable, an Investment Manager as to the investments in which Members may invest. The Committee may determine to offer as investment media any investment fund, program or other vehicle that is suitable as a proper and permissible investment of contributions made to a retirement plan qualified pursuant to Section 401(a) of the Code. The investment directions of the Members shall be implemented by the Trustee or, if applicable, an Investment Manager provided, however, that the Trustee or, if applicable, an Investment Manager shall not be obligated to follow the investment direction of a Member if such direction would result in a prohibited transaction described in Section 406 of ERISA or Section 4975 of the Code, would generate income that would be taxable to the Plan, or:

(i) would not be in accordance with the documents and instruments governing the Plan insofar as such documents and instruments are consistent with the provisions of Title I of ERISA;

(ii) would cause a fiduciary to maintain the indicia of ownership of any assets of the Plan outside the jurisdiction of the district courts of the United States other than as permitted by Section 404(b) of ERISA and Department of Labor Regulations §2550.404b-1;

(iii) would jeopardize the Plan's tax qualified status under the Code;

(iv) could result in a loss in excess of a Member's or Beneficiary's account balance; or

(v) would result in a direct or indirect:

(1) sale, exchange, or lease of property between the Company (or any affiliate of the Company) and the Plan except for the acquisition or disposition of any interest in a fund, subfund or portfolio managed by the Company (or an affiliate of the Company), or the purchase or sale of any qualifying employer security (as defined in Section 407(d)(5) of ERISA) which meets the conditions of Section 408(e) of ERISA and subparagraph (4) below;

(2) loan to the Company or any affiliate of the Company;

(3) acquisition or sale of any employer real property (as defined in Section 407(d)(2) of ERISA); or

(4) acquisition or sale of any employer security except to the extent that any such employer security and any such acquisition or sale complies with the requirements of Department of Labor Regulations §2550.404c-1(d)(2)(4).

(b) Modification of Investment Media. The Committee shall be authorized at any time and from time to time to modify, alter, delete or add to the funds available for investment at the direction of a Member. In the event a modification occurs, the Committee shall notify those Members whom the Committee, in its sole and absolute discretion, determines are affected by the change, and shall give such persons such additional time as is determined by the Committee to designate the manner and percentage in which amounts invested in those funds thereby affected shall be invested.

The Committee shall not be obligated to substitute funds of similar investment criteria for existing funds, nor shall it be obligated to continue the types of investments presently available to the Members. Nothing contained herein shall constitute any action by the Committee as a direction of investment of the assets or an attempt to control such direction.

(c) Investment Direction. Any Member, on or before his entry into the Plan, within the time period established by the Committee, may designate the manner and the percentage in which the Member desires the Trustee or, if applicable, an Investment Manager to invest his current Company Contributions and forfeitures, pursuant to the provisions set forth above, which designation shall continue in effect until revoked or modified by the Member. If a Member fails to designate the investment of his current Company Contributions and forfeitures on or before his entry into the Plan, or if a Member wishes to change such designation, the Member may make such designation or change, within the time period established by the Committee, to become effective for all such future contributions and forfeitures as soon as practicable following the date of

receipt by the Committee of such designation or change, and such designation or change shall continue in effect until revoked by the Member in accordance with this Plan.

Any amounts with respect to which the Trustee or, if applicable, an Investment Manager fails to receive a proper investment direction from any Member shall be invested, as directed by the Committee, in a qualified default investment alternative, as defined in Department of Labor Regulations §2550.404c-5 and such other subsequent guidance as may be promulgated by the Department of Labor, and with respect to which the other conditions set forth in Department of Labor Regulations §2550.404c-5 are met, including, but not limited to, the delivery to the Member of any material provided to the Plan that relates to the Member's investment therein. All investment designations shall be made in the manner prescribed by the Committee.

The Committee shall maintain separate subaccounts in the name of each Member within his Individual Account to reflect such Member's accrued benefit attributable to his directed investment in the above investment media.

#### 12.2 Conversion of Investments.

(a) Member's Individual Account. Effective as of any Valuation Date, within the time period prior thereto established by the Committee, and subject to any restrictions on transfer imposed under particular investment funds, a Member may, pursuant to guidelines established by the Committee, direct the Committee to instruct the Trustee to convert any whole percentage, up to one hundred percent (100%), of the amount in such Member's Individual Account that is invested in any of the investment media offered for investment under the Plan into one or more other of such investment media. Such direction shall be effective as soon as practicable following the date of receipt by the Committee of such direction to convert. Notwithstanding any provision herein to the contrary, applicable fund redemption and short-term trading fees may be imposed upon the Member's Individual Account in connection with any direction by such Member to convert investments hereunder.

(b) Conversion Directions. A direction to convert by any eligible Member shall be irrevocable and shall be made in the manner prescribed by the Committee within the time period established by the Committee. Any conversion of investments pursuant to this Section 12.2 shall not affect a Member's direction of investments with respect to his future contributions and forfeitures pursuant to Section 12.1.

(c) Direction of Spouse. If a Member's spouse who is not a Member in this Plan acquires an interest in a Member's Individual Account pursuant to a qualified domestic relations order, then the Member's spouse may direct the Committee to convert the investment of the interest to which such spouse is thus entitled in the same manner and at the same time as the Member may direct a conversion of investments, as provided above. If such spouse becomes a Member of the Plan, the spouse shall be entitled to convert such investments in accordance with the rights of Members in the Plan.

(d) Miscellaneous. The Committee is authorized to establish such other rules and regulations, including adding additional times to convert investments, as it determines are necessary to carry out the provisions of Section 12.1 and this Section 12.2, the specific dates of conversion to be determined by the Committee, and all earnings on the Member's investments after such dates shall be allocated in accordance with the Member's Employer Savings Account, as adjusted on such dates. The Committee shall be authorized to modify the allocations of earnings, provided such change is made on a reasonable and nondiscriminatory basis.

### **ARTICLE XIII ADMINISTRATION**

13.1 Appointment of Committee. The Plan shall be administered by a Committee consisting of at least three or more persons who shall be appointed by and serve at the pleasure of the board of directors of the Company. All usual and reasonable expenses of the Committee shall be paid by the Trustee out of the principal or income of the Trust and, to the extent not so paid, shall be paid by the Company. The members of the Committee shall not receive compensation with respect to their services for the Committee. The members of the Committee may serve without bond or security for the performance of their duties hereunder unless applicable law makes the furnishing of such bond or security mandatory or unless required by the Company. Any member of the Committee may resign by delivering his written resignation to the Company and to the other members of the Committee.

13.2 Committee Powers and Duties. The Committee shall have such powers as may be necessary to discharge its duties hereunder, including, but not by way of limitation, the following powers and duties:

- (a) to construe and interpret the Plan, decide all questions of eligibility and determine the amount, manner and time of payment of any benefits hereunder;
- (b) to prescribe procedures to be followed by distributees in obtaining benefits;
- (c) to make a determination as to the right of any person to a benefit and to afford any person dissatisfied with such determination the right to a hearing thereon;
- (d) to receive from the Company, Eligible Affiliates, and from Members such information as shall be necessary for the proper administration of the Plan;
- (e) to delegate to one or more of the members of the Committee the right to act in its behalf in all matters connected with the administration of the Plan and Trust;
- (f) to receive and review reports of the financial condition and of the receipts and disbursements of the Trust Fund from the Trustee;
- (g) to appoint or employ for the Plan any agents it deems advisable, including, but not limited to, legal counsel; and

(h) to take any and all further actions from time to time as the Committee, in its sole and absolute discretion, shall deem necessary for the proper administration of the Plan.

The Committee shall have no power to add to, subtract from or modify any of the terms of the Plan, nor to change or add to any benefits provided by the Plan, nor to waive or fail to apply any requirements of eligibility for benefits under the Plan. The Committee shall have full and absolute discretion in the exercise of each and every aspect of its authority under this Plan, including without limitation, all of the rights, powers and authorities specified in this Section 13.2 and, if applicable, in Section 13.3 hereof.

A majority of the members of the Committee shall constitute a quorum for the transaction of business. No action of the Committee shall be taken except upon a majority vote of the Committee members, other than as described in subparagraph (e) above. An individual shall not vote or decide upon any matter relating solely to himself or vote in any case in which his individual right or claim to any benefit under the Plan is particularly involved. If, in any case in which a Committee member is so disqualified to act, and the remaining members cannot agree, the board of directors of the Company will appoint a temporary substitute member to exercise all the powers of the disqualified member concerning the matter in which he is disqualified.

**13.3 Duties and Powers of the Plan Administrator.** The Plan Administrator shall have such powers as may be necessary to discharge its duties hereunder, including, but not by way of limitation, the following powers and duties:

- (a) to file with the Secretary of Labor the annual report and other pertinent documents that may be requested by the Secretary;
- (b) to file with the Secretary of Labor such terminal and supplementary reports as may be necessary in the event of the termination of the Plan;
- (c) to furnish each Member, former Member and each Beneficiary receiving benefits hereunder a summary plan description explaining the Plan;
- (d) to furnish any Member, former Member or Beneficiary, who requests in writing, statements indicating such Member's, former Member's or Beneficiary's total accrued benefits and nonforfeitable benefits, if any;
- (e) to furnish to a Member a statement containing information contained in a registration statement required by Section 6057(a)(2) of the Code;
- (f) to maintain all records necessary for verification of information required to be filed with the Secretary of Labor;
- (g) to allocate the assets of the Plan available to provide benefits to Members in the event the Plan should terminate; and
- (h) to report to the Trustee all available information regarding the amount of benefits payable to each Member, the computations with respect to the allocation of

assets, and any other information that the Trustee may require in order to terminate the Plan.

13.4 Rules and Decisions. The Committee may adopt such rules as it deems necessary or desirable. All rules and decisions of the Committee shall be uniformly and consistently applied to all Employees in similar circumstances. The Committee is required to provide a notice in writing to any person whose claim for benefits under the Plan has been denied, setting forth the specific reasons for such denial. The Committee shall adopt rules or procedures to carry out the intent of this Section and to provide a basis for a full and fair review by the Committee of the decision denying the claim and provide such person with an opportunity to supply any evidence he has to sustain the claim.

13.5 Committee Procedures. The Committee may adopt such bylaws as it deems desirable. The Committee shall elect one of its members as chairman. The Committee shall advise the Trustee of such election in writing. The Committee shall keep a record of all meetings and forward all necessary communications to the Trustee.

13.6 Authorization of Benefit Payments. The Committee shall issue directions to the Trustee concerning all benefits that are to be paid from the Trust Fund pursuant to the provisions of the Plan. The Committee shall keep on file, in such manner as it may deem convenient or proper, all reports from the Trustee.

13.7 Payment of Expenses. All expenses incident to the administration of the Plan and Trust, including but not limited to, actuarial, legal, accounting, investment advisory, investment education, recordkeeping, Trustee's fees, and any other plan administrative expenses, shall be paid by the Trustee from the Trust Fund and, until paid, shall constitute a first and prior claim and lien against the Trust Fund. To the extent such expenses are not paid by the Trustee from the Trust Fund, they shall be paid by the Company.

13.8 Indemnification of Members of the Committee. The Company shall, to the maximum extent permitted under the Company's bylaws, indemnify the members of the Committee against liability or loss sustained by them by an act or failure to act in their capacity as members of the Committee.

#### **ARTICLE XIV NOTICES**

14.1 Notice to Trustee. As soon as practicable after a Member ceases to be in the employ of the Company for any of the reasons set forth in Articles VII through X, inclusive, the Committee shall give notice to the Trustee, which notice shall include such of the following information and directions as are necessary or advisable under the circumstances:

- (a) name and address of the Member;
- (b) name and address of the Beneficiary or Beneficiaries in case of a Member's death;

(c) amount to which the Member is entitled in case of termination of employment pursuant to Article X; and

(d) manner and amount of payments to be made pursuant to Article XV.

If a former Member dies, the Committee shall give a like notice to the Trustee, but only if the Committee learns of his death.

14.2 Subsequent Notices. At any time and from time to time after giving the notice as provided for in Section 14.1, the Committee may modify such original notice or any subsequent notice by means of a further notice or notices to the Trustee; but, any action theretofore taken or payments theretofore made by the Trustee pursuant to a prior notice shall not be affected by a subsequent notice.

14.3 Reliance upon Notice. Upon receipt of any notice as provided in this Article, the Trustee shall promptly take whatever action and make whatever payments are called for therein, it being intended that the Trustee may rely upon the information and directions in such notice absolutely and without question. However, the Trustee may call to the attention of the Committee any error or oversight that the Trustee believes to exist in any notice.

#### **ARTICLE XV BENEFIT PAYMENTS**

15.1 Method of Payment. As soon as practicable after a Member, former Member, or Beneficiary becomes entitled to receive benefits hereunder, as provided in Articles VII, VIII, IX or X and this Article XV, the Committee shall give written notice to the Trustee. Such benefits shall be paid to the Member, former Member, or his Beneficiary in a lump sum. Any benefit payable hereunder will be paid in cash or in whole shares of Common Stock, as elected by the Member, former Member or Beneficiary; provided, however, that such benefit shall in any event be paid in whole shares of Common Stock to the extent that such Member's, former Member's or Beneficiary's Individual Account is invested in Common Stock, pursuant to Article XII hereof. Any fractional shares of Common Stock shall be converted to, and paid, in cash.

15.2 Time of Payment. Distribution shall be made as soon as administratively practicable, but in no event later than one (1) year after the Valuation Date coincident with or immediately following the separation from service of a Member, former Member, or Beneficiary who is entitled to receive a benefit hereunder. Notwithstanding the foregoing, if the nonforfeitable portion of a Member's or former Member's Individual Account exceeds One Thousand and No/100 Dollars (\$1,000.00), no distributions, other than distributions upon the death of such Member or former Member, may commence without the consent of the Member or former Member until he attains age sixty-two (62), at which time distribution shall be made. Such consent must be obtained within the one hundred eighty (180) day period ending on the date of distribution. The Committee shall notify the Member or former Member of the right to defer any distribution until the date on which he attains age sixty-two (62). Such notification shall include a general description of the material features, and an explanation of the relative values of, the optional forms of benefit available under the Plan in a manner that would satisfy the notice requirements of Section 417(a)(3) of the Code, and shall be provided no less than thirty

(30) days and no more than one hundred eighty (180) days prior to the annuity starting date. The annuity starting date is the first day of the first period for which a benefit is paid hereunder. Notwithstanding the foregoing, the consent of the Member or former Member shall not be required to the extent that a distribution is required to satisfy Section 415 of the Code. In addition, upon termination of this Plan, if the Plan does not then offer an annuity option, the Member's or former Member's Individual Account may, without his consent, be distributed to the Member or former Member or transferred to another defined contribution plan maintained by an Affiliate.

Distribution shall be made no later than the required beginning date, which is April 1st of the calendar year following the later of: (a) the calendar year in which a Member attains age 70<sup>1/2</sup> or (b) the calendar year in which the Member retires; provided that if a Member is a Five Percent (5%) Owner (as defined in Section 19.1(f) hereof), then the required beginning date is April 1st of the calendar year following the calendar year in which such Member attains age 70<sup>1/2</sup>. Subject to the provisions of Section 18.10 hereof, distribution of the entire Individual Account of a Member shall be made in a single lump sum on or before such Member's required beginning date; provided, however, that in the case of a Member who attained age 70<sup>1/2</sup> prior to September 15, 2000, or in the case of a Member who is a Five Percent Owner, only the minimum distribution required for the calendar year immediately preceding the Member's required beginning date must be made on or before his required beginning date. Furthermore, a minimum distribution for other calendar years, including the minimum distribution for the calendar year in which such Member's required beginning date occurs, must be made on or before December 31 of such calendar year. All minimum distributions required under this Article XV shall be determined and made in accordance with the applicable Treasury Regulations under Section 401(a)(9) of the Code, and the requirements of this Article will take precedence over any inconsistent provisions of the Plan. Required minimum distributions will be determined beginning with the first distribution calendar year and up to and including the distribution calendar year that includes the Member's date of death. During such Member's lifetime, the minimum amount that will be distributed for each distribution calendar year is the lesser of:

(a) the quotient obtained by dividing the Member's Individual Account balance by the distribution period in the Uniform Lifetime Table set forth in section 1.401(a)(9)-9 of the Treasury Regulations, using the Member's age as of the Member's birthday in the distribution calendar year; or

(b) if the Member's sole designated beneficiary for the distribution calendar year is the Member's spouse, the quotient obtained by dividing the Member's Individual Account balance by the number in the Joint and Last Survivor Table set forth in section 1.401(a)(9)-9 of the Treasury Regulations, using the Member's and spouse's attained ages as of the Member's and spouse's birthdays in the distribution calendar year.

Notwithstanding any provision herein to the contrary, any Member who attains age 70<sup>1/2</sup> in a calendar year after 1995 and prior to September 15, 2000, may irrevocably elect, in the manner established by the Committee, by April 1 of the calendar year following the year in which the Member attains age 70<sup>1/2</sup> (or by December 31, 1997 in the case of a Member who attains age 70<sup>1/2</sup> in 1996) to defer distributions until April 1 of the calendar year following the calendar year in which the Member retires. If no such election is made, the Member will begin

receiving distributions by the April 1 of the calendar year following the year in which the Member attains age 70½ (or by December 31, 1997 in the case of a Member who attains age 70½ in 1996), and any such distributions shall comply with the provisions of the preceding paragraph. Furthermore, any Member who attains age 70½ in a calendar year prior to 1996, may irrevocably elect, in the manner established by the Committee, to stop distributions and recommence distributions as of the April 1 of the calendar year following the calendar year in which such Member retires.

If distributions have commenced so that payments are being made over the life of the Member, and he dies before his entire interest has been distributed, then the remaining portion of such interest shall be distributed at least as rapidly as under the method of distribution being used as of the date of his death, but in no event later than one year after the Valuation Date coincident with or immediately following his death. On the other hand, if a Member dies before the distribution of any of his benefits has begun, then his entire interest will be distributed no later than one year after the Valuation Date coincident with or immediately following his death. If the designated Beneficiary is the Member's surviving spouse and such surviving spouse dies after the Member, but before payment to such surviving spouse is made, then the provisions of the preceding sentence shall be applied as if the surviving spouse were the Member. Furthermore, if the designated Beneficiary is the surviving spouse of the Member, then distribution to such surviving spouse will not be required earlier than the later of: (a) December 31 of the calendar year immediately following the calendar year of the Member's death and (b) December 31 of the calendar year in which the Member would have attained age 70½. Distribution of benefits is considered to have begun, for purposes of this paragraph, on the required beginning date; provided that if a Member's designated Beneficiary is his surviving spouse, and such surviving spouse dies after the Member but before payments to such surviving spouse have begun, then distribution of benefits is considered to have begun on the date distribution to the surviving spouse is required to begin pursuant to the provisions of this paragraph.

Notwithstanding any provision herein to the contrary, unless a Member or former Member elects otherwise, in writing, no distribution hereunder shall start later than 60 days after the close of the Plan Year in which the last to occur of the following occurs:

- (a) the Member or former Member attains Normal Retirement Age,
- (b) the 10th anniversary of the year in which the Member or former Member commenced participation in the Plan, or
- (c) the Member or former Member terminates service with the Company.

15.3 Cash Out Distribution. If a Member or former Member who has received a distribution of his benefits hereunder on or before the last day of the second Plan Year following the year in which his separation from service occurs, has forfeited a portion of his Individual Account, then in the event such Member or former Member is subsequently rehired by the Company or an Eligible Affiliate prior to the date on which he incurs five (5) consecutive Breaks in Service, he shall be entitled to repay, at any time prior to the earlier of: (i) the date which is five (5) years after the first date on which he is subsequently reemployed by the Company or an

Eligible Affiliate and (ii) the date on which he incurs five (5) consecutive Breaks in Service, the amount of the distribution to him from his Individual Account. Upon such repayment, the rehired Member's or former Member's Individual Account shall be credited with the exact amount that was nonvested at the time of termination. In the event a rehired Member or former Member who has received a distribution hereunder does not timely repay such distribution from his Individual Account, as provided above, then the amount he forfeited at the time of his distribution pursuant to the terms of Section 10.3 hereof shall remain forfeited. His prior years of Vesting Service shall be taken into account, however, for purposes of determining his vested interest in contributions following reemployment. If a Member or former Member who does not have any nonforfeitable right to his Individual Account and thus is deemed to have received a cashout distribution, pursuant to the provisions of Section 10.3 hereof, is subsequently reemployed by the Company or an Eligible Affiliate prior to incurring five (5) consecutive Breaks in Service, then upon such reemployment, the rehired Member's or former Member's Individual Account shall be credited with the exact amount that was nonvested at the time of termination.

15.4 Minority or Disability Payments. During the minority or Disability of any person entitled to receive benefits hereunder, the Committee may direct the Trustee to make payments due such person directly to him or to his spouse or a relative or to any individual or institution having custody of such person. Neither the Committee nor the Trustee shall be required to see to the application of payments so made, and the receipt of the payee (including the endorsement of a check or checks) shall be conclusive as to all interested parties.

15.5 Distributions Under Domestic Relations Orders. Nothing contained in this Plan shall prevent the Trustee, in accordance with the direction of the Committee, from complying with the provisions of a qualified domestic relations order (as defined in Section 414(p) of the Code). The Plan specifically permits distribution to an alternate payee under a qualified domestic relations order at any time, irrespective of whether the Member or former Member has attained his earliest retirement age under the Plan, as defined in Section 414(p) of the Code; provided, however, that a distribution to an alternate payee prior to the Member or former Member's attainment of earliest retirement age is available only if: (1) the order specifies distribution at that time or permits an agreement between the Plan and the alternate payee to authorize an earlier distribution; (2) the order specifies that such distribution will be in the form of a single, lump-sum payment; and (3) if the amount to which the alternate payee is entitled under the Plan exceeds \$1,000, and the order so requires, the alternate payee consents to any distribution occurring prior to the alternate payee's attainment of age sixty-two (62). If an alternate payee has not previously received a distribution of the entire interest to which such alternate payee is entitled hereunder, distribution shall be made to such alternate payee as soon as practicable following the alternate payee's attainment of age sixty-two (62). Nothing in this Section 15.5 gives a Member or former Member a right to receive distribution at a time otherwise not permitted under the Plan nor does it permit the alternate payee to receive a form of payment not otherwise permitted under the Plan.

The Plan Administrator shall establish reasonable procedures to determine the qualified status of a domestic relations order. Upon receiving a domestic relations order, the Plan Administrator shall promptly notify the Member or former Member and any alternate payee named in the order, in writing, of the receipt of the order and the Plan's procedures for

determining the qualified status of the order. Within a reasonable period of time after receiving the domestic relations order, the Plan Administrator shall determine the qualified status of the order and shall notify the Member or former Member and each alternate payee, in writing, of its determination. The Plan Administrator shall provide notice under this paragraph by mailing to the individual's address specified in the domestic relations order, or in a manner consistent with Department of Labor regulations. The Plan Administrator may treat as qualified any domestic relations order entered prior to January 1, 1985, irrespective of whether it satisfies all the requirements described in Section 414(p) of the Code.

If any portion of an Individual Account is payable during the period the Plan Administrator is making its determination of the qualified status of the domestic relations order, the Committee shall direct the Trustee to segregate the amounts that are payable into a separate account and to invest the segregated account solely in fixed income investments. If the Plan Administrator determines the order is a qualified domestic relations order within eighteen (18) months of receiving the order, the Committee shall direct the Trustee to distribute the segregated account in accordance with the order. If the Plan Administrator does not make its determination of the qualified status of the order within eighteen (18) months after receiving the order, the Committee shall direct the Trustee to distribute the segregated account in the manner in which the Plan would otherwise distribute if the order did not exist and shall apply the order prospectively if the Plan Administrator later determines the order is a qualified domestic relations order.

To the extent it is not inconsistent with the provisions of the qualified domestic relations order, the Committee may direct the Trustee to invest any amount that is subject to being paid to an alternate payee pursuant to said order into a segregated subaccount or separate account and to invest the account in federally insured, interest-bearing savings account(s) or time deposit(s) (or a combination of both), or in other fixed income investments. A segregated subaccount shall remain a part of the Trust, but it alone shall share in any income it earns, and it alone shall bear any expense or loss it incurs.

The Trustee shall make any payments or distributions required under this Section 15.5 by separate benefit checks or other separate distribution to the alternate payee(s).

15.6 Direct Rollover of Eligible Rollover Distributions. An individual who is entitled to a benefit hereunder (including a Participant's surviving spouse, a Participant's spouse or former spouse who is the alternate payee under a qualified domestic relation order, as defined in Section 414(p) of the Code, and a non-spouse Beneficiary designated in accordance with Section 8.2 hereof), the distribution of which would qualify as an "eligible rollover distribution", as such term is hereinafter defined, may, in lieu of receiving any payment or payments from the Plan, direct the Trustee to transfer all or any portion of such payment or payments directly to the trustee of one or more "eligible retirement plans", as such term is hereinafter defined. For purposes of this Section 15.6, the term "eligible rollover distribution" is defined as any distribution of all or any portion of the balance to the credit of the distributee, including any portion of such balance that consists of amounts that are not includible in gross income, except that an eligible rollover distribution does not include: any distribution that is one of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or life expectancy) of the distributee or the joint lives (or joint life expectancies) of the distributee and

the distributee's designated beneficiary, or for a specified period of ten years or more and any distribution to the extent such distribution is required under Code Section 401(a)(9). For purposes of this Section 15.6, the term "eligible retirement plan" shall mean (i) an individual retirement account described in Section 408(a) of the Code; (ii) an individual retirement annuity described in Section 408(b) of the Code (other than an endowment contract); (iii) a qualified trust described under Section 401(a) of the Code; (iv) an annuity plan described in Section 403(a) of the Code; (v) an annuity contract described in Section 403(b) of the Code; and (vi) an eligible plan under Section 457(b) of the Code that is maintained by a state, political subdivision of a state, or any agency or instrumentality of a state or political subdivision of a state and that agrees to separately account for amounts transferred into such plan from this Plan. Notwithstanding the foregoing, in the case of a non-spouse Beneficiary, the term "eligible retirement plan" shall refer only to a plan described in clauses (i) and (ii) above that is established on behalf of the designated Beneficiary and that is required to be treated as an inherited IRA pursuant to the provisions of Section 402(c)(11) of the Code. Also, in this case, the determination of any required minimum distribution under Section 401(a)(9) of the Code that is ineligible for rollover shall be made in accordance with IRS Notice 2007-7, Q&A 17 and 18, 2007-5 I.R.B. 395.

A portion of a distribution that consists of after-tax employee contributions may be transferred only to an individual retirement account or annuity described in Section 408(a) or (b) of the Code, or to a qualified defined contribution or defined benefit plan described in Section 401(a) or an annuity contract described in Section 403(b) of the Code that agrees to separately account for amounts so transferred, including separately accounting for the portion of such distribution that is includible in gross income and the portion of such distribution that is not so includible (as defined in Section 401(a)(31)(D) of the Code).

Any such election of a direct rollover must be made on a form provided by the Committee for that purpose and received by the Committee no later than the date established by the Committee preceding the date on which the distribution is to occur. Any election made pursuant to this Section 15.6 may be revoked at any time prior to the date established by the Committee preceding the date on which the distribution is to occur. If an individual who is so entitled has not elected a direct rollover within the time and in the manner set forth above, such distributee shall be deemed to have affirmatively waived a direct rollover. A distributee who wishes to elect a direct rollover shall provide to the Committee, within the time and in the manner prescribed by the Committee, such information as the Committee shall reasonably request regarding the eligible retirement plan or plans to which the payment or payments are to be transferred. The Committee shall be entitled to rely on the information so provided, and shall not be required to independently verify such information. The Committee shall be entitled to delay the transfer of any payment or payments pursuant to this Section 15.6 until it has received all of the information which it has requested in accordance with this Section 15.6.

## **ARTICLE XVI TRUSTEE**

16.1 Appointment of Trustee. A Trustee (or Trustees) shall be appointed by the Committee to administer the Trust Fund. The Trustee shall serve at the pleasure of the Committee and shall have such rights, powers and duties as are provided to a Trustee under ERISA for the investment of assets and for the administration of the Trust Fund.

16.2 Appointment of Investment Manager. An Investment Manager (or Investment Managers) may be appointed by the Committee to manage (including the power to acquire and dispose of) any part or all of the assets of the Trust Fund. The Investment Manager shall serve at the pleasure of the Committee, and shall have the rights, powers and duties provided to a named fiduciary under ERISA for the investment of the assets assigned to it. (The Investment Manager may be referred to from time to time hereafter as “he,” “they,” or “it,” or may be referred to in the singular or plural, but all such references shall be to the then acting Investment Manager or Investment Managers serving hereunder.)

16.3 Responsibility of Trustee and Investment Manager. All contributions under this Plan shall be paid to and held by the Trustee. The Trustee shall have responsibility for the investment and reinvestment of the Trust Fund except with respect to the management of those assets specifically delegated to the Investment Manager and those funds invested pursuant to the provisions of Section 15.5. The Investment Manager shall have exclusive management and control of the investment and/or reinvestment of the assets of the Trust Fund assigned to it in writing by the Trustee. All property and funds of the Trust Fund, including income from investments and from all other sources, shall be retained for the exclusive benefit of Members or former Members, as provided herein, and shall be used to pay benefits to Members or former Members or their Beneficiaries, or to pay expenses of administration of the Plan and Trust Fund.

This Plan and the related Trust are intended to allocate to each fiduciary the individual responsibilities of the prudent execution of the functions assigned to each. None of the allocated responsibilities or any other responsibility shall be shared by the fiduciaries or the Trustee unless such sharing shall be provided for by a specific provision in this Plan or related Trust.

16.4 Bonding of Trustee and Investment Manager. Neither the Trustee nor the Investment Manager shall be required to furnish any bond or security for the performance of their powers and duties hereunder unless the applicable law makes the furnishing of such bond or security mandatory.

## **ARTICLE XVII AMENDMENT AND TERMINATION OF PLAN**

17.1 Amendment of Plan. The Company may, without the assent of any other party, make from time to time any amendment or amendments to this Plan which do not cause any part of the Trust Fund to be used for, or diverted to, any purpose other than the exclusive benefit of Members or former Members of the Plan. Any such amendment shall be by a written instrument executed by the Company, and shall become effective as of the date specified in such instrument. Notwithstanding the foregoing, no amendment to the Plan shall be effective to the extent that it has the effect of decreasing a Member’s or former Member’s accrued benefit, except as provided in Section 412(c)(8) of the Code. For purposes of the preceding sentence, an amendment which has the effect of decreasing a Member’s or former Member’s Individual Account or eliminating an optional form of benefit, with respect to benefits attributable to service prior to such amendment shall be treated as reducing an accrued benefit. If any amendment changes the vesting schedule set forth in Section 10.1, then a Member’s or former Member’s nonforfeitable percentage in his Individual Account because of a change to the vesting schedule shall not be less than his nonforfeitable percentage computed under the vesting schedule in effect prior to the

amendment. Furthermore, if any amendment changes the vesting schedule set forth in Section 10.1, then each Member or former Member having at least three (3) Years of Vesting Service may elect to be governed under the vesting schedule set forth in the Plan without regard to the amendment. The Member or former Member must file his written election with the Committee within sixty (60) days after receipt of a copy of the amendment. The Committee shall furnish the Member or former Member with a copy of the amendment and with notice of the time within which his election must be returned to the Committee.

17.2 Termination of Plan. The Company may at any time, effective as specified, terminate the Plan by resolution of its board of directors. A certified copy of such resolution shall be delivered to the Trustee.

17.3 Complete Discontinuance of Contributions. In the event the Company decides it is impossible or inadvisable for it to continue to make its contributions as provided in Article IV, it shall have the power by appropriate resolution to either:

- (a) discontinue its contributions to the Plan; or
- (b) terminate the Plan.

A complete discontinuance of contributions by the Company shall not constitute a formal termination of the Plan and shall not preclude later contributions, but all Individual Accounts of Members or former Members not theretofore fully vested shall be and become 100% vested and nonforfeitable in the respective Members or former Members, irrespective of the provisions of Section 10.1. In such event, Employees who become eligible to enter the Plan subsequent to the discontinuance shall receive no benefit, and no additional benefits shall accrue to any of such Employees unless such contributions are resumed. After the date of a complete discontinuance of contributions, the Trust shall remain in existence as provided in this Section 17.3, and the provisions of the Plan and Trust shall remain in force as may be necessary in the sole and absolute discretion of the Committee.

17.4 Liquidation of Trust Fund. Upon termination or partial termination of the Plan, the Individual Accounts of all Members, former Members and Beneficiaries shall thereupon be and become fully vested and nonforfeitable. Thereupon, the Trustee shall convert the Trust Fund to cash after deducting all charges and expenses. The Committee shall then adjust the balances of all Individual Accounts, as provided in Section 5.2. Thereafter, the Trustee shall distribute the amount to the credit of each affected Member, former Member and Beneficiary, in accordance with the provisions of Article XV hereof.

17.5 Consolidation or Merger. This Plan shall not be merged or consolidated with, nor shall any assets or liabilities be transferred to, any other plan, unless the benefits payable on behalf of each Member or former Member if the Plan were terminated immediately after such action would be equal to or greater than the benefits to which such Member or former Member would have been entitled if this Plan had been terminated immediately before such action. The Trustee shall not accept a direct transfer of assets from a plan subject to the requirements of Section 417 of the Code.

**ARTICLE XVIII  
GENERAL PROVISIONS**

18.1 No Employment Contract. Nothing contained in this Plan shall be construed as giving any person whomsoever any legal or equitable right against the Committee, the Company, its stockholders, officers or directors or against the Trustee, except as the same shall be specifically provided for in this Plan. Nor shall anything in this Plan give any Member, former Member or other Employee the right to be retained in the service of the Company or an Eligible Affiliate and the employment of all persons by the Company or an Eligible Affiliate shall remain subject to termination by the Company or such Eligible Affiliate to the same extent as if this Plan had never been executed.

18.2 Manner of Payment. Wherever and whenever it is herein provided for payments or distributions to be made, whether in money or otherwise, said payments or distributions shall be made directly into the hands of the Member or former Member, his Beneficiary, his administrator, executor or guardian, or an alternate payee pursuant to Section 15.5 herein, as the case may be. A deposit to the credit of a person entitled to payment in any bank or trust company selected by such person shall be deemed payment into his hands, and provided further that in the event any person otherwise entitled to receive any payment or distribution shall be a minor or an incompetent, such payment or distribution may be made to his guardian or other person as may be determined by the Committee.

18.3 Nonalienation of Benefits. Subject to Code Section 414(p) and Section 15.5 herein relating to qualified domestic relations orders, the interest of any Member, former Member or Beneficiary hereunder shall not be subject in any manner to any indebtedness, judgment, process, creditors' bills, attachments, garnishment, levy, execution, seizure or receivership, nor shall such interest be in any manner reduced or affected by any transfer, assignment, conveyance, sale, encumbrance, act, omission, or mishap, voluntary or incidental, anticipatory or otherwise, of or to said Member, former Member or Beneficiary, and they and any of them shall have no right or power to transfer, convey, assign, sell or encumber said benefits and their interest therein, legal or equitable, during the existence of this Plan. Notwithstanding the foregoing, no provision of this Plan shall preclude the enforcement of a Federal tax levy made pursuant to Section 6331 of the Code or collection by the United States on a judgment resulting from an unpaid tax assessment.

18.4 Titles for Convenience Only. Titles of the Articles and Sections hereof are for convenience only and shall not be considered in construing this Plan. Also words used in the singular or the plural may be construed as though in the plural or singular where they would so apply.

18.5 Validity of Plan. This Plan and each of its provisions shall be construed and their validity determined by the laws of the State of Texas, and all provisions hereof shall be administered in accordance with the laws of said State, provided that in case of conflict, the provisions of ERISA shall control.

18.6 Plan Binding. This Plan shall be binding upon the successors and assigns of the Company and the Trustee and upon the heirs and personal representatives of those individuals who become Members hereunder.

18.7 Return of Contributions. This Plan and the related Trust are designed to qualify under Sections 401(a) and 501(a) of the Code. Anything contained herein to the contrary notwithstanding, if the initial determination letter is issued by the District Director of Internal Revenue to the effect that this Plan and related Trust hereby created, or as amended prior to the receipt of such letter, do not meet the requirements of Section 401(a) and 501(a) of the Code, the Company shall be entitled at its option to withdraw all contributions theretofore made, in which event the Plan and Trust shall then terminate.

Each contribution to the Plan is specifically conditioned on the deductibility of such contribution under the Code. The Trustee, upon written request from the Company, shall return to the Company the amount of the Company's contribution made as a result of a mistake of fact or the amount of the Company's contribution disallowed as a deduction under Section 404 of the Code. Such return of contribution must be made within one (1) year after (a) the Company made the contribution by mistake of fact or (b) the disallowance of the contribution as a deduction. The amount of contribution subject to being returned hereunder shall not be increased by any earnings attributable to the contribution, but such amount subject to being returned shall be decreased by any losses attributable to it.

18.8 Missing Members or Beneficiaries. Each Member shall file with the Committee from time to time in writing a mailing address and any change of mailing address for himself and his designated Beneficiary. Any communication, statement or notice addressed to a Member or Beneficiary at the last mailing address filed with the Committee, or if no such address is filed with the Committee, then at his last mailing address as shown on the Company's records, shall be binding on the Member or his Beneficiary for all purposes of the Plan. The Committee shall not be required to search for or locate a Member or Beneficiary. If the Committee notifies any Member or Beneficiary that he is entitled to a distribution and also notifies him of the provisions of this Section 18.8 (or makes reasonable effort to so notify such Member or Beneficiary by certified letter, return receipt requested, to the last known address, or such other further diligent effort, including consultation with the Internal Revenue Service or the Social Security Administration, to ascertain the whereabouts of such Member or Beneficiary as the Committee deems appropriate) and the Member or Beneficiary fails to claim his distributive share or make his whereabouts known to the Committee within three years thereafter, the distributive share of such Member or Beneficiary will be forfeited and reallocated according to Section 6.2. However, if the Member or his Beneficiary should, thereafter, make a proper claim for such share, it shall be distributed to him.

18.9 Voting Rights.

(a) Each Member shall be entitled to direct the Trustee as to the manner in which any Common Stock allocated to said Member's Accounts shall be voted. The Committee shall furnish to each Member a proxy adequate for such purpose. The Trustee shall vote specifically in accordance with each Member's instructions to the extent of such Member's whole shares and shall, to the extent possible, vote the combined

fractional shares of such Members in such manner as to reflect the Members' expressed desires. To the extent permitted under ERISA, the Trustee shall vote shares of Common Stock with respect to which it does not receive instructions and shares of Common Stock which have not been allocated to Members' Accounts under the Plan in the same proportion as are voted the shares of Common Stock held under the Plan with respect to which instructions were received by the Trustee from Members.

(b) Notwithstanding anything to the contrary contained in the Plan, if a cash tender offer or exchange offer for shares of Common Stock is made, Common Stock allocated to each Member's accounts under the Plan shall be tendered or exchanged by the Trustee pursuant to such cash tender offer or exchange offer only in accordance with the written instructions and directions of such Member to the Trustee to so tender or exchange. If a cash tender offer or exchange offer for shares of Common Stock is made, the Trustee shall use its best efforts to take those steps reasonably necessary to furnish information to, and allow decision by, each Member with respect to such cash tender offer or exchange offer and the shares of Common Stock allocated to such Member's accounts under the Plan in substantially the same manner as would be available to holders of Common Stock generally, and, in that connection, the Trustee shall:

(i) Inform each Member as to the existence of such cash tender offer or exchange offer;

(ii) Transmit to each Member as soon as practicable such written information, explanation and other materials relative to such cash tender offer or exchange offer as are made available by the Company or by the persons or entities making such cash tender offer or exchange offer to the holders of shares of Common Stock generally;

(iii) Request detailed written instructions and directions from each Member as to whether to tender or exchange the shares of Common Stock allocated to such Member's accounts under the Plan and as to the time and manner of such tender or exchange, if so instructed and directed; and

(iv) Use its best efforts to effect on a nondiscriminatory basis the tender or exchange of Common Stock held under the Plan with respect to such cash tender offer or exchange offer solely in accordance with written instructions and directions received from Members. If written instructions or directions are not timely received from a Member, the shares of Common Stock allocated to his accounts under the Plan shall not be tendered or exchanged pursuant to such cash tender offer or exchange offer.

For purposes of this subparagraph (b), the term cash tender offer shall include a tender offer for, or request or invitation for tenders of, shares of Common Stock in exchange for cash, as made to the Plan or to holders of shares of Common Stock generally; the term exchange offer shall include a tender offer for, or request or invitation for tenders of, any shares of Common Stock in exchange for any consideration other than for all cash, as made to the Plan or to holders of shares of Common Stock generally.

(c) If any shares of Common Stock held under the Plan are tendered or exchanged pursuant to a cash tender offer or exchange offer in accordance with subparagraph (b) above, any cash proceeds obtained by the Trustee in connection therewith shall be temporarily invested in such short term investments as the Trustee may determine, until such time as such temporarily invested cash proceeds are reinvested in Common Stock. Any other property obtained by the Trustee pursuant to an exchange offer shall be temporarily held in kind by the Trustee, until such time as such temporarily held property is sold and the proceeds therefrom are reinvested in Common Stock.

18.10 Preretirement Diversification Rights. If, as of December 31, 2007, a Member has attained age fifty-five (55) and has been credited with ten (10) years of participation in the Plan (hereinafter referred to as a "Qualified Member"), notwithstanding the provisions of Section 15.1 hereof, the following rules shall apply to any distribution made under the Plan to or on behalf of such Qualified Member.

(a) Annuity Distributions to Qualified Members. The Committee shall direct the Trustee to distribute such Member's benefits held in a Qualified Member's Individual Account in the form of a qualified joint and survivor annuity, unless the Qualified Member has a valid waiver election (described in Section 18.10(b) hereof) in effect. A qualified joint and survivor annuity is an immediate annuity (a) that is payable for the life of the Qualified Member, with, if the Qualified Member is married on the annuity starting date, as defined below, a survivor annuity for the life of the Qualified Member's surviving spouse that is equal to fifty percent (50%) of the amount of the annuity payable during the joint lives of the Qualified Member and his spouse, and (b) that is the actuarial equivalent of a single annuity for the life of the Qualified Member. On or before the annuity starting date (the first day of the first period for which the Qualified Member would receive an amount as an annuity or in any other form), the Committee shall direct the Trustee to pay the Qualified Member's benefits in a lump sum, in lieu of a qualified joint and survivor annuity, if the nonforfeitable portion of a Qualified Member's Individual Account is not greater than One Thousand and No/100 Dollars (\$1,000.00).

If a Qualified Member who is married dies prior to commencement of payment of his benefits, the Committee shall direct the Trustee to distribute the Qualified Member's Individual Account, as calculated under Article VIII, to the Qualified Member's surviving spouse in the form of a preretirement survivor annuity, unless the Qualified Member has a valid waiver election (as described in Section 18.10(c) hereof) in effect. A preretirement survivor annuity is an annuity that is payable for the life of the Qualified Member's surviving spouse. The surviving spouse may elect to have the preretirement survivor annuity distributed within a reasonable period after the Qualified Member's death. The Committee shall direct the Trustee to pay the Qualified Member's Individual Account in a lump sum, in lieu of a preretirement survivor annuity, if the nonforfeitable portion of a Qualified Member's Individual Account is not greater than One Thousand and No/100 Dollars (\$1,000.00).

The Committee is not required to distribute any survivor annuity described herein to the spouse of a Qualified Member unless the Qualified Member and his spouse were married throughout the one-year period ending on the earlier of the Qualified Member's

annuity starting date or the Qualified Member's death; provided, however, this exception shall not apply if the Qualified Member marries within one year before the annuity starting date and has been married for at least a one-year period ending on or before the date of the Qualified Member's death.

If the Qualified Member has in effect a valid waiver election regarding the qualified joint and survivor annuity or the preretirement survivor annuity, and has not elected to receive a qualified optional survivor annuity, as provided in paragraph (b) below, the Committee shall direct the Trustee to distribute the Participant's Individual Account in accordance with Section 15.1. Furthermore, the Qualified Member's surviving spouse may elect a qualified optional survivor annuity or the form of payment described in Section 15.1 in lieu of the preretirement survivor annuity. For purposes of applying this Section 18.10, the Committee shall treat a former spouse as the Qualified Member's spouse or surviving spouse to the extent required under a qualified domestic relations order.

(b) Waiver Election – Qualified Joint and Survivor Annuity. Within a reasonable period of time (no less than thirty (30) days and no more than one hundred eighty (180) days) before the Qualified Member's annuity starting date, the Committee shall provide the Qualified Member a written explanation of the terms and conditions of the qualified joint and survivor annuity and the qualified optional survivor annuity, the Qualified Member's right to make, and the effect of, an election to waive the qualified joint and survivor form of benefit, the rights of a married Qualified Member's spouse regarding the waiver election and the Qualified Member's right to make, and the effect of, a revocation of a waiver election.

A Qualified Member's waiver election is not valid unless:

- (i) the Qualified Member makes the waiver election within the one hundred eighty (180) day period ending on his annuity starting date;
- (ii) in the event the nonforfeitable portion of the Qualified Member's Individual Account exceeds Five Thousand and No/100 Dollars (\$5,000.00), the Qualified Member's spouse (to whom the survivor annuity is payable under the qualified joint and survivor annuity) consents in writing to the waiver election, the spouse's consent acknowledges the effect of the election, and a notary public or a Committee member (or its representative) witnesses the spouse's consent; and
- (iii) in the event the nonforfeitable portion of a Qualified Member's Individual Account exceeds Five Thousand and No/100 Dollars (\$5,000.00), either the spouse is the Qualified Member's sole primary Beneficiary or the spouse consents to the Qualified Member's Beneficiary designation or to any change in the Qualified Member's Beneficiary Designation.

Additionally, a Qualified Member's waiver of the qualified joint and survivor annuity shall not be effective unless the election designates a form of benefit payment, which may include a qualified optional survivor annuity, which may not be changed

without spousal consent (or the spouse expressly permits designations by the Qualified Member without any further spousal consent).

The Committee may accept as valid a waiver election that does not satisfy the spousal consent requirements described in paragraphs (ii) and (iii) above if the Committee establishes that the Qualified Member does not have a spouse, the Committee is not able to locate the Qualified Member's spouse, or other circumstances prescribed by Treasury Department regulations.

Any consent by a spouse obtained under this Section (or the establishment that the consent of a spouse may not be obtained) shall be effective only with respect to such spouse. A consent that permits designations by the Qualified Member without any requirement of further consent by such spouse must acknowledge that the spouse has the right to limit consent to a specific Beneficiary, and a specific form of benefit where applicable, and that the spouse voluntarily elects to relinquish either or both of such rights. A revocation of a prior waiver may be made by a Qualified Member without the consent of the spouse at any time before the commencement of benefits. The number of revocations shall not be limited. No consent obtained under this Section shall be valid unless the Qualified Member has received an explanation of the terms and conditions of the qualified joint and survivor annuity and the qualified optional survivor annuity, as provided herein. For purposes of this Section 18.10, a qualified optional survivor annuity is an immediate annuity (a) that is payable for the life of the Qualified Member, with, if the Qualified Member is married on the annuity starting date, a survivor annuity for the life of the Qualified Member's surviving spouse that is equal to seventy-five percent (75%) of the amount of the annuity payable during the joint lives of the Qualified Member and his spouse, and (b) that is the actuarial equivalent of a single annuity for the life of the Qualified Member.

(c) Waiver Election — Preretirement Survivor Annuity. The Committee shall provide each Qualified Member, within a reasonable period after the Member becomes a Qualified Member, a written explanation of the terms and conditions of the preretirement survivor annuity, the Qualified Member's right to make, and the effect of, an election to waive the preretirement survivor annuity, the rights of the Qualified Member's spouse regarding the waiver election and the Qualified Member's right to make, and the effect of, a revocation of a waiver election.

For purposes of applying this subsection, a reasonable period is the end of the two-year period beginning one year prior to the date on which the Member becomes a Qualified Member, and ending one year after that date.

A Qualified Member's waiver election of the preretirement survivor annuity is not valid unless the election satisfies the spousal consent requirements described in Section 18.10(b).

18.11 Qualified Military Service. Notwithstanding any provision of this Plan to the contrary, contributions, benefits and service credit with respect to qualified military service will be provided in accordance with Section 414 (u) of the Code.

**ARTICLE XIX**  
**TOP-HEAVY RULES**

19.1 Definitions. For purposes of applying the provisions of this Article XIX:

(a) “Key Employee” shall mean, as of any Determination Date (as defined below), any Employee or former Employee (including any deceased Employee) who, at any time during the Plan Year that includes the Determination Date, was an officer of the Company having Annual Compensation greater than \$130,000 (as adjusted under section 416(i)(1) of the Code for Plan Years beginning on or after January 1, 2003), a 5-percent owner of the Company, or a 1-percent owner of the Company having Annual Compensation of more than \$150,000. For this purpose, Annual Compensation means compensation within the meaning of Section 6.5(b)(iv) of the Plan. The determination of who is a Key Employee will be made in accordance with section 416(i)(1) of the Code and the applicable regulations and other guidance of general applicability issued thereunder. The constructive ownership rules of Section 318 of the Code will apply to determine ownership in the Company.

(b) “Non-Key Employee” is an Employee who does not meet the definition of Key Employee.

(c) “Required Aggregation Group” means:

(i) Each qualified plan of the Company or an Affiliated Entity (as defined below) in which at least one (1) Key Employee participates or participated at any time during the Plan Year that includes the Determination Date, or during the preceding four Plan Years (regardless of whether the plan has terminated); and

(ii) Any other qualified plan of the Company that enables a plan described in (1) to meet the requirements of Section 401(a)(4) or Section 410 of the Code.

(d) “Permissive Aggregation Group” is the Required Aggregation Group plus any other qualified plans maintained by the Company, but only if such group would satisfy in the aggregate the requirements of Section 401(a)(4) and Section 410 of the Code. The Committee shall determine which plans to take into account in determining the Permissive Aggregation Group.

(e) “Determination Date” for any Plan Year is the Allocation Date of the preceding Plan Year or, in the case of the first Plan Year of the Plan, the Allocation Date of that Plan Year.

(f) “Five Percent (5%) Owner” is any person who owns more than five percent (5%) of the outstanding stock of the Company or stock possessing more than five percent (5%) of the total combined voting power of all stock of the Company.

(g) "One Percent (1%) Owner" is any person who owns more than one percent (1%) of the outstanding stock of the Company or stock possessing more than one percent (1%) of the total combined voting power of all stock of the Company.

(h) "Affiliated Entity" shall mean all the members of (i) a controlled group of corporations as defined in Section 414(b) of the Code; (ii) a commonly controlled group of trades or businesses (whether or not incorporated) as defined in Section 414(c) of the Code; (iii) an affiliated service group as defined in Section 414(m) of the Code of which the Company is a part; or (iv) a group of entities required to be aggregated pursuant to Section 414(o) of the Code and the regulations issued thereunder.

**19.2 Determination of Top-Heavy Status.** The Plan is top heavy for a Plan Year if the top heavy ratio as of the Determination Date (as defined in Section 19.1 above) exceeds sixty percent (60%). The top heavy ratio is a fraction, the numerator of which is the sum of the present value of the Individual Accounts of all Key Employees (as defined in Section 19.1 above) as of the Determination Date and the denominator of which is a similar sum determined for all Employees in the Plan. The present value of the Individual Account balance of an Employee as of the Determination Date shall be increased by the distributions made with respect to the Employee under the Plan and any plan aggregated with the Plan under section 416(g)(2) of the Code during the 1-year period ending on the Determination Date. The preceding sentence shall also apply to distributions under a terminated plan which, had it not been terminated, would have been aggregated with the Plan under section 416(g)(2)(A)(i) of the Code. In the case of a distribution made for a reason other than separation from service, death, or disability, this provision shall be applied by substituting "5-year period" for "1-year period." The Individual Account of any individual who has not performed services for the Employer during the 1-year period ending on the Determination Date shall not be taken into account. The Committee shall calculate the top heavy ratio without regard to any Non Key Employee (as defined in Section 19.1 above) who was formerly a Key Employee. The Committee shall calculate the top heavy ratio, including the extent to which it must take into account distributions, rollovers and transfers, in accordance with Section 416 of the Code and the regulations under that Code Section.

If the Company maintains other qualified plans (including a simplified employee pension plan) this Plan is top-heavy only if it is part of the Required Aggregation Group (as defined in Section 19.1 above), and the top-heavy ratio for both the Required Aggregation Group and the Permissive Aggregation Group (as defined in Section 19.1 above) exceeds sixty percent (60%). The Committee will calculate the top-heavy ratio in the same manner as required by the first paragraph of this Section 19.2, taking into account all plans within the aggregation group. The Committee shall calculate the present value of accrued benefits and the other amounts the Committee must take into account, under defined benefit plans or simplified employee pension plans included within the group in accordance with the terms of those plans, Section 416 of the Code and the regulations under that Code Section. The Committee shall calculate the top-heavy ratio with reference to the Determination Dates that fall within the same calendar year.

**19.3 Minimum Company Contribution.** Notwithstanding anything contained herein to the contrary, for any Plan Year in which this Plan is determined to be top-heavy pursuant to Section 19.2 hereof, each Non-Key Employee who is an eligible Member shall be entitled to a supplemental contribution equal to three percent (3%) of such Non-Key Employee's Annual

Compensation, reduced by (i) the amount of “Qualified Nonelective Contributions”, if any, allocated to a Member’s “Salary Reduction Contribution Account” under the Southwest Airlines Co. 401(k) Plan for the applicable Plan Year and (ii) the amount of “Non-Elective Contributions”, if any, allocated to a Member’s “Participant’s Elective Account” under the Southwest Airlines Pilots Retirement Savings Plan for the applicable Plan Year. For purposes of this Section 19.3, an eligible Member is a Non-Key Employee who is employed by the Company on the last day of the applicable Plan Year.

The percentage referred to in the preceding paragraph shall not exceed the percentage of Annual Compensation at which Company contributions are made or allocated under this Plan and all other qualified defined contribution plans maintained by the Company, including “Salary Reduction Contributions” under the Southwest Airlines Co. 401(k) Plan and “Elective Contributions” under the Southwest Airlines Pilots Retirement Savings Plan, to the Key Employee for whom such percentage is the largest; provided, however, this sentence shall not apply if the Plan is required to be included in an Aggregation Group and enables a defined benefit plan required to be included in such group to meet the requirements of Code Sections 401(a)(4) or 410. If the minimum allocation is made for a Non-Key Employee pursuant to another qualified plan maintained by the Company, then the minimum allocation requirement will be considered satisfied for purposes of this Plan. “Company Matching Contributions” under the Southwest Airlines Co. 401(k) Plan and “matching contributions” under the Southwest Airlines Pilots Retirement Savings Plan shall be taken into account for purposes of satisfying the minimum contribution requirements of section 416(c)(2) of the Code and the Plan and shall be treated as matching contributions for purposes of the actual contribution percentage test and other requirements of section 401(m) of the Code.

## **ARTICLE XX FIDUCIARY PROVISIONS**

20.1 General Allocation of Duties. Each fiduciary with respect to the Plan shall have only those specific powers, duties, responsibilities and obligations as are specifically given him under the Plan. The board of directors of the Company shall have the sole responsibility for authorizing its contributions under the Plan. The Company shall have the sole authority to appoint and remove the members of the Committee and to amend or terminate this Plan, in whole or in part. The Committee shall have the sole authority to appoint and remove the Trustee and Investment Managers. However, neither the board nor the Committee shall be liable for any acts or omissions of the Trustee or Investment Manager or be under any obligation to invest or otherwise manage any assets of the Trust Fund which are subject to the management of the Trustee or Investment Manager. Except as otherwise specifically provided, the Committee shall have the sole responsibility for the administration of the Plan, which responsibility is specifically described herein. Except as otherwise specifically provided, the Trustee shall have the sole responsibility for the administration, investment and management of the assets held under the Plan. It is intended under the Plan that each fiduciary shall be responsible for the proper exercise of its own powers, duties, responsibilities and obligations hereunder and shall not be responsible for any act or failure to act of another fiduciary, except to the extent provided by law or as specifically provided herein.

20.2 Fiduciary Duty. Each fiduciary under the Plan shall discharge its duties and responsibilities with respect to the Plan:

- (a) solely in the interest of the Members of the Plan, for the exclusive purpose of providing benefits to such Members and their Beneficiaries, and defraying reasonable expenses of administering the Plan;
- (b) with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
- (c) by diversifying the investments of the Plan so as to minimize the risk of large losses, unless under the circumstances it is prudent not to do so; and
- (d) in accordance with the documents and instruments governing the Plan insofar as such documents and instruments are consistent with applicable law.

20.3 Fiduciary Liability. A fiduciary shall not be liable in any way for any acts or omissions constituting a breach of fiduciary responsibility occurring prior to the date it becomes a fiduciary or after the date it ceases to be a fiduciary.

20.4 Co-Fiduciary Liability. A fiduciary shall not be liable for any breach of fiduciary responsibility by another fiduciary unless:

- (a) it participates knowingly in, or knowingly undertakes to conceal, an act or omission of such other fiduciary, knowing such act or omission is a breach;
- (b) by its failure to comply with Section 404(a)(1) of ERISA in the administration of its specific responsibilities which give rise to its status as a fiduciary, it has enabled such other fiduciary to commit a breach; or
- (c) having knowledge of a breach by such other fiduciary, it fails to make reasonable efforts under the circumstances to remedy the breach.

20.5 Delegation and Allocation. The Committee may appoint subcommittees, individuals or any other agents as it deems advisable and may delegate to any of such appointees any or all of the powers and duties of the Committee. Such appointment and delegations must clearly specify the powers and duties delegated. Upon such appointment and delegation, the delegating Committee members shall have no liability for the acts or omissions of any such delegate, as long as the delegating Committee members do not violate their fiduciary responsibility in making or continuing such delegation.

IN WITNESS WHEREOF, Southwest Airlines Co. has caused its corporate seal to be affixed hereto and these presents to be duly executed in its name and behalf by its proper officers thereunto duly authorized this 14th day of December, 2007.

**SOUTHWEST AIRLINES CO.**

By: /s/ Gary C. Kelly  
Gary C. Kelly, Chief Executive Officer

SOUTHWEST AIRLINES CO.  
401(k) PLAN

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**SOUTHWEST AIRLINES CO.  
401(k) PLAN**

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SOUTHWEST AIRLINES CO.  
401(k) PLAN

**PREAMBLE**

WHEREAS, SOUTHWEST AIRLINES CO., a corporation formed under the laws of the State of Texas (the "Company") has previously adopted a profit sharing plan and trust designated as the Southwest Airlines Co. ProfitSharing Plan, effective as of January 1, 1973, which was subsequently amended and restated in its entirety, effective as of January 1, 1986, and which was again amended and restated in its entirety, effective as of January 1, 1991, to comply with the Tax Reform Act of 1986 and subsequent legislation and to continue the cash or deferred feature of the plan as a separate Plan (the "Prior Plan"); and

WHEREAS, the Company now desires to again amend and restate the Prior Plan in its entirety to implement certain provisions of, and for compliance with, the Pension Protection Act of 2006, to add an automatic enrollment feature, to incorporate amendments that have previously been made, and to reflect certain other operational and administrative practices;

NOW, THEREFORE, in consideration of the premises and to carry out the purposes and intent as set forth above, effective as of January 1, 2008, except as otherwise specifically provided herein, the Prior Plan is hereby restated and amended in its entirety, superseded and replaced by this plan (hereinafter referred to as the "Plan"), and the Company does hereby adopt this restated Plan for the benefit of its eligible employees. There will be no gap or lapse in time or effect between such plans, and the existence of a qualified plan shall be continuous and uninterrupted.

The terms and conditions of this restated Plan are as follows:

**ARTICLE I**  
**PURPOSE**

The purpose of this Plan is to reward Employees of the Company for their loyal and faithful service, to help the Employees accumulate funds for their later years, and to provide funds for their Beneficiaries in the event of death or disability. The benefits provided by this Plan will be paid from a Trust Fund established by the Company and will be in addition to the benefits Employees are entitled to receive under any other programs of the Company and under the Social Security Act.

This Plan and the separate related Trust forming a part hereof are established and shall be maintained for the exclusive benefit of the Members hereunder and their Beneficiaries. No part of the Trust Fund can ever revert to the Company, except as hereinafter provided, or be used for or diverted to purposes other than the exclusive benefit of the Members of this Plan and their Beneficiaries.

**ARTICLE II**  
**DEFINITIONS AND CONSTRUCTION**

2.1 Definitions. Where the following words and phrases appear in this Plan, they shall have the respective meanings set forth below, unless their context clearly indicates to the contrary:

(a) Affiliate. A member of a controlled group of corporations (as defined in Section 414(b) of the Code), a group of trades or businesses (whether or not incorporated) which are under common control (as defined in Section 414(c) of the Code), or an affiliated service group (as defined in Section 414(m) of the Code) of which the Company is a member, or any entity otherwise required to be aggregated with the Company pursuant to Section 414(o) of the Code and the regulations issued thereunder.

(b) Allocation Date. With respect to Qualified Nonelective Contributions, if any, the last day of the Plan Year and, with respect to Salary Reduction Contributions and Company Matching Contributions, the Valuation Date coincident with or next following the date on which such contributions are transmitted to the Trust.

(c) Annual Compensation. The total amounts paid by the Company or any Eligible Affiliate to an Employee as remuneration for personal services rendered during each Plan Year, including expense allowances (to the extent includible in the gross income of the Employee) and any amounts not includible in the gross income of the Employee pursuant to Sections 402(e)(3), 125(a), or 132(f)(4) of the Code, but excluding (1) director's fees; (2) expense reimbursements and nontaxable expense allowances; (3) prizes and awards; (4) expatriate bonuses; (5) items of imputed income; (6) contributions made by the Company under this Plan or any other employee benefit plan or program it maintains, such as group insurance, hospitalization or like benefits; (7) amounts realized or recognized from qualified or nonqualified stock options or when restricted stock or property held by the Employee either becomes freely transferable or is no longer subject to a substantial risk of forfeiture; (8) Company contributions to a plan of deferred compensation that are not included in the Employee's gross income for the taxable year in which contributed, or any distributions from a deferred compensation plan; (9) amounts, if any, paid to an Employee in lieu of a Company Contribution to the Southwest Airlines Co. ProfitSharing Plan in the event that such Company Contribution would constitute an annual addition, as defined in Section 415(c)(2) of the Code, in excess of the limitations under Section 415(c) of the Code; and (10) severance payments. For purposes of this Section 2.1(c), severance payments include severance pay, unfunded nonqualified deferred compensation benefits and parachute payments made after an Employee's severance from employment, but shall not include amounts attributable to payments made within 2½ months following severance from employment that, absent a severance from employment, would have been paid to the Employee for services rendered prior to the severance from employment and for accrued bona fide sick, vacation, or other leave (to the extent the Employee would have been able to use the leave if employment had continued). Annual Compensation shall include amounts otherwise includible, as provided above, which are paid by the Company or an Eligible Affiliate to the Employee

through another person, pursuant to the common paymaster provisions of Sections 3121(s) and 3306(p) of the Code.

The Annual Compensation of each Member or former Member taken into account under the Plan for any Plan Year shall not exceed \$230,000, as adjusted by the Secretary of the Treasury for increases in the cost of living at the time and in the manner set forth in Section 401(a)(17)(B) of the Code. If a Plan Year consists of fewer than twelve (12) months, then the dollar limitation in the preceding sentence will be multiplied by a fraction, the numerator of which is the number of months in the Plan Year, and the denominator of which is twelve (12). Except as otherwise provided herein, for purposes of an allocation under the Plan based on Annual Compensation, Annual Compensation shall only include amounts actually paid to an Employee during the period he is a Member of the Plan. Notwithstanding the limitation in the preceding sentence, for purposes of an allocation of a Company Matching Contribution, Annual Compensation shall include amounts actually paid to an Employee during the applicable Plan Year.

(d) Beneficiary. A person designated by a Member or former Member to receive benefits hereunder upon the death of such Member or former Member.

(e) Break in Service. An Employee shall have a Break in Service for each Plan Year in which he completes fewer than 501 Hours of Service with the Company unless he is on a leave of absence authorized by the Company in accordance with its leave policy.

(f) Code. The Internal Revenue Code of 1986, as amended.

(g) Committee. The persons who may be appointed to administer the Plan in accordance with Article XIII.

(h) Company. Southwest Airlines Co., or its successor or successors.

(i) Company Matching Contributions. Contributions that may be made by the Company for any Plan Year on behalf of a Member who has elected to receive Salary Reduction Contributions for such Plan Year as provided in Section 4.2 hereof. Company Matching Contributions shall be determined on behalf of Members whose conditions of employment are governed by a collective bargaining agreement between the Company and a labor union in accordance with the terms of such collective bargaining agreement, as then in effect, and shall be determined on behalf of Members whose conditions of employment are not so governed in the sole and absolute discretion of the board of directors of the Company.

(j) Company Matching Contribution Account. A separate subaccount to which is credited a Member's Company Matching Contributions, if any, and any earnings attributable thereto, adjusted to reflect any withdrawals, distributions, or investment losses attributable thereto.

(k) Deemed Election Date. Except as otherwise provided herein, the Entry Date on which an eligible Employee commences or recommences participation in the

Plan after January 1, 2008, in accordance with Section 3.1 hereof. Notwithstanding the foregoing, in the event an eligible Employee's employment with the Company and all Affiliates terminates, any deemed election that would otherwise be in effect shall automatically terminate and such Employee shall have a new Deemed Election Date, which shall be the first day of the calendar month concurrent with or next following such Employee's completion of thirty (30) consecutive days of Service, beginning on the date on which such Employee is reemployed. Furthermore, a deemed election in effect with respect to any Member shall automatically terminate upon the date of a withdrawal from such Member's Salary Reduction Contribution Account in accordance with the provisions of Section 11.2(e) hereof. An Employee hired prior to January 1, 2008 shall not have a Deemed Election Date unless such Employee terminates employment and is subsequently rehired after January 1, 2008.

(l) Disability. A physical or mental condition which, in the judgment of the Committee, totally and presumably permanently prevents the Employee from engaging in any substantial gainful employment with the Company. A determination of Disability shall be based upon competent medical evidence satisfactory to the Committee. The Committee shall apply the rules with respect to Disability uniformly and consistently to all Employees in similar circumstances.

(m) Effective Date. January 1, 2008, except as otherwise specifically provided herein.

(n) Employee. Any person who is receiving remuneration for personal services rendered to the Company, or who would be receiving such remuneration except for an authorized leave of absence; provided, however, that any individual whose conditions of employment are governed by a collective bargaining agreement between the Company and a labor union shall not be considered an Employee unless the collective bargaining agreement provides for coverage of such individual under the Plan. In no event shall any individual employed by any Affiliate or subsidiary of the Company be considered an Employee. Notwithstanding the foregoing, individuals whose conditions of employment are governed by a collective bargaining agreement that does not provide for coverage of such individual under the Plan shall nonetheless be deemed to be an Employee for purposes of crediting service pursuant to the provisions of subsections 2.1(s), (ii) and (mm) hereunder.

The term "Employee" shall also include any "leased employee," as such term is defined below, deemed to be an employee of an Employer or any Affiliate as provided in Sections 414(n) or (o) of the Code. The term "leased employee" means any person (other than an employee of the recipient) who, pursuant to an agreement between the recipient and any other person ("leasing organization"), has performed services for the recipient (or for the recipient and related persons determined in accordance with Section 414(n)(6) of the Code) on a substantially full-time basis for a period of at least one year, and such services are performed under the primary direction of or control by the recipient. Contributions or benefits provided by the leasing organization that are attributable to services performed for the recipient shall be treated as provided by the recipient. Notwithstanding the foregoing, a leased employee shall not be considered an employee of

the recipient if: (i) such employee is covered by a money purchase pension plan that provides: (1) a nonintegrated employer contribution rate of at least ten percent (10%) of compensation, as defined in Section 415(c)(3) of the Code, but including amounts contributed pursuant to a salary reduction agreement that are excludable from the employee's gross income under Section 125, Section 402(e)(3), Section 402(h)(1)(B), or Section 403(b) of the Code, (2) immediate participation, and (3) full and immediate vesting; and (ii) leased employees do not constitute more than twenty percent (20%) of the recipient's nonhighly compensated work force.

(o) Entry Date. The first day of each calendar month.

(p) ERISA. The Employee Retirement Income Security Act of 1974, as amended.

(q) Fund or Trust Fund. All assets of whatsoever kind or nature held from time to time by the Trustee in the Trust Fund forming a part of this Plan, without distinction as to income and principal and without regard to source, e.g., allocations, contributions, earnings, forfeitures, or gifts.

(r) Highly Compensated Employee. The term Highly Compensated Employee includes highly compensated active employees and highly compensated former employees. A highly compensated active employee includes any Employee who performs Service for the Company during the determination year and who, during the look-back year received compensation from the Company in excess of \$105,000 (as adjusted pursuant to Section 415(d) of the Code). The term Highly Compensated Employee also includes Employees who are Five Percent (5%) Owners (as defined in Section 19.1(f) hereof) at any time during the look-back year or determination year. For purposes of this Section 2.1(s), the determination year shall be the Plan Year. The look-back year shall be the twelve-month period immediately preceding the determination year. For purposes of this Section 2.1(r), the term "compensation" shall have the same meaning as set forth in Section 415(c)(3) of the Code.

A highly compensated former employee includes any Employee who separated from service (or was deemed to have separated from service) prior to the determination year, performs no Service for the Company during the determination year, and was a highly compensated active employee for either the separation year or any determination year ending on or after the Employee's 55th birthday. The determination of the identity of Highly Compensated Employees will be made in accordance with Section 414(q) of the Code and the regulations thereunder.

(s) Hour of Service. An Hour of Service shall include all hours for which pay is received or for which an Employee is entitled to payment, whether worked or not, plus service credit on the basis of the number of his regularly scheduled working hours for any other period of absence for which the Employee is paid or entitled to payment and which is authorized by the Company in accordance with its uniform leave policy for vacation, holiday, sick leave, illness, Disability, layoff, military service, or civic duty. In no event shall credit for the number of Hours of Service attributable to a single continuous period

for which no duties are performed exceed 501. Service credit shall also be given for each other leave of absence authorized by the Company for which the Employee is paid or entitled to payment.

Hours of Service shall be computed on an equivalency basis, whereby for each month during which an Employee would be credited with at least one Hour of Service (or, in the case of flight attendants, one trip), such Employee shall be credited with one hundred ninety (190) Hours of Service.

These hours must be credited to Employees in the computation period during which the duties were performed, or if no duties were performed, during which the applicable period of absence occurred, and not when paid, if different. Credit must also be given, without duplicating any hours described above, for each hour for which back pay, irrespective of mitigation of damages, has been awarded or agreed to by the Company. These hours must be credited in the computation period or periods to which the award or agreement pertains rather than that in which the payment, award, or agreement was made.

In determining the number of Hours of Service to be credited to an Employee in the case of a payment that is made or due to an Employee under the provisions of the paragraphs above, the Committee shall apply the rules set forth in Department of Labor Regulations 2530.200 b-2(b) and (c), which rules are incorporated into and made a part of this Plan by reference.

For purposes of determining whether an Employee has incurred a Break in Service as defined in Section 2.1(e), the Committee shall credit an Employee with Hours of Service during absence from work for maternity or paternity reasons that would otherwise have been credited to such Employee but for such absence. For purposes of this Plan, an Employee shall be deemed to be on maternity or paternity leave if the Employee's absence from work is (1) by reason of the pregnancy of the Employee, (2) by reason of the birth of a child of the Employee, (3) by reason of the placement of a child with the Employee in connection with the adoption of such child by the Employee, or (4) for purposes of caring for such child for a period beginning immediately following such birth or placement. The Hours of Service credited under this paragraph shall be limited to the lesser of (1) the number necessary to prevent the Employee from incurring a Break in Service or (2) 501 Hours of Service. Hours of Service credited under this paragraph shall be credited in the Plan Year in which the absence begins, but if the Employee does not need those Hours of Service to prevent a Break in Service in the Plan Year in which the absence began, then they shall be credited in the immediately following Plan Year.

(t) Individual Account. The account or record maintained by the Committee showing the monetary value of the individual interest in the Trust Fund of each Member, former Member, and Beneficiary.

(u) Investment Managers. The qualified and acting Investment Managers, as defined in ERISA, who under this Plan may be appointed by the Company to invest and manage Plan assets as fiduciaries.

(v) Member. An Employee who has met the eligibility requirements for participation in this Plan, as set forth in Article III hereof. A former Member is a Member who has terminated employment with the Company but who has an Individual Account under the Plan, and shall include those individuals who have an Individual Account under the Plan and who were not employed by the Company, but who were formerly employed by Morris Air Corporation.

(w) Named Fiduciary. The Committee shall be the Named Fiduciary designated to manage the operation and administration of the Plan.

(x) Normal Retirement Date. The date on which a Member attains the age of sixty (60) years.

(y) Plan. Southwest Airlines Co. 401(k) Plan, as amended from time to time.

(z) Plan Administrator. Such person or persons as designated by the Committee, which shall be the Committee unless and until it designates such other person or persons.

(aa) Plan Year. The annual period beginning January 1st and ending December 31st, both dates inclusive of each year.

(bb) Prior Plan. The Southwest Airlines Co. 401(k) Plan, effective January 1, 1991, as heretofore amended and restated from time to time.

(cc) Qualified Nonelective Contributions. Contributions which may, at the election of the Company, be made to the Plan by the Company in an amount necessary to assure the Plan's compliance with the deferral percentage test described in Section 4.5 hereof or the contribution percentage test described in Section 4.6 hereof.

(dd) Retirement. Separation from service after a Member has reached his Normal Retirement Date. Retirement shall be considered as commencing on the day immediately following a Member's last day of service.

(ee) Rollover Contributions. Contributions that may be made to the Plan by a Member or Employee, as provided in Section 4.7 hereof.

(ff) Rollover Contribution Account. A separate subaccount to which is credited a Member's or Employee's Rollover Contributions, if any, and any earnings attributable thereto, adjusted to reflect any withdrawals, distributions, or investment losses attributable thereto

(gg) Salary Reduction Contributions. Contributions made to the Plan by the Company, at the election of a Member, in lieu of cash compensation, pursuant to a salary reduction agreement, as provided in Sections 4.1 and 4.2 hereof.

(hh) Salary Reduction Contribution Account. A separate subaccount to which is credited a Member's Salary Reduction Contributions, Qualified Nonelective

Contributions, if any, and any earnings attributable thereto, adjusted to reflect any withdrawals, distributions, or investment losses attributable thereto.

(ii) Service. A period or periods of employment by an Employee used in determining eligibility for Plan participation or in determining the amount of benefits. If the Company is a member of a controlled group of corporations (as defined in Section 414(b) of the Code), is one of a group of trades or businesses (whether or not incorporated) which are under common control (as defined in Section 414(c) of the Code), is a member of an affiliated service group (as defined in Section 414(m) of the Code), or is otherwise required to be aggregated with any entity pursuant to Section 414(o) of the Code and the regulations issued thereunder, then Service shall include any employment with any member of such controlled group of corporations, such group of trades or businesses under common control, such affiliated service group, or such other entity required to be so aggregated, including Service prior to the Effective Date.

(jj) Trust. Southwest Airlines Co. 401(k) Trust, as amended from time to time, which was established to hold and invest Salary Reduction Contributions, Company Matching Contributions, and Qualified Nonelective Contributions, if any, made under the Plan and Prior Plan for the exclusive benefit of the Members included in the Plan from which the benefits will be distributed.

(kk) Trustee. The qualified and acting Trustee under the Trust, who shall be the fiduciary designated to invest and manage the Plan assets, other than those that may be managed exclusively by an Investment Manager, and to operate and administer the Trust Fund.

(ll) Valuation Date. Each business day on which the financial markets are open for trading activity.

(mm) Vesting Service. Vesting Service is the period of employment used in determining eligibility for benefits. A year of Vesting Service shall be granted for each Plan Year in which an Employee has completed 1,000 or more Hours of Service with the Company, subject to the following exceptions:

(i) Vesting Service prior to January 1, 1973 shall be excluded.

(ii) Vesting Service completed after December 31, 1972 and prior to January 1, 1976 shall be excluded if such service would have been disregarded under the break in service rules of the Prior Plan, as then in effect. For this purpose, break in service rules are those rules that result in the loss of prior vesting because of service termination or failure to complete a required period of service within a specified time.

(iii) Prior to January 1, 1985, in the case of an Employee who has any Break in Service, all years of Vesting Service incurred after such Break shall be disregarded for purposes of measuring years of Vesting Service before such Break. However, effective January 1, 1985 and thereafter, in the case of an Employee who has a Break in Service, his years of Vesting Service before such

Break in Service shall not be taken into account until he has completed a year of Vesting Service following his reemployment. In the case of an Employee who has five (5) or more consecutive Breaks in Service, all years of Vesting Service incurred after such Breaks in Service will be disregarded for purposes of measuring years of Vesting Service before such Breaks in Service.

(iv) Prior to January 1, 1985, if an Employee who does not have any nonforfeitable right to his Company Matching Contribution Account incurs a period of consecutive Breaks in Service that equals or exceeds the aggregate number of years of Vesting Service incurred before such period, then all of his prior years of Vesting Service before such period shall no longer be credited to him. However, effective January 1, 1985, and thereafter, if an Employee who does not have any nonforfeitable right to his Company Matching Contribution Account incurs a period of five or more consecutive Breaks in Service, then all of his prior years of Vesting Service before such period shall no longer be credited to him.

2.2 Construction. The masculine gender, where appearing in the Plan, shall be deemed to include the feminine gender, unless the context clearly indicates to the contrary. The words "hereof," "herein," "hereunder," and other similar compounds of the word "here" shall mean and refer to the entire Plan, not to any particular provision or section. The Plan and Trust shall each form a part of the other by reference, and terms shall be used therein interchangeably.

### **ARTICLE III ELIGIBILITY AND PARTICIPATION**

3.1 Eligibility Requirements. Every Employee who was a Member in the Prior Plan on the day before the Effective Date shall continue to be a Member in the Plan. Except as otherwise provided herein, every other Employee shall become a Member in the Plan as of the first Entry Date concurrent with or next following such Employee's completion of thirty (30) consecutive days of Service, beginning on his employment commencement date. The employment commencement date is the first day for which an Employee is entitled to be credited hereunder with an Hour of Service. Notwithstanding the foregoing, non-resident aliens who receive no earned income from the Company that constitutes income from sources within the United States shall not be eligible to participate in the Plan. Furthermore, "leased employees" (as such term is defined in Section 2.1(n) hereof) and Employees classified by the Company as interns shall not be eligible to participate in the Plan. A person who is not treated as an Employee on the Company's books and records (such as a person who as a matter of practice is treated by the Company as an independent contractor, but who is later determined to be an Employee as a matter of fact) shall not be an eligible Employee during any part of a Plan Year in which such person was not treated as an Employee, despite any retroactive recharacterization.

3.2 Notification of Eligibility. The Committee shall notify in writing each Employee of the qualifications for eligibility and shall furnish each Employee a copy of such explanation of the Plan as the Committee shall provide for that purpose. The Committee shall provide a notice explaining the Employee's rights and obligations under the automatic enrollment arrangement provided under the Plan. The notice shall explain: (a) the Employee's right to elect not to have

Salary Reduction Contributions, as described in Section 4.1 hereof, made on the Employee's behalf or to elect to have Salary Reduction Contributions made in a different percentage (including an election of 0%) and (b) the manner in which Salary Reduction Contributions made under the arrangement will be invested in the absence of any investment direction by the Employee in accordance with Section 12.1 hereof. The notice shall also explain that the Employee shall be given a reasonable period of time following the date of such notice to make an affirmative election with respect to the percentage of Salary Reduction Contributions to be made (including an election of 0%) and the manner and applicable percentages in which the Employee desires the Trustee to invest such contributions.

3.3 Re-entry of Prior Members. An Employee who terminates employment after becoming a Member hereunder shall be eligible to participate immediately upon his completion of one Hour of Service following his reemployment by the Company. An Employee who terminates employment after satisfying the requirements of Section 3.1 hereof, but prior to the first Entry Date following the satisfaction of such requirements, shall be eligible to participate immediately upon his completion of one Hour of Service following his reemployment by the Company, or if later, the first Entry Date following the satisfaction of such requirements.

#### **ARTICLE IV CONTRIBUTIONS**

4.1 Salary Reduction Contributions. Each Member may elect to have contributed on his behalf to the Trust Fund, on a pre-tax basis, any whole percentage of his Annual Compensation that is not less than one percent (1%) and that does not exceed fifty percent (50%). Salary Reduction Contributions shall be elected pursuant to a salary reduction election, in accordance with Section 5.3 hereof. If, following notice to the Member, in accordance with Section 3.2 above, the Committee fails to receive a proper election for a Member prior to the Member's Deemed Election Date, the Member shall, on his Deemed Election Date, be deemed to have made an election under this Section 4.1 to have contributed on his behalf a percentage of his Annual Compensation equal to three percent (3%). Notwithstanding any provision herein to the contrary, any percentage of Annual Compensation elected (or deemed elected) to be contributed to the Trust Fund on the Member's behalf may not exceed the applicable dollar amount for such Plan Year, as provided in Section 402(g) of the Code, adjusted for increases in the cost of living as provided in Section 402(g)(4) of the Code. Salary Reduction Contributions are at all times one hundred percent (100%) vested and nonforfeitable. Salary Reduction Contributions made on behalf of a Member shall be added to the Trust Fund as soon as practicable after deduction from a Member's paycheck and shall be credited to the Salary Reduction Contribution Account of the Member as of each Allocation Date, as provided in Section 6.1.

4.2 Catch-Up Contributions. Each Member who has attained or would have attained age fifty (50) prior to the close of the Member's taxable year, and who has affirmatively elected, in accordance with the provisions of Section 4.1, to have Salary Reduction Contributions made to the Plan on his behalf, shall be deemed to have elected to have Catch-Up Contributions contributed on his behalf to the Trust Fund on a pre-tax basis, in accordance with, and subject to the limitations of, Section 414(v) of the Code. Except as otherwise provided under Sections 4.5, 4.6, 4.7 and 6.5 hereof, Catch-Up Contributions shall be made pursuant to a salary reduction election, in accordance with Section 5.3 hereof. Catch-Up Contributions are at all times one

hundred percent (100%) vested and nonforfeitable. Catch-Up Contributions made on behalf of a Member shall be added to the Trust Fund as soon as practicable after deduction from a Member's paycheck, and shall be credited to the Salary Reduction Contribution Account of the Member as of each Allocation Date, as provided in Section 6.1. The Plan shall not be treated as failing to satisfy any provision implementing the requirements of Section 401(k)(3), 401(k)(11), 401(k)(12), 410(b), or 416 of the Code, as applicable, by reason of the making of such Catch-Up Contributions.

4.3 Company Matching Contributions. The Company may, as provided below, contribute to the Trust Fund a Company Matching Contribution. Company Matching Contributions shall be determined on behalf of Members whose conditions of employment are governed by a collective bargaining agreement between the Company and a labor union in accordance with the terms of such collective bargaining agreement, as then in effect, and shall be determined on behalf of Members whose conditions of employment are not so governed, in the sole and absolute discretion of the board of directors of the Company. If a Company Matching Contribution is made, such Contribution will equal a specified percentage of the Member's Salary Reduction Contributions, including, if applicable, Catch-Up Contributions, not to exceed the specific amount set forth in the collective bargaining agreement, if applicable, or otherwise established by the board of directors of the Company. Company Matching Contributions shall be added to the Trust Fund as soon as practicable after deduction of the applicable Salary Reduction Contributions, including, if applicable, Catch-Up Contributions from a Member's paycheck and credited, as of each Allocation Date, to the Company Matching Contribution Account of each eligible Member who has elected to have Salary Reduction Contributions, including, if applicable, Catch-Up Contributions made to the Trust Fund on his behalf during the applicable period.

4.3 Qualified Nonelective Contributions. The Company may, for each Plan Year, contribute to the Trust Fund Qualified Nonelective Contributions. Qualified Nonelective Contributions are at all times one hundred percent (100%) vested and nonforfeitable. Qualified Nonelective Contributions shall be added to and become a part of the Trust Fund, and as of each Allocation Date, shall be credited to the Individual Accounts of the Members, as provided in Section 6.2.

4.4 Reduction of Excess Deferrals. If a Member's Salary Reduction Contributions hereunder should exceed the applicable dollar amount set forth in Section 402(g) of the Code, adjusted for increases in the cost of living, as set forth in Section 402(g)(4) of the Code, the excess (with earnings thereon) shall be reduced as follows:

(a) To the extent that such excess Salary Reduction Contributions do not exceed the applicable dollar limitation under Section 414(v), reduced by Catch-Up Contributions previously made and Salary Reduction Contributions previously treated as Catch-Up Contributions, whether under this Plan or another applicable employer plan (as defined in Section 414(v)(6)(A) of the Code), the amount of such excess Salary Reduction Contributions shall be recharacterized as Catch-Up Contributions, if such Member is otherwise eligible to make Catch-Up Contributions in accordance with Section 4.2 hereof during the Plan Year in which such excess deferrals were made.

(b) If the Member is not eligible to make Catch-Up Contributions, as provided in Section 4.2 hereof, or to the extent that recharacterization of such excess Salary Reduction Contributions, together with Catch-Up Contributions previously made and Salary Reduction Contributions previously treated as Catch-Up Contributions, whether under this Plan or another applicable employer plan (as defined in Section 414(v)(6)(A) of the Code), exceeds the applicable dollar limitation under Section 414(v), the amount of such excess Salary Reduction Contributions shall be distributed to the Member. Any distribution under this paragraph (b) shall be made to the Member no later than the April 15th immediately following the close of the Member's taxable year with respect to which such excess deferrals were made.

If the Member also participates in another elective deferral program (within the meaning of Section 402(g)(3) of the Code) and if, when aggregating his elective deferrals under all such programs, an excess of deferral contributions arises under the dollar limitation in Code Section 402(g) with respect to such Member, the Member shall, no later than March 1st following the close of the Member's taxable year, notify the Committee as to the portion of such excess deferrals to be allocated to this Plan and such excess so allocated to this Plan (with earnings thereon) shall be deemed a Catch-Up Contribution in accordance with subparagraph (a) herein, as the case may be, or distributed to the Member in accordance with subparagraph (b) herein. In the event there is a loss allocable to an excess deferral, any distribution to a Member as required by this Section shall be no greater than the lesser of: (i) the value of the Member's Salary Reduction Contribution Account or (ii) the Member's excess deferrals for the Plan Year.

#### 4.5 Deferral Percentage Test.

(a) Determination of Deferral Percentages. As soon as administratively feasible after the end of each Plan Year (or other applicable period) the Committee shall determine:

(i) Deferral Percentage. The "deferral percentage" for each Employee who is then eligible for Salary Reduction Contributions (not including Catch-Up Contributions, if applicable), which shall be the ratio of the amount of such Employee's Salary Reduction Contributions for such Plan Year (less excess Salary Reduction Contributions treated as Catch-Up Contributions for the Plan Year in accordance with Section 4.4 above) to the Employee's compensation (as defined in Section 2.1(r) hereof) for such Plan Year;

(ii) Highly Compensated Deferral Percentage. The "highly compensated deferral percentage," which shall be the average of the "deferral percentages" for all Highly Compensated Employees then eligible for Salary Reduction Contributions; and

(iii) Nonhighly Compensated Deferral Percentage. The "nonhighly compensated deferral percentage," which shall be the average of the "deferral percentages" for all Employees then eligible for Salary Reduction Contributions who were not included in the "highly compensated deferral percentage," in (ii) above.

If a Highly Compensated Employee participates in two (2) or more plans maintained by an Employer or any Affiliate that are subject to the deferral percentage test, then such Employee's deferral percentage shall be determined by aggregating his participation in all such plans. In addition, if the Company maintains two (2) or more plans subject to the deferral percentage test and such plans are treated as a single plan for purposes of the requirements for qualified plans under either Code Section 410(b) or 401(a)(4), then such plans are treated as a single plan for purposes of the deferral percentage test. For purposes of implementing the deferral percentage test, elective deferrals treated as Catch-Up Contributions shall be disregarded. If, however, the Company elects to apply Section 410(b)(4)(B) in determining whether the Plan meets the requirements of Section 410(b)(1) of the Code, the Company may, in determining whether the Plan meets the requirements of this Section 4.5, either elect to (A) exclude from consideration all eligible Employees (other than Highly Compensated Employees) who have not met the minimum age and service requirements of Section 410(a)(1)(A) of the Code or (B) perform the deferral percentage test separately for the group of Employees who have met the minimum age and service requirements of Section 410(a)(1)(A) of the Code and the group of Employees who have not met the minimum age and service requirements of Section 410(a)(1)(A) of the Code.

(b) Limitation on Highly Compensated Deferral Percentage. In no event shall the "highly compensated deferral percentage" exceed the greater of: (1) a deferral percentage equal to one and one-fourth ( $1\frac{1}{4}$ ) times the "nonhighly compensated deferral percentage" or (2) a deferral percentage equal to two (2) times the "nonhighly compensated deferral percentage," but not more than two (2) percentage points greater than the "nonhighly compensated deferral percentage."

(c) Recharacterization of Excess Salary Reduction Contributions. If the above deferral percentage test would otherwise be violated as of the end of the Plan Year, then, to the extent that the excess Salary Reduction Contributions of such Highly Compensated Employees do not exceed the applicable dollar limitation under Section 414(v), reduced by elective deferrals previously treated as Catch-Up Contributions, whether under this Plan or another elective deferral program (as defined under Section 402(g)(3)), the amount of the excess Salary Reduction Contributions of such Highly Compensated Employees shall be recharacterized as Catch-Up Contributions, if such Member is otherwise eligible to make Catch-Up Contributions in accordance with Section 4.2 hereof during the Plan Year in which the excess deferral arises.

(d) Application of Qualified Nonelective Contributions. If, after recharacterization of the excess Salary Reduction Contributions of such Highly Compensated Employees, the deferral percentage test would still be violated as of the end of the Plan Year, then, subject to satisfaction of the conditions described in Section 1.401(k)-1(b)(5) of the Treasury Regulations, the "deferral percentage," as defined in (a)(i) above, shall instead be the ratio of the sum of the Employee's Salary Reduction Contributions (less excess Salary Reduction Contributions treated as Catch-Up Contributions for the Plan Year), Qualified Nonelective Contributions, if any, and, to the extent necessary to satisfy the deferral percentage test, Company Matching Contributions for such Plan Year to the Employee's compensation (as defined in Section 2.1(r) hereof)

for such Plan Year. Any Company Matching Contributions so utilized to satisfy the deferral percentage test shall at all times be one hundred percent (100%) vested and nonforfeitable and shall be excluded from consideration for purposes of the contribution percentage test described in Section 4.6.

(e) Distribution of Excess Contributions. If, after consideration of Qualified Nonelective Contributions, if any, and applicable Company Matching Contributions, as described above, the deferral percentage test would still be violated as of the end of the Plan Year, then notwithstanding any other provision hereof, every Salary Reduction Contribution (other than excess Salary Reduction Contributions treated as Catch-Up Contributions for the Plan Year) included in the “highly compensated deferral percentage” for a Member whose deferral percentage is greater than the permitted maximum shall be revoked to the extent necessary to comply with such deferral percentage test and the amount of such Salary Reduction Contribution (other than excess Salary Reduction Contributions treated as Catch-Up Contributions for the Plan Year), to the extent revoked, shall constitute an “excess contribution” to be distributed (with earnings thereon) no later than the last day of the Plan Year following the Plan Year with respect to which such contribution was made. Excess contributions are allocated to the Highly Compensated Employees with the largest amounts of Employer contributions taken into account in calculating the deferral percentage test for the Plan Year in which the excess arose, beginning with the Highly Compensated Employee with the largest amount of such Employer contributions and continuing in descending order until all excess contributions have been allocated. For purposes of the preceding sentence, the “largest” amount is determined after distribution of any amounts distributed hereunder pursuant to Section 4.4 hereof. In the event there is a loss allocable to an excess contribution, any distribution to a Member as required by this Section shall be no greater than the lesser of: (a) the value of the Member’s Salary Reduction Contribution Account (without regard to Catch-Up Contributions) or (b) the Member’s excess contribution for the Plan Year. If an excess contribution is distributed to a Member in accordance with the foregoing, any Company Matching Contribution relating to such excess contribution shall be forfeited and then utilized as described in Section 6.3 hereof, and shall not be taken into account in determining the Member’s contribution percentage under Section 4.6.

#### 4.6 Contribution Percentage Test.

(a) Determination of Contribution Percentages. As soon as administratively feasible after the end of each Plan Year (or other applicable period) the Committee shall determine:

(i) Contribution Percentage. The “contribution percentage” for each Employee who is then eligible to receive Company Matching Contributions, which shall be the ratio of the amount of such Employee’s Company Matching Contributions for such Plan Year to such Employee’s compensation (as defined in Section 2.1(r) hereof) for such Plan Year;

(ii) Highly Compensated Contribution Percentage. The “highly compensated contribution percentage,” which shall be the average of the “contribution percentages” for all Highly Compensated Employees then eligible for Company Matching Contributions; and

(iii) Nonhighly Compensated Contribution Percentage. The “nonhighly compensated contribution percentage,” which shall be the average of the “contribution percentages” for all Employees then eligible for Company Matching Contributions who were not included in the “highly compensated contribution percentage,” in (ii) above.

If a Highly Compensated Employee participates in two (2) or more plans maintained by an Employer or any Affiliate that are subject to the contribution percentage test, then such Employee’s contribution percentage shall be determined by aggregating his participation in all such plans. In addition, if the Company maintains two (2) or more plans subject to the contribution percentage test and such plans are treated as a single plan for purposes of the requirements for qualified plans under either Code Section 410(b) or 401(a)(4), then such plans are treated as a single plan for purposes of the contribution percentage test. If, however, the Company elects to apply Section 410(b)(4) (B) in determining whether the Plan meets the requirements of Section 410(b)(1) of the Code, the Company may, in determining whether the Plan meets the requirements of this Section 4.6, either elect to (A) exclude from consideration all eligible Employees (other than Highly Compensated Employees) who have not met the minimum age and service requirements of Section 410(a)(1)(A) of the Code or (B) perform the contribution percentage test separately for the group of Employees who have met the minimum age and service requirements of Section 410(a)(1)(A) of the Code and the group of Employees who have not met the minimum age and service requirements of Section 410(a)(1)(A) of the Code.

(b) Limitation on Highly Compensated Contribution Percentage. In no event shall the “highly compensated contribution percentage” exceed the greater of: (1) a contribution percentage equal to one and one-fourth ( $1\frac{1}{4}$ ) times the “nonhighly compensated contribution percentage” or (2) a contribution percentage equal to two (2) times the “nonhighly compensated contribution percentage” but not more than two (2) percentage points greater than the “nonhighly compensated contribution percentage.”

(c) Application of Qualified Nonelective Contributions. If the above contribution percentage test would otherwise be violated as of the end of the Plan Year, then subject to satisfaction of the conditions described in Section 1.401(m)-1(b)(5) of the Treasury Regulations, the “contribution percentage,” as defined in (a) above, shall instead be the ratio of the sum of the Employee’s Company Matching Contributions, Qualified Nonelective Contributions, if any, and to the extent necessary to satisfy the contribution percentage test, Salary Reduction Contributions for the applicable Plan Year to the Employee’s compensation (as defined in Section 2.1(r) hereof) for the applicable Plan Year. Any Salary Reduction Contributions or Qualified Nonelective Contributions so utilized to satisfy the contribution percentage test shall be excluded from consideration for purposes of the deferral percentage test described in Section 4.5.

(d) Distribution of Excess Aggregate Contributions. If after consideration of applicable Salary Reduction Contributions and Qualified Nonelective Contributions, if any, as described above, the contribution percentage test would still be violated as of the end of the Plan Year, then notwithstanding any other provision hereof, every Company Matching Contribution included in the “highly compensated contribution percentage” for a Member whose contribution percentage is greater than the permitted maximum shall automatically be revoked to the extent necessary to comply with such contribution percentage test and the amount of such contribution, to the extent revoked, shall constitute an “excess aggregate contribution” to be distributed to such Member (with earnings thereon) or forfeited, if applicable, no later than the last day of the Plan Year following the Plan Year for which such contribution was made. Excess aggregate contributions are allocated to the Highly Compensated Employees with the largest amounts of Employer contributions taken into account in calculating the contribution percentage test for the Plan Year in which the excess arose, beginning with the Highly Compensated Employee with the largest amount of such Employer contributions and continuing in descending order until all excess aggregate contributions have been allocated. For purposes of the preceding sentence, the “largest amount” is determined after first determining required distributions under Section 4.4 hereof, and then determining excess contributions under Section 4.5. In the event there is a loss allocable to an excess aggregate contribution, any distribution to a Member as required by this Section shall be no greater than the lesser of: (a) the value of the Member’s Company Matching Contribution Account or (b) the Member’s excess aggregate contribution for the Plan Year.

#### 4.7 Rollover Contributions.

(a) Direct Rollovers. A Member who is entitled to receive an “eligible rollover distribution”, as such term is defined in Section 15.6 hereof, from (i) a qualified plan described in section 401(a) or 403(a) of the Code, (ii) an annuity contract described in section 403(b) of the Code, or (iii) an eligible plan under section 457(b) of the Code that is maintained by a state, political subdivision of a state, or any agency or instrumentality of a state or political subdivision of a state, may, in accordance with procedures approved by the Committee, elect to transfer directly to the Trustee, as a trustee-to-trustee transfer, in cash only, an amount equal to all or a portion of such distribution; provided, however, that the maximum amount of such transfer shall be the fair market value of that portion of the distribution that would be includable in gross income if not so transferred (determined without regard to Section 402(c) of the Code).

(b) Member Rollover Contributions from Other Plans. Any Member who has distributed to him an amount that qualifies as an “eligible rollover distribution”, as such term is defined in Section 15.6 hereof, from (i) a qualified plan described in section 401(a) or 403(a) of the Code, (ii) an annuity contract described in section 403(b) of the Code, (iii) an eligible plan under section 457(b) of the Code that is maintained by a state, political subdivision of a state, or any agency or instrumentality of a state or political subdivision of a state, or (iv) any portion of a distribution from an individual retirement account annuity described in section 408(a) or 408(b) of the Code, may, in accordance with procedures approved by the Committee, contribute, in cash only, an amount equal to

all or any portion of such distribution that is eligible to be rolled over and that would otherwise be includible in gross income if not so transferred (determined without regard to Section 402(c) of the Code). Such transfer must occur on or before the 60<sup>th</sup> day following the Member's receipt of such distribution, or such later date as permitted by the Internal Revenue Service for distributions on and after January 1, 2002.

(c) Method of Transfer. The Committee shall develop such procedures, and may require such information from a Member desiring to make such a transfer, as it deems necessary or desirable to determine that the proposed transfer will meet the requirements of this Section. Upon approval by the Committee, the amount transferred shall be deposited in the Trust and shall be credited, as of the Valuation Date next following such transfer, to a Rollover Contribution Account for the Member.

(d) Rollover Contributions Prior to Eligibility as a Member. An Employee, prior to satisfying the eligibility conditions of the Plan, as set forth in Section 3.1 hereof, may make a Rollover Contribution to the Trust Fund to the same extent and in the same manner as a Member. If an Employee makes a Rollover Contribution to the Trust Fund prior to satisfying the Plan's eligibility conditions, the Committee and Trustee shall treat the Employee as a Member for all purposes of the Plan except for purposes of sharing in Company Matching Contributions, Salary Reduction Contributions, or Qualified Nonelective Contributions under the Plan until he actually becomes a Member. If the Employee terminates employment prior to becoming a Member, the Trustee will distribute his Rollover Contribution Account to him in accordance with the provisions of Article XV hereof as if such Employee were a Member of the Plan.

(e) Vesting and Distribution of Rollover Contribution Account. Each Member's Rollover Contribution Account shall be 100% vested and nonforfeitable at all times and shall share in asset adjustments pursuant to Section 5.2 herein, but shall not share in Company contributions. Upon termination of employment, the total amount of a Member's Rollover Contribution Account shall be distributed in accordance with Article XV hereof.

## **ARTICLE V ADJUSTMENT OF INDIVIDUAL ACCOUNTS**

5.1 Individual Accounts. The Committee shall establish an Individual Account for each Member showing the monetary value of the individual interest in the Trust Fund of each Employee, former Employee, and Beneficiary. The Individual Account of each Member shall be composed of a Company Matching Contribution Account, to which Company Matching Contributions, if any, shall be credited; a Salary Reduction Contribution Account, to which Salary Reduction Contributions, if any, including Catch-Up Contributions, if any, together with Qualified Nonelective Contributions and Company Matching Contributions, if any, utilized to satisfy the deferral percentage test or the contribution percentage test, as set forth in Sections 4.5 and 4.6 hereof, if any, shall be credited; and, if applicable, a Rollover Contribution Account. Such accounts are primarily for accounting purposes and do not require a segregation of the Trust Fund, except as otherwise provided herein.

5.2 Method of Adjustment. As of each Valuation Date, before any restoration of accounts as required pursuant to Section 15.3 hereof and before taking into account contributions of the Company for the period since the last preceding Valuation Date, the Committee or the Trustee, as directed by the Committee, shall value the assets of each investment fund and adjust the Individual Accounts of all Members who have elected to participate in such investment fund as follows:

(a) The Committee shall determine the market value of the investment fund, including the effect of expenses of administration and other charges against such investment fund since the last Valuation Date.

(b) The Committee shall determine the total aggregate value of all Individual Accounts participating in the investment fund as shown in its records as of the prior Valuation Date. The Individual Account balances of Employees, former Employees, and Beneficiaries shall be reduced by any amounts paid to them from the investment fund since the last Valuation Date.

(c) The Committee shall then adjust the value of each Individual Account participating in the investment fund by crediting each Individual Account with its proportion of the difference between (a) and (b) if (a) is the larger or charging it with its proportion of the difference between (a) and (b) if (b) is larger; the proportion to be so credited or charged to each Individual Account shall be calculated by multiplying the difference between (a) and (b) by a fraction, the numerator of which is the then value of said Individual Account and the denominator of which is the then aggregate value of all Individual Accounts participating in such investment fund.

5.3 Salary Reduction Elections. Each Member who desires to make Salary Reduction Contributions (including an election to contribute 0% of his Annual Compensation) shall indicate such intent by making a salary reduction election to be effective as of the Entry Date on which such Member first satisfies the eligibility requirements of Article III hereof or as of any subsequent payroll period. Such election must be made in the manner and within the time period prior to such Entry Date (or subsequent payroll period) prescribed by the Committee. Each Member with respect to whom a deemed election has been made pursuant to Section 4.1 hereof shall be deemed to have filed a salary reduction election to be effective as of the Deemed Election Date. Each Member with respect to whom a deemed election has been made pursuant to Section 4.2 hereof shall be deemed to have filed a salary reduction election to be effective with respect to Catch-Up Contributions made on his behalf. Salary reduction elections (including deemed elections) shall be effective for each payroll period thereafter until modified or amended, as provided below.

Salary reduction elections (including deemed elections) shall constitute a payroll withholding agreement between the Member and the Company, and shall constitute authorization for the reduction in Annual Compensation described above. The terms of such election shall evidence the Member's intent to have the Company withhold from his compensation each payroll period any whole percentage of his Annual Compensation, subject to the applicable limitations of Article IV. The Company will make a contribution to the Trust Fund on behalf of the Member for each payroll period in an amount equal to the total amount by which the Member's

Annual Compensation from the Company was reduced during such payroll period pursuant to a salary reduction election.

Notwithstanding any provision of this Section 5.3 to the contrary, salary reduction elections shall be governed by the following general guidelines:

(a) A salary reduction election shall be made in the manner determined by the Committee. All salary reduction elections (including deemed elections) shall apply to each payroll period during which such election is in effect. Upon termination of employment, such election will become void.

(b) A Member may revoke a salary reduction election (including a deemed election under Section 4.1) at any time upon advance notice to the Committee, within the time period established by the Committee, and thus discontinue all future withholding thereafter. A revocation of a salary reduction election under Section 4.1 shall automatically revoke any deemed election under Section 4.2. Following the revocation of a salary reduction election, a Member may elect to resume withholding effective as of the first day of the first full payroll period next following the payroll period in which the revocation occurs, or as of the first day of any payroll period thereafter next following timely receipt by the Committee of such notice. A resumption of withholding following the revocation of a salary reduction election may be made only upon advance notice to the Committee, within the time period established by the Committee. A Member may increase the percentage to be withheld from his Annual Compensation or decrease the percentage to be withheld from his Annual Compensation upon advance notice to the Committee, within the time period established by the Committee, and in the manner prescribed by the Committee, such increase or decrease to be effective as of the first day of the first full payroll period next following timely receipt by the Committee of such notice. Any revocation of or change in the terms of a salary reduction election shall be made in the manner prescribed by the Committee.

(c) The Company may unilaterally amend or revoke a salary reduction election (including a deemed election) at any time, including an amendment to recharacterize an election of Salary Reduction Contributions as an election of Catch-Up Contributions, if the Company determines that such revocation or amendment is necessary to insure that a Member's Annual Additions, as defined in subsection 6.5(b) hereof, for any Plan Year will not exceed the limitations of Article VI or to ensure that the requirements of Section 401(k) of the Code and Sections 4.1 and 4.2 hereof have been satisfied with respect to the amount that may be withheld and contributed on behalf of a Member. Furthermore, a deemed election in effect with respect to any Member shall automatically terminate upon the date of a withdrawal from such Member's Salary Reduction Contribution Account in accordance with the provisions of Section 11.2(e) hereof.

**ARTICLE VI  
ALLOCATIONS**

6.1 Salary Reduction, Company Matching, and Rollover Contributions. Salary Reduction Contributions and Company Matching Contributions shall be credited to the Individual Accounts of the Members and former Members, as of each Allocation Date, in accordance with each Member's or former Member's salary reduction election and the Company Matching Contribution, if any, made with respect to such Salary Reduction Contributions. Rollover Contributions shall be credited to the Individual Accounts of Members as provided in Section 4.7 hereof.

6.2 Qualified Nonelective Contributions. As of each Allocation Date, but after any adjustment of Individual Accounts as provided in Section 5.2 and other applicable provisions herein, the Committee shall allocate Qualified Nonelective Contributions, if any, for the Plan Year ending with said Allocation Date to the Individual Accounts of all Members and former Members who are not Highly Compensated Employees for the Plan Year. The amount of the contribution allocated under this Section 6.2 to the Individual Account of each such Member or former Member shall be in the proportion that his Annual Compensation bears to the total Annual Compensation of all such Members and former Members.

6.3 Forfeitures. If a Member or former Member forfeits a portion of his Individual Account as provided in Section 10.3 or Section 11.2(e) hereof, such forfeited amount shall be used first to restore the Individual Accounts of rehired Members as required under Section 15.3 hereof. Any remaining forfeitures shall be used to reduce the Company Matching Contribution. If a Member or former Member who does not have any nonforfeitable right to his Individual Account terminates his employment and thereby forfeits his Individual Account, then in the event such Member or former Member is reemployed before he has incurred five (5) or more consecutive Breaks in Service, his Individual Account that was forfeited shall be restored by the Company at the time of his reemployment.

6.4 Notification to Members. At least annually, the Committee shall advise each Member, former Member, and Beneficiary for whom an Individual Account is held hereunder of the then balance in such account.

6.5 Maximum Annual Addition to Account or Benefit.

(a) Limitations. If the Employer maintains, or has ever maintained, this Plan and one or more other qualified defined contribution plans, the Annual Additions (as defined in subsection (b) below) allocated under this Plan to any Member's Individual Account shall be limited in accordance with the allocation provisions of this subsection 6.5(a).

The amount of the Annual Additions that may be allocated under this Plan to the Individual Account of any Member as of any Allocation Date, together with Annual Additions allocated on behalf of any such member under any other defined contribution plan of the Employer for the Limitation Year (as defined in subsection (b) below) in which such Allocation Date occurs, shall not exceed the Maximum Permissible DC

Amount (as defined in subsection (b) below), based upon Annual Compensation up to such Allocation Date for such Limitation Year.

If the Annual Additions allocated on behalf of a Member or former Member under this Plan and any other defined contribution plan of the Employer are to be reduced as of any Allocation Date as a result of exceeding the limitations described in the next preceding two paragraphs, such reduction shall be, to the extent required, effected by first reducing the Annual Additions to be allocated on behalf of such Member or former Member under such other defined contribution plan of the Employer as of such Allocation Date.

If as a result of the first three paragraphs of this subsection 6.5(a) the allocation of Annual Additions under this Plan is to be reduced, such reduction shall be made as follows:

(i) To the extent that the excess Annual Additions of such Member do not exceed the applicable dollar amount under Section 414(v) of the Code, reduced by Catch-Up Contributions previously made and Salary Reduction Contributions previously treated as Catch-Up Contributions for the taxable year in which the Plan Year ends, whether under this Plan or another elective deferral program (as defined under Section 402(g)(3) of the Code), the amount of the excess Annual Additions of such Member shall be recharacterized as Catch-Up Contributions, if such Member is otherwise eligible to make Catch-Up Contributions under Section 4.2 during the taxable year in which the excess Annual Addition arises.

(ii) To the extent permitted under applicable Treasury Regulations, the amount of such reduction consisting of Salary Reduction Contributions, and earnings attributable thereto, shall be paid to the Member or former Member as soon as administratively feasible.

(iii) If an excess amount still exists after applying subparagraph (1), the excess amount shall be allocated to a suspense account as of such Allocation Date and held therein until the next succeeding Valuation Date or Dates on which Company Matching Contributions or Qualified Nonelective Contributions, if any, may be allocated under the provisions of the Plan, at which time such excess amount shall be used to reduce such Company Matching Contributions and Qualified Nonelective Contributions, if any. In the event of termination of the Plan, the suspense account shall revert to the Company.

(iv) If a suspense account is in existence at any time during a Limitation Year pursuant to this Section, it will not participate in the allocation of the Trust Fund's investment gains and losses.

(b) Definitions Applicable to Section 6.5. For purposes of Section 6.5, the following definitions shall apply:

(i) Annual Additions. Annual Additions are the sum of the following amounts allocated on behalf of a Member or former Member for a Limitation Year:

- (1) all Employer contributions;
- (2) forfeitures, if any;
- (3) all Employee contributions, other than Catch-Up Contributions; and

(4) amounts allocated after March 31, 1984, to an individual medical benefit account, as defined in Code Section 415(l)(2), which is part of a pension or annuity plan maintained by the Employer, and amounts derived from contributions paid or accrued after December 31, 1985, in taxable years ending after such date, which are attributable to post-retirement medical benefits allocated to the separate account of a key employee (as defined in Code Section 419A(d)(3)) under a welfare benefit plan (as defined in Code Section 419(e)) maintained by the Employer.

The Annual Additions for any Limitation Year beginning before January 1, 1987, shall not be recomputed to treat all Employee Contributions as Annual Additions. Nothing in this definition of Annual Additions shall be construed as requiring the allocation of forfeitures to the Individual Accounts of Members, former Members, or Beneficiaries rather than to reduce Company Matching Contributions, as provided in Section 6.3 hereof.

(ii) Employer. Employer shall mean, in addition to the Company (as defined in Section 2.1(i) hereof, all members of a controlled group of corporations (as defined in Section 414(b) of the Code as modified by Section 415(h)), all commonly controlled trades or businesses (as defined in Section 414(c) as modified by Section 415(h)) or affiliated service groups (as defined in Section 414(m)) of which the Company is a part, and any other entity required to be aggregated with the Company pursuant to regulations under Section 414(o) of the Code.

(iii) Limitation Year. The Limitation Year shall be the twelve (12) consecutive month period ending on the last day of December or any other twelve (12) consecutive month period for all qualified plans of the Company pursuant to a written resolution the Company adopts.

(iv) Maximum Permissible DC Amount. The Maximum Permissible DC Amount for a given Limitation Year is equal to the lesser of (i) 100% of compensation or (ii) \$46,000, as adjusted for increases in the cost-of-living under section 415(d) of the Code. The compensation limit referred to in this subparagraph (iv) shall not apply to any contribution for medical benefits after separation from service (within the meaning of section 401(h) or section 419A(f)(2) of the Code) that is otherwise treated as an Annual Addition. For

purposes of this subparagraph (b)(iv), compensation shall mean compensation as defined in Section 3401(a) of the Code and all other payments of compensation to an Employee by the Company (in the course of the Company's trade or business) for which the Company is required to furnish the Employee a written statement under Sections 6041(d), 6051(a)(3), and 6052 of the Code without regard to any rules under Section 3401(a) that limit the remuneration included in wages based on the nature or location of the employment or the services performed. For Limitation Years beginning after December 31, 1997, compensation shall include any amounts not includable in the gross income of an Employee pursuant to Sections 125, 132(f)(4), 402(e)(3), 403(b), 457, or 402(h)(1)(B) of the Code applicable to such Limitation Year. If a short Limitation Year is created because of an amendment changing the Limitation Year to a different twelve (12) consecutive month period, the dollar limitation referred to above is multiplied by a fraction, the numerator of which is equal to the number of months in the short Limitation Year and the denominator of which is twelve.

## **ARTICLE VII RETIREMENT**

7.1 Normal or Late Retirement. A Member, upon reaching his Normal Retirement Date for the purposes of this Plan, shall be one hundred percent (100%) vested in his Individual Account, and such amount contained therein shall be nonforfeitable. If a Member continues in the service of the Company beyond his Normal Retirement Date, he shall continue to participate in the Plan.

7.2 Benefit. Upon Retirement (whether normal or late Retirement in accordance with Section 7.1), a Member shall be entitled to the entire amount to the credit of his Individual Account as of the Valuation Date concurrent with or next following his date of Retirement, including his portion, if any, of Qualified Nonelective Contributions allocated after his date of Retirement, adjusted for earnings and losses, if any, that accrue to the Valuation Date immediately preceding the date of distribution, if later. Upon his Retirement under this Article VII, a Member shall receive the benefits to which he is entitled at the time and in the manner provided in Article XV hereof.

## **ARTICLE VIII DEATH**

8.1 Death of Member. Upon the death of a Member while employed by the Company, such Member's Individual Account shall thereupon become one hundred percent (100%) vested, and the amount contained therein shall be nonforfeitable.

8.2 Designation of Beneficiary. Each Member and former Member may, from time to time, designate one or more Beneficiaries and alternate Beneficiaries to receive benefits pursuant to this Article in the event of the death of such Member or former Member. Such designation shall be made in writing upon a form provided by the Committee and shall be effective only when filed with the Committee. The last such designation filed with the Committee shall control.

If a member is married, his spouse shall automatically be designated his Beneficiary; provided, however, a Beneficiary other than his spouse may be designated if (1) his spouse consents in writing to such designation, the consent acknowledges the effect of such designation, and the designation is witnessed by a member of the Committee or a notary public; or (2) it is established to the satisfaction of the Committee that there is sufficient reason why the consent may not be obtained. Notwithstanding the foregoing, divorce after the filing of a designation or designations that name the spouse as beneficiary shall be deemed to revoke such designation or designations if written notice of such divorce is received by the Committee before payment has been made in accordance with existing designation or designations on file with the Committee.

8.3 Benefit. Upon the death of a Member or former Member, his designated Beneficiary shall be entitled to the entire amount to the credit of his Individual Account as of the Valuation Date concurrent with or next following his date of death including his portion, if any, of Qualified Nonelective Contributions allocated after the date of his death, adjusted for earnings and losses, if any, that accrue to the Valuation Date immediately preceding the date of distribution, if later. Payment shall be made at the time and in the manner provided in Article XV hereof.

8.4 No Beneficiary. If a Member or former Member dies without a designated Beneficiary surviving him, or if all his Beneficiaries die before receiving the payment to which they are entitled, then any amounts to which such Member, former Member, or Beneficiary is entitled hereunder shall be paid to his estate.

For the purpose of this Plan, the production of a certified copy of the death certificate of any Employee or other person shall be sufficient evidence of death, and the Committee shall be fully protected in relying thereon. In the absence of such proof, the Committee may rely upon such other evidence of death as it deems necessary or advisable.

#### **ARTICLE IX DISABILITY**

9.1 Disability. If a Member's employment with the Company terminates as a result of his Disability, such Member's Individual Account shall thereupon become one hundred percent (100%) vested, and the amount contained therein shall be nonforfeitable.

9.2 Benefit. In the event of the Disability of a Member or former Member, he shall be entitled to the entire amount to the credit of his Individual Account as of the Valuation Date concurrent with or next following the date on which his termination of employment occurs as a result of his Disability including his portion, if any, of Qualified Nonelective Contributions allocated after the date of his termination of employment, adjusted for earnings and losses, if any, that accrue to the Valuation Date immediately preceding the date of distribution, if later. Payments shall be made at the time and in the manner provided in Article XV hereof.

#### **ARTICLE X TERMINATION OF EMPLOYMENT AND FORFEITURES**

10.1 Eligibility and Benefits.

(a) Salary Reduction, Rollover and Qualified Nonelective Contributions. If a Member's employment with the Company shall terminate for any reason other than his Retirement under Article VII, death under Article VIII, or Disability under Article IX, such Member shall be entitled to all of his Salary Reduction Contribution Account and all of his Rollover Contribution Account as of the Valuation Date concurrent with or next following the date on which his termination of employment occurs, including his portion, if any, of Salary Reduction Contributions and Qualified Nonelective Contributions allocated after the date of his termination of employment, adjusted for earnings and losses, if any, that accrue to the Valuation Date immediately preceding the date of distribution, if later.

(b) Company Matching Contributions. In addition, such Member shall be entitled to a percentage of the amount in his Company Matching Contribution Account as of the Valuation Date concurrent with or next following the date on which his termination of employment occurs, including his portion, if any, of Company Matching Contributions allocated after the date of his termination of employment, adjusted for earnings and losses, if any, that accrue to the Valuation Date immediately preceding the date of distribution, if later. The percentage of a Member's Company Matching Contribution Account to which he is entitled shall be determined in accordance with the following schedule:

Completed Years of Service	Percentage Payable
Less than 1 year	0%
1 year but less than 2 years	20%
2 years but less than 3 years	40%
3 years but less than 4 years	60%
4 years but less than 5 years	80%
5 years or more	100%

The provisions of this paragraph (b) shall be subject to the provisions of Section 17.3 hereof, which shall be given full effect.

10.2 Time of Payment. The amount to which a Member shall be entitled under Section 10.1 shall be paid to him at the time and in the manner provided in Article XV hereof.

10.3 Forfeitures. A Member to whom Section 10.1 is applicable shall forfeit that portion of the amount in his Individual Account to which he is not entitled under Section 10.1, and the amount thus forfeited shall be used to reduce Company Matching Contributions pursuant to the provisions of Section 6.3. A Member who does not have any nonforfeitable right to his Individual Account shall be deemed to have received a cashout distribution pursuant to Section 15.3 hereof, and shall forfeit the amount in such Individual Account in the Plan Year in which his separation from service occurs. A Member who receives a cashout distribution in accordance with the provisions of Section 15.3 hereunder shall forfeit that portion of his Individual Account to which he is not entitled under Section 10.1 in the Plan Year in which the cashout distribution occurs. A Member who is entitled to a portion of his Individual Account but who is not one

hundred percent (100%) vested in such Individual Account and who does not receive a cashout distribution under Section 15.3, shall forfeit that portion of his Individual Account to which he is not entitled under Section 10.1 in the Plan Year in which he incurs five (5) consecutive Breaks in Service.

10.4 Forfeitures for Cause. In the event a Member who has not completed at least three (3) years of Vesting Service is discharged due to his dishonest or criminal act (proven by conclusive evidence to the unanimous satisfaction of the Committee) or due to embezzlement, fraud, or dishonesty against and damaging to the Company whereby the reasons for such discharge are confirmed by resolution of the board of directors or other governing authority of the Company, the entire amount credited to the benefit of such Member in his Company Matching Contribution Account shall be forfeited and neither he nor his Beneficiary shall be entitled to any benefit hereunder with respect to such amounts. Likewise, any amounts credited to, but not distributed from, the Company Matching Contribution Account of a former Member who has not completed at least three (3) years of Vesting Service shall be forfeited upon the discovery of any embezzlement, fraud, or dishonesty of such former Member against and damaging to the Company. Notwithstanding the foregoing, in the event the Plan is top-heavy for any Plan Year, pursuant to Section 19.2 hereof, the provisions of Section 10.1 shall supersede this Section 10.4 and shall be controlling for all purposes hereunder.

## ARTICLE XI WITHDRAWALS AND LOANS

### 11.1 Loans to Members.

(a) General. Subject to such rules and regulations as may from time to time be promulgated by the Committee, the Committee upon application of a Member may, in its sole and absolute discretion, direct the Trustee to make a loan or loans to such Member from his Rollover Contribution Account, and upon depletion of the funds in his Rollover Contribution Account, from his Salary Reduction Contribution Account upon such terms as the Committee deems appropriate, subject to the following requirements.

The maximum amount that may be loaned is the lesser of (i) \$50,000.00, reduced as provided below, or (ii) one-half of the sum of the value of the Member's Rollover Contribution Account and the value of the Member's Salary Reduction Contribution Account as of the Valuation Date next preceding the date on which the Committee receives the Member's loan application. The \$50,000.00 limitation shall be reduced by the excess (if any) of:

- (i) the highest outstanding balance of loans from the Plan to the Member during the one-year period ending on the day before the date on which such loan was made, over
- (ii) the outstanding balance of loans from the Plan to the Member on the date on which such loan was made.

The minimum amount that may be loaned is the sum of: (i) One Thousand and No/100 Dollars (\$1,000.00) and (ii) an amount equal to the Plan's loan administration fee

in effect on the date on which the loan is made. Only one loan from the Plan per calendar year may be approved for any Member, and no more than one such loan may be outstanding at any time. Notwithstanding the foregoing, if, immediately prior to the merger of the Morris Air Corporation Employee Retirement Plan (the "Morris Air Plan") into this Plan, a Member had an outstanding loan under this Plan and an outstanding loan under the Morris Air Plan, then both such loans may remain outstanding. Loans shall be granted by the Committee in a uniform and nondiscriminatory manner. Each loan shall bear a reasonable rate of interest and be adequately secured and shall by its terms require repayment in no later than five years, unless such loan is used to acquire any dwelling unit that within a reasonable time is to be used (determined at the time the loan is made) as a principal residence of the Member. All loans shall be repaid pro rata to the applicable account from which the loan proceeds were paid pursuant to a salary deduction procedure established by the Company unless the Member is on an authorized leave of absence or transfers to a location that does not participate in a salary deduction procedure, in which case payment shall be made to the principal office of the Company by check.

All loans to Members granted under this provision are to be considered a directed investment of such Member. The loan shall remain an asset of the Trust, but to the extent of the outstanding balance of any such loan at any time, the Rollover Contribution Account and, if applicable, Salary Reduction Contribution Account of the Member to whom such loan is made alone shall share in any interest paid on such loan and alone shall bear any expense or loss incurred in connection with such loan. The Trustee may retain any principal or interest paid on any such loan in an interest-bearing segregated account held on behalf of the Member to whom such loan is made until the Trustee deems it appropriate to add such amounts to a Member's Rollover Contribution Account, and if applicable, Salary Reduction Contribution Account. Each loan applicant shall receive a clear statement of the charges involved in each loan transaction. This statement shall include the dollar amount and annual interest rate of the finance charge. Any outstanding loan or loans to a Member shall, if not paid when due, be liquidated out of the interest of such Member; provided, however, that no such liquidation shall occur prior to the time a Member is entitled to receive a distribution under Article VII, VIII, IX or X hereof or a withdrawal under Section 11.2(b) hereof. No distribution shall be made to any Member or former Member, or to a Beneficiary or Beneficiaries, or the estate of a Member unless and until all unpaid loans to such Member, together with interest, have been liquidated, as described above, or paid in full.

(b) Qualified Hurricane Loans. Notwithstanding any provision of this Plan to the contrary, any Member whose principal place of abode was located in a Hurricane Disaster Area on the date applicable to such hurricane, as indicated below, and who sustained an economic loss by reason of such hurricane, shall be eligible to request a Qualified Hurricane Loan, regardless of any other outstanding loans from this Plan.

Applicable Date for Location of Principal Place of Abode

Hurricane Katrina	August 28, 2005
Hurricane Rita	September 23, 2005
Hurricane Wilma	October 23, 2005

For purposes of this subsection (b), a Member shall be deemed to have sustained an economic loss on account of loss, damage to, or destruction of real or personal property from fire, flooding, looting, vandalism, theft, wind, or other cause; loss related to displacement from such Member's home; loss of livelihood due to temporary or permanent layoff, and such other economic loss as the Committee, in its sole discretion, shall determine. A Qualified Hurricane Loan is a loan from the Plan that is made to a Member on or before December 31, 2006, in an amount that does not exceed the lesser of: (1) one hundred percent (100%) of such Member's vested Individual Account balance or (2) \$100,000, reduced by the excess of:

- (i) the highest outstanding balance on loans from the Plan to the Member during the one-year period ending on the day before the date on which such loan was made, over
- (ii) the outstanding balance of loans from the Plan to the Member on the date on which such loan was made.

A Qualified Hurricane Loan made with respect to Hurricane Katrina must be made on or after September 24, 2005, and a Qualified Hurricane Loan made with respect to Hurricanes Rita or Wilma must be made on or after December 21, 2005.

(c) Suspension of Plan Loans. Any Member who is eligible to receive a Qualified Hurricane Loan, as set forth in subsection (b) above, may suspend for one year any loan payments under an outstanding loan from the Plan to such Member originally due during the following periods:

- (i) August 25, 2005 through December 31, 2006 for Members whose principal place of abode was located in the Hurricane Katrina Disaster Area;
- (ii) September 23, 2005 through December 31, 2006 for Members whose principal place of abode was located in the Hurricane Rita Disaster Area; and
- (iii) October 23, 2005 through December 31, 2006 for Members whose principal place of abode was located in the Hurricane Wilma Disaster Area.

After any period during which a Member elects to suspend the payment(s) on an outstanding loan, the outstanding balance of the loan(s) shall be reamortized to include the interest accruing during such delay. Any delay elected by a Member shall increase the repayment period for such loan, and the maximum repayment period determined under subsection (a) above for such loan shall be increased by the period of up to one year when no payments were made. Notwithstanding subsection (a) above, a Member may pledge up to 100% of his Individual Account as collateral for a Qualified Hurricane Loan.

(d) Hurricane Disaster Areas. For purposes of subsections (b) and (c) above, the following Hurricane Disaster Areas shall apply:

Hurricane Katrina Disaster Area: The States of Alabama, Florida, Louisiana and Mississippi.

Hurricane Rita Disaster Area: The States of Louisiana and Texas.

Hurricane Wilma Disaster Area: The State of Florida.

#### 11.2 Withdrawals.

(a) Financial Hardship. A Member may, upon the approval of the Committee, withdraw on account of financial hardship any portion of his Rollover Contribution Account and upon depletion of the funds in his Rollover Contribution Account, any portion of his Salary Reduction Contribution Account other than amounts attributable to Qualified Nonelective Contributions, if any, and income on such Member's Salary Reduction Contributions and Qualified Nonelective Contributions, if any. A Member may not withdraw, on account of hardship, amounts in his Company Matching Contribution Account. A Member who wishes to request a hardship withdrawal shall file with the Committee a written request for withdrawal on a form provided by the Committee. The Committee shall adopt uniform and nondiscriminatory rules regarding the granting of such requests and shall evaluate hardship requests made under this Section. For purposes of this Plan, a financial hardship means an immediate and heavy financial need of the Member for which funds are not reasonably available from other resources of the Member. The determination of whether a Member suffers sufficient hardship to justify the granting of his written request and of the amount permitted to be withdrawn under this Section shall be made in the sole and absolute discretion of the Committee after a full review of the Member's written request and evidence presented by the Member showing financial hardship. Upon a Member's receipt of a withdrawal for financial hardship, such Member shall be prohibited from making Salary Reduction Contributions, including Catch-Up Contributions, if applicable, for a period of at least six (6) months, beginning on the date on which the hardship withdrawal is made. A Member may elect to resume Salary Reduction Contributions, including Catch-Up Contributions, if applicable, under this Plan as of the first day of any new payroll period following the last day of such six (6) month period by filing a new salary reduction election within the time period prior to the first day of such payroll period established by the Committee.

If approved by the Committee, any withdrawal for financial hardship may not exceed the amount deemed necessary to meet the immediate financial need created by the hardship, including any amounts necessary to pay any federal, state, or local income taxes or penalties reasonably anticipated to result from the withdrawal. The request of any Member for a hardship withdrawal shall be deemed necessary to meet the immediate financial need of the Member if the Member has theretofore (i) obtained all currently available distributions, other than hardship distributions, (ii) obtained all nontaxable loans permitted under all plans maintained by the Company; and (iii) agreed to suspend his or her Salary Reduction Contributions, including Catch-Up Contributions, if applicable,

under this Plan and elective contributions and employee contributions under all other plans (other than a health or welfare benefit plan) maintained by the Company for a period of at least six (6) months following receipt of the hardship distribution. A Member may elect to resume Salary Reduction Contributions, including Catch-Up Contributions, if applicable, under this Plan in the manner described hereinabove and may elect to resume elective contributions and employee contributions under all other plans in accordance with their respective terms.

Notwithstanding the foregoing, a request for a hardship withdrawal will generally be treated as necessary to satisfy a financial hardship if the Committee relies upon the Member's representation (made in writing or such other form as may be prescribed by the Commissioner), unless the Committee has actual knowledge to the contrary, that the hardship cannot reasonably be relieved:

- (i) through reimbursement or compensation by insurance or otherwise;
- (ii) by liquidation of the Member's assets;
- (iii) by cessation of Salary Reduction Contributions, including Catch-Up Contributions, if applicable, under the Plan;
- (iv) by other distributions or nontaxable (determined at the time of the loan) loans from plans maintained by the Company, or any other employer of such Member, or
- (v) by borrowing from commercial sources on reasonable commercial terms in an amount sufficient to satisfy the financial hardship.

Expenses that may warrant approval of a Member's request for a hardship withdrawal include:

- (vi) Expenses for (or necessary to obtain) medical care that would be deductible under Section 213 of the Code (determined without regard to whether the expenses exceed 7.5% of adjusted gross income);
- (vii) Expenses (excluding mortgage payments) incurred to purchase a principal residence of the Member;
- (viii) Payment of tuition, related educational fees, and room and board expenses for the next twelve (2) months of post-secondary education for the Member, his or her spouse, or children or dependents (as defined in Section 152 of the Code, without regard to Section 152(b)(1), (b)(2) and (d)(1)(B) of the Code);
- (ix) Payments necessary to prevent the eviction of the Member from his principal residence or foreclosure on the mortgage of the Member's principal residence;

(x) Payments incurred for burial or funeral expenses for the Member's deceased parent, spouse, children or dependents (as defined in Section 152 of the Code, without regard to Section 152(b)(1), (b)(2) and (d)(1)(B) of the Code);

(xi) Expenses for the repair of damage to the Member's principal residence that would qualify for the casualty deduction under Section 165 of the Code (determined without regard to whether the loss exceeds 10% of adjusted gross income); and

(xii) Such other expenses as the Committee may determine to be within the intent of this Section.

(b) Attainment of Age 59-1/2. A Member who has attained the age of fifty-nine and one-half (59½) may elect, in writing, within the time period established by the Committee for such elections, to withdraw all or any portion of his vested interest (determined pursuant to Section 10.1 hereof) in his Individual Account. Any partial withdrawal shall be taken from such Member's Individual Account as follows: first, from the after-tax amounts, if any, in the Member's Individual Account until such amounts are fully depleted; second, from the Member's Rollover Contribution Account until such account is fully depleted; third, from the Member's Salary Reduction Contribution Account until such account is fully depleted; and fourth, from the Member's Company Matching Contribution Account until such account is fully depleted. No more than one such withdrawal may be made by the Member during any Plan Year. The amount available for withdrawal shall be determined as of the Valuation Date next following the date on which the Committee receives the Member's withdrawal election, and the withdrawal amount shall be distributed to the Member as soon as practicable thereafter.

(c) Withdrawals from Rollover Contribution Account. A Member may elect, in writing, within the time period established by the Committee for such elections, to withdraw all or any portion of his Rollover Contribution Account. No more than one such withdrawal may be made by the Member during any Plan Year. The amount available for withdrawal shall be determined as of the Valuation Date next following the date on which the Committee receives the Member's withdrawal election, and the withdrawal amount shall be distributed to the Member as soon as practicable thereafter.

(d) Qualified Hurricane Distributions. A Member may, upon the approval of the Committee, take a Qualified Hurricane Distribution from his Individual Account.

(i) Amount. The Qualified Hurricane Distribution shall not exceed the lesser of: (i) 100% of the Member's vested Individual Account balance or (ii) the excess of (A) \$100,000 over (B) the aggregate amounts treated as Qualified Hurricane Distributions in all prior taxable years.

(ii) Recontributions. At any time during the three-year period beginning on the day after the date on which a Member receives a Qualified Hurricane Distribution from the Plan, such Member may retribute the amount of the Qualified Hurricane Distribution to the Plan through one or more

contributions. Such contributions will be treated in the same manner as Rollover Contributions, as provided in Section 4.7, and shall be credited to the Member's Rollover Contribution Account.

(iii) Definitions.

(1) Qualified Hurricane Distribution means:

(A) Any distribution from the Plan made on or after August 25, 2005, and before January 1, 2007, to a Member whose principal place of abode on August 28, 2005, was located in the Hurricane Katrina Disaster Area and who has sustained an economic loss by reason of Hurricane Katrina;

(B) Any distribution from the Plan made on or after September 23, 2005, and before January 1, 2007, to a Member whose principal place of abode on September 23, 2005, was located in the Hurricane Rita Disaster Area and who has sustained an economic loss by reason of Hurricane Rita; and

(C) Any distribution from the Plan made on or after October 23, 2005, and before January 1, 2007, to a Member whose principal place of abode on October 23, 2005, was located in the Hurricane Wilma Disaster Area and who has sustained an economic loss by reason of Hurricane Wilma.

For purposes of this subparagraph (i), a Member shall be deemed to have sustained an economic loss on account of loss, damage to, or destruction of real or personal property from fire, flooding, looting, vandalism, theft, wind, or other cause; loss related to displacement from such Member's home; loss of livelihood due to temporary or permanent layoff; and such other economic loss as the Committee, in its sole discretion, shall determine. As long as a Member has sustained an economic loss by reason of Hurricane Katrina, Hurricane Rita or Hurricane Wilma, Qualified Hurricane Distributions are permitted without regard to the Member's need, and the amounts of such distributions are not required to correspond to the amount of economic loss suffered by the Member.

(2) The Hurricane Katrina Disaster Area consists of the States of Alabama, Florida, Louisiana and Mississippi.

(3) The Hurricane Rita Disaster Area consists of the States of Louisiana and Texas.

(4) The Hurricane Wilma Disaster Area consists of the State of Florida.

(e) Automatic Enrollment Contributions: Any Member may elect, within the ninety (90) day period following the first date on which amounts are contributed on his behalf pursuant to a deemed election under Section 4.1 hereof, and in the manner prescribed by the Committee, to withdraw the entire amount of such Salary Reduction Contributions made prior to the date of such withdrawal election (adjusted for earnings and/or losses attributable thereto). The amount available for withdrawal shall be determined as of the Valuation Date next following the date on which the Committee receives the Member's withdrawal election, and the withdrawal amount shall be distributed to the Member as soon as practicable thereafter. In the event a Member elects to withdraw the Salary Reduction Contributions made on his behalf pursuant to a deemed election, as provided above, all Company Matching Contributions (adjusted for earnings and/or losses attributable thereto) made on behalf of such Member and attributable to the Salary Reduction Contributions withdrawn under this subparagraph (e) shall be forfeited and the amount thus forfeited shall be used to reduce Company Matching Contributions pursuant to the provisions of Section 6.3. Furthermore, the deemed election of such Member under Section 4.1 shall automatically terminate on the date of an election to withdraw under this subparagraph (e) and no further Salary Reduction Contributions shall be made on behalf of such Member until the later of: (i) the date on which the Member makes an affirmative election under Section 4.1 hereof to have Salary Reduction Contributions made on his behalf or (ii) a subsequent Deemed Election Date of such Member.

(f) Qualified Reservist Withdrawal. Effective November 15, 2007, a Member who (by reason of being a member of a reserve component, as such term is defined in Section 101 of Title 37, United States Code), is ordered or called to active duty after September 11, 2001 and prior to December 31, 2007 (or such later date as may be set forth in Section 72(t)(2)(G)(iv) of the Code) for a period in excess of one hundred seventy-nine (179) days, or for an indefinite period, may, upon the approval of the Committee, take a "Qualified Reservist Withdrawal", as such term is defined below, from his Salary Reduction Contribution Account. A Qualified Reservist Withdrawal is a withdrawal of all or any portion of a Member's Salary Reduction Contribution Account that is made during the period beginning on the date of a Member's order or call to active duty, as set forth above, and ending on the last day of the active duty period. The amount available for withdrawal shall be determined as of the Valuation Date next following the date on which the Committee receives the Member's withdrawal election, and the withdrawal amount shall be distributed to the Member as soon as practicable thereafter.

## **ARTICLE XII INVESTMENT OF THE TRUST FUND**

### **12.1 Member Direction of Investment**

(a) Investment of Contributions. Each Member shall have the right, within the guidelines established by the Committee, to direct the Committee to instruct the Trustee to invest any whole percentage, up to one hundred percent (100%), of the contributions made by or on behalf of such Member in one or more of such investment media as the Committee may designate from time to time. The Committee shall direct

the Trustee or, if applicable, an Investment Manager as to the investments in which Members may invest. The Committee may determine to offer as investment media any investment fund, program, or other vehicle that is suitable as a proper and permissible investment of contributions made to a retirement plan qualified pursuant to Section 401(a) of the Code. The investment directions of the Members shall be implemented by the Trustee or, if applicable, an Investment Manager; provided, however, that the Trustee or, if applicable, an Investment Manager shall not be obligated to follow the investment direction of a Member if such direction would result in a prohibited transaction described in Section 406 of ERISA or Section 4975 of the Code, would generate income that would be taxable to the Plan, or:

(i) would not be in accordance with the documents and instruments governing the Plan insofar as such documents and instruments are consistent with the provisions of Title I of ERISA;

(ii) would cause a fiduciary to maintain the indicia of ownership of any assets of the Plan outside the jurisdiction of the district courts of the United States other than as permitted by Section 404(b) of ERISA and Department of Labor Regulations §2550.404b-1;

(iii) would jeopardize the Plan's tax qualified status under the Code;

(iv) could result in a loss in excess of a Member's or Beneficiary's account balance; or

(v) would result in a direct or indirect:

(1) sale, exchange, or lease of property between the Company (or any affiliate of the Company) and the Plan except for the acquisition or disposition of any interest in a fund, subfund or portfolio managed by the Company (or an affiliate of the Company), or the purchase or sale of any qualifying employer security (as defined in Section 407(d)(5) of ERISA) which meets the conditions of Section 408(e) of ERISA and subparagraph (4) below;

(2) loan to the Company or any affiliate of the Company;

(3) acquisition or sale of any employer real property (as defined in Section 407(d)(2) of ERISA); or

(4) acquisition or sale of any employer security.

(b) Modification of Investment Media. The Committee shall be authorized at any time, and from time to time, to modify, alter, delete, or add to the funds available for investment at the direction of a Member. In the event a modification occurs, the Committee shall notify those Members whom the Committee, in its sole and absolute discretion, determines are affected by the change and shall give such persons such

additional time as is determined by the Committee to designate the manner and percentage in which amounts invested in those funds thereby affected shall be invested.

The Committee shall not be obligated to substitute funds of similar investment criteria for existing funds, nor shall it be obligated to continue the types of investments presently available to the Members. Nothing contained herein shall constitute any action by the Committee as a direction of investment of the assets or an attempt to control such direction.

(c) Investment Direction. Any Member, on or before entry into the Plan, within the time period established by the Committee, may designate the manner and the percentage in which the Member desires the Trustee or, if applicable, an Investment Manager to invest his current contributions, pursuant to the provisions set forth above, which designation shall continue in effect until revoked or modified by the Member. If a Member fails to designate the investment of his current contributions on or before his entry into the Plan, or if a Member wishes to change such designation, the Member may make such designation or change, within the time period established by the Committee, to become effective for all future contributions as soon as practicable following the date of receipt by the Committee of such designation or change, and such designation or change shall continue in effect until revoked by the Member in accordance with this Plan.

Any amounts with respect to which the Trustee or, if applicable, an Investment Manager fails to receive a proper investment direction from any Member shall be invested, as directed by the Committee, in a qualified default investment alternative, as defined in Department of Labor Regulations §2550.404c-5 and such other subsequent guidance as may be promulgated by the Department of Labor, and with respect to which the other conditions set forth in Department of Labor Regulations §2550.404c-5 are met, including, but not limited to, the delivery to the Member of any material provided to the Plan that relates to the Member's investment therein. All investment designations shall be made in the manner prescribed by the Committee.

The Committee shall maintain separate subaccounts in the name of each Member within his Individual Account to reflect such Member's accrued benefit attributable to his directed investment in the above investment media.

#### 12.2 Conversion of Investments.

(a) Member's Individual Account. Effective as of any Valuation Date, within the time period prior thereto established by the Committee, and subject to any restrictions on transfer imposed under particular investment funds, a Member who has an account balance in his Individual Account in excess of any loan receivables from such Member may, pursuant to guidelines established by the Committee, direct the Committee to instruct the Trustee to convert any whole percentage, up to one hundred percent (100%), of such amount in his Individual Account (in excess of the loan receivables) that is invested in any of the investment media offered for investment under the Plan into one or more other of such investment media. Such direction shall be effective as soon as practicable following the date of receipt by the Committee of such direction to convert.

Notwithstanding any provision herein to the contrary, applicable fund redemption and short-term trading fees may be imposed upon the Member's Individual Account in connection with any direction by such Member to convert investments hereunder.

(b) Conversion Directions. A direction to convert by any eligible Member shall be irrevocable and shall be made in the manner prescribed by the Committee within the time period established by the Committee. Any conversion of investments pursuant to this Section 12.2 shall not affect a Member's direction of investments with respect to his future contributions pursuant to Section 12.1.

(c) Direction of Spouse. If a Member's spouse who is not a Member in this Plan acquires an interest in a Member's Individual Account pursuant to a qualified domestic relations order, then the Member's spouse may direct the Committee to convert the investment of the interest to which such spouse is thus entitled in the same manner and at the same time as the Member may direct a conversion of investments, as provided above. If such spouse becomes a Member of the Plan, the spouse shall be entitled to convert such investments in accordance with the rights of Members in the Plan.

(d) Miscellaneous. The Committee is authorized to establish such other rules and regulations, including adding additional times to convert investments, as it determines are necessary to carry out the provisions of Section 12.1 and this Section 12.2, the specific dates of conversion to be determined by the Committee, and all earnings on the Member's investments after such dates shall be allocated in accordance with the Member's Individual Accounts, as adjusted on such dates. The Committee shall be authorized to modify the allocations of earnings, provided such change is made on a reasonable and nondiscriminatory basis.

### **ARTICLE XIII ADMINISTRATION**

13.1 Appointment of Committee. The Plan shall be administered by a Committee consisting of at least three or more persons who shall be appointed by and serve at the pleasure of the board of directors of the Company. All usual and reasonable expenses of the Committee shall be paid by the Trustee out of the principal or income of the Trust and, to the extent not so paid, shall be paid by the Company. The members of the Committee shall not receive compensation with respect to their services for the Committee. The members of the Committee may serve without bond or security for the performance of their duties hereunder unless applicable law makes the furnishing of such bond or security mandatory or unless required by the Company. Any member of the Committee may resign by delivering his written resignation to the Company and to the other members of the Committee.

13.2 Committee Powers and Duties. The Committee shall have such powers as may be necessary to discharge its duties hereunder, including, but not by way of limitation, the following powers and duties:

(a) to construe and interpret the Plan, decide all questions of eligibility and determine the amount, manner, and time of payment of any benefits hereunder;

- (b) to prescribe procedures to be followed by distributees in obtaining benefits;
- (c) to make a determination as to the right of any person to a benefit and to afford any person dissatisfied with such determination the right to a hearing thereon;
- (d) to receive from the Company and from Members such information as shall be necessary for the proper administration of the Plan;
- (e) to delegate to one or more of the members of the Committee the right to act in its behalf in all matters connected with the administration of the Plan and Trust;
- (f) to receive and review reports of the financial condition and of the receipts and disbursements of the Trust Fund from the Trustee;
- (g) to appoint or employ for the Plan any agents it deems advisable, including, but not limited to, legal counsel; and
- (h) to take any and all further actions from time to time as the Committee, in its sole and absolute discretion, shall deem necessary for the proper administration of the Plan.

The Committee shall have no power to add to, subtract from or modify any of the terms of the Plan, nor to change or add to any benefits provided by the Plan, nor to waive or fail to apply any requirements of eligibility for benefits under the Plan. The Committee shall have full and absolute discretion in the exercise of each and every aspect of its authority under this Plan, including without limitation, all of the rights, powers and authorities specified in this Section 13.2 and, if applicable, in Section 13.3 hereof.

A majority of the members of the Committee shall constitute a quorum for the transaction of business. No action of the Committee shall be taken except upon a majority vote of the Committee members other than as described in subparagraph (e) above. An individual shall not vote or decide upon any matter relating solely to himself or vote in any case in which his individual right or claim to any benefit under the Plan is particularly involved. If in any case in which a Committee member is so disqualified to act, and the remaining members cannot agree, the board of directors of the Company will appoint a temporary substitute member to exercise all the powers of the disqualified member concerning the matter in which he is disqualified.

13.3 Duties and Powers of the Plan Administrator. The Plan Administrator shall have such powers as may be necessary to discharge its duties hereunder, including, but not by way of limitation, the following powers and duties:

- (a) to file with the Secretary of Labor the annual report and other pertinent documents that may be requested by the Secretary;
- (b) to file with the Secretary of Labor such terminal and supplementary reports as may be necessary in the event of the termination of the Plan;

- (c) to furnish each Member, former Member and each Beneficiary receiving benefits hereunder a summary plan description explaining the Plan;
- (d) to furnish any Member, former Member or Beneficiary, who requests in writing, statements indicating such Member's, former Member's or Beneficiary's total accrued benefits and nonforfeitable benefits, if any;
- (e) to furnish to a Member a statement containing information contained in a registration statement required by Section 6057(a)(2) of the Code;
- (f) to maintain all records necessary for verification of information required to be filed with the Secretary of Labor;
- (g) to allocate the assets of the Plan available to provide benefits to Members in the event the Plan should terminate; and
- (h) to report to the Trustee all available information regarding the amount of benefits payable to each Member, the computations with respect to the allocation of assets, and any other information that the Trustee may require in order to terminate the Plan.

13.4 Rules and Decisions. The Committee may adopt such rules as it deems necessary or desirable. All rules and decisions of the Committee shall be uniformly and consistently applied to all Employees in similar circumstances. The Committee is required to provide a notice in writing to any person whose claim for benefits under the Plan has been denied, setting forth the specific reasons for such denial. The Committee shall adopt rules or procedures to carry out the intent of this Section and to provide a basis for a full and fair review by the Committee of the decision denying the claim and provide such person with an opportunity to supply any evidence he has to sustain the claim.

13.5 Committee Procedures. The Committee may adopt such bylaws as it deems desirable. The Committee shall elect one of its members as chairman. The Committee shall advise the Trustee of such election in writing. The Committee shall keep a record of all meetings and forward all necessary communications to the Trustee.

13.6 Authorization of Benefit Payments. The Committee shall issue directions to the Trustee concerning all benefits that are to be paid from the Trust Fund pursuant to the provisions of the Plan. The Committee shall keep on file, in such manner as it may deem convenient or proper, all reports from the Trustee.

13.7 Payment of Expenses. All expenses incident to the administration of the Plan and Trust, including but not limited to, actuarial, legal, accounting, investment advisory, investment education, recordkeeping, Trustee's fees, and any other plan administrative expenses, shall be paid by the Trustee from the Trust Fund and until paid, shall constitute a first and prior claim and lien against the Trust Fund. To the extent such expenses are not paid by the Trustee from the Trust Fund, they shall be paid by the Company.

13.8 Indemnification of Members of the Committee. The Company shall, to the maximum extent permitted under the Company's bylaws, indemnify the members of the Committee against liability or loss sustained by them by an act or failure to act in their capacity as members of the Committee.

**ARTICLE XIV  
NOTICES**

14.1 Notice to Trustee. As soon as practicable after a Member ceases to be in the employ of the Company for any of the reasons set forth in Articles VII through X, inclusive, the Committee shall give notice to the Trustee, which notice shall include such of the following information and directions as are necessary or advisable under the circumstances:

- (a) name and address of the Member;
- (b) name and address of the Beneficiary or Beneficiaries in case of a Member's death;
- (c) amount to which the Member is entitled in case of termination of employment pursuant to Article X; and
- (d) manner and amount of payments to be made pursuant to Article XV.

If a former Member dies, the Committee shall give a like notice to the Trustee, but only if the Committee learns of his death.

14.2 Subsequent Notices. At any time and from time to time after giving the notice as provided for in Section 14.1, the Committee may modify such original notice or any subsequent notice by means of a further notice or notices to the Trustee; but any action theretofore taken or payments theretofore made by the Trustee pursuant to a prior notice shall not be affected by a subsequent notice.

14.3 Reliance upon Notice. Upon receipt of any notice as provided in this Article, the Trustee shall promptly take whatever action and make whatever payments are called for therein, it being intended that the Trustee may rely upon the information and directions in such notice absolutely and without question. However, the Trustee may call to the attention of the Committee any error or oversight that the Trustee believes to exist in any notice.

**ARTICLE XV  
BENEFIT PAYMENTS**

5.1 Method of Payment. As soon as practicable after the separation from service of a Member, former Member, or Beneficiary who is entitled to receive benefits hereunder, as provided in Articles VII, VIII, IX or X and this Article XV, the Committee shall give written notice to the Trustee. Such benefits shall be paid to the Member, former Member, or his Beneficiary in a lump sum. Any benefit payable hereunder will be paid in cash.

15.2 Time of Payment. Distribution shall be made as soon as administratively practicable, but in no event later than one (1) year after the Valuation Date coincident with or immediately following the separation from service of a Member, former Member, or Beneficiary who is entitled to receive a benefit hereunder. Notwithstanding the foregoing, if the nonforfeitable portion of a Member's or former Member's Individual Account exceeds One Thousand and No/100 Dollars (\$1,000.00), no distributions, other than distributions upon the death of such Member or former Member, may commence without the consent of the Member or former Member until he attains age sixty-two (62), at which time distribution shall be made. Such consent must be obtained within the one hundred eighty (180) day period ending on the date of distribution. The Committee shall notify the Member or former Member of the right to defer any distribution until the date on which he attains age sixty-two (62). Such notification shall include a general description of the material features, and an explanation of the relative values of, the optional forms of benefit available under the Plan in a manner that would satisfy the notice requirements of Section 417(a)(3) of the Code, and shall be provided no less than thirty (30) days and no more than one hundred eighty (180) days prior to the date of distribution. Notwithstanding the foregoing, the consent of the Member or former Member shall not be required to the extent that a distribution is required to satisfy Section 415 or Sections 401(k)(8) or 401(m)(6) of the Code. In addition, upon termination of this Plan, if the Plan does not then offer an annuity option, the Member's or former Member's Individual Account may, without his consent, be distributed to the Member or former Member or transferred to another defined contribution plan maintained by an Affiliate. Furthermore, if a distribution is one to which Sections 401(a)(11) and 417 of the Code do not apply, such distribution may commence less than thirty (30) days after the notice required under Section 1.411(a)-11(c) of the Treasury Regulations is given, provided that: (i) the Committee clearly informs the Member or former Member that he has a right to a period of at least thirty (30) days after receiving the notice to consider the decision of whether or not to elect a distribution (and, if applicable, a particular distribution option), and (ii) the Member or former Member, after receiving the notice, affirmatively elects a distribution.

Distribution shall be made no later than the required beginning date, which is April 1st of the calendar year following the later of: (a) the calendar year in which a Member attains age 70<sup>1/2</sup> or (b) the calendar year in which the Member retires; provided that if a Member is a Five Percent (5%) Owner (as defined in Section 19.1(f) hereof), then the required beginning date is April 1st of the calendar year following the calendar year in which such Member attains age 70<sup>1/2</sup>. Effective as of November 16, 2001, distribution of a Member's entire Individual Account shall be made in a single lump sum on or before such Member's required beginning date. In the case of a Member who attained age 70<sup>1/2</sup> prior to November 16, 2001, or in the case of a Member who is a five percent (5%) owner, the minimum distribution required for the calendar year immediately preceding the Member's required beginning date must be made on or before his required beginning date. The minimum distribution for other calendar years, including the minimum distribution for the calendar year in which the Member's required beginning date occurs, must be made on or before December 31 of such calendar year. All minimum distributions required under this Article XV shall be determined and made in accordance with the applicable Treasury Regulations under Section 401(a)(9) of the Code, and the requirements of this Article will take precedence over any inconsistent provisions of the Plan. Required minimum distributions will be determined beginning with the first distribution calendar year and up to and including the distribution calendar year that includes the Member's date of death.

Effective January 1, 2003, during such Member's lifetime, the minimum amount that will be distributed for each distribution calendar year is the lesser of:

(a) the quotient obtained by dividing the Member's Individual Account balance by the distribution period in the Uniform Lifetime Table set forth in section 1.401(a)(9)-9 of the Treasury Regulations, using the Member's age as of the Member's birthday in the distribution calendar year; or

(b) if the Member's sole designated beneficiary for the distribution calendar year is the Member's spouse, the quotient obtained by dividing the Member's Individual Account balance by the number in the Joint and Last Survivor Table set forth in section 1.401(a)(9)-9 of the Treasury Regulations, using the Member's and spouse's attained ages as of the Member's and spouse's birthdays in the distribution calendar year.

Notwithstanding any provision herein to the contrary, any Member who attains age 70½ in a calendar year after 1995 and prior to November 16, 2001, may irrevocably elect, in the manner established by the Committee, by April 1 of the calendar year following the year in which the Member attains age 70½ (or by December 31, 1997 in the case of a Member who attains age 70½ in 1996) to defer distributions until April 1 of the calendar year following the calendar year in which the Member retires. If no such election is made, the Member will begin receiving distributions by the April 1 of the calendar year following the year in which the Member attains age 70½ (or by December 31, 1997 in the case of a Member who attains age 70½ in 1996), and any such distributions shall comply with the provisions of the preceding paragraph. Furthermore, any Member who attains age 70½ in a calendar year prior to 1996, may irrevocably elect, in the manner established by the Committee, to stop distributions and recommence distributions as of the April 1 of the calendar year following the calendar year in which such Member retires.

If distributions have commenced so that payments are being made over the life of the Member, and he dies before his entire interest has been distributed, then the remaining portion of such interest shall be distributed at least as rapidly as under the method of distribution being used as of the date of his death, but in no event later than one year after the Valuation Date coincident with or immediately following his death. On the other hand, if a Member dies before the distribution of any of his benefits has begun, then his entire interest will be distributed no later than one year after the Valuation Date coincident with or immediately following his death. If the designated Beneficiary is the Member's surviving spouse and such surviving spouse dies after the Member, but before payment to such surviving spouse is made, then the provisions of the preceding sentence shall be applied as if the surviving spouse were the Member. Furthermore, if the designated Beneficiary is the surviving spouse of the Member, then distribution to such surviving spouse will not be required earlier than the later of: (a) December 31 of the calendar year immediately following the calendar year of the Member's death and (b) December 31 of the calendar year in which the Member would have attained age 70½. Distribution of benefits is considered to have begun, for purposes of this paragraph, on the required beginning date; provided that if a Member's designated Beneficiary is his surviving spouse, and such surviving spouse dies after the Member but before payments to such surviving spouse have begun, then distribution of benefits is considered to have begun on the date

distribution to the surviving spouse is required to begin pursuant to the provisions of this paragraph.

Notwithstanding any provision herein to the contrary, unless a Member or former Member elects otherwise, in writing, no distribution hereunder shall start later than 60 days after the close of the Plan Year in which the last to occur of the following occurs:

- (a) the Member or former Member attains Normal Retirement Age,
- (b) the 10<sup>th</sup> anniversary of the year in which the Member or former Member commenced participation in the Plan, or
- (c) the Member or former Member terminates service with the Company.

15.3 Cash Out Distribution. If a Member or former Member who has received a distribution of his benefits hereunder on or before the last day of the second Plan Year following the year in which his separation from service occurs, has forfeited a portion of his Individual Account, then in the event such Member or former Member is subsequently rehired by the Company prior to the date on which he incurs five (5) consecutive Breaks in Service, he shall be entitled to repay, at any time prior to the earlier of: (i) the date which is five (5) years after the first date on which he is subsequently reemployed by the Company and (ii) the date on which he incurs five (5) consecutive Breaks in Service, the amount of the distribution to him from his Individual Account. Upon such repayment, the rehired Member's or former Member's Individual Account shall be credited with the exact amount that was nonvested at the time of termination. In the event a rehired Member or former Member who has received a distribution hereunder does not timely repay such distribution from his Individual Account, as provided above, then the amount he forfeited at the time of his distribution pursuant to the terms of Section 10.3 hereof shall remain forfeited. His prior years of Vesting Service shall be taken into account, however, for purposes of determining his vested interest in contributions following reemployment. If a Member or former Member who does not have any nonforfeitable right to his Individual Account and thus is deemed to have received a cashout distribution, pursuant to the provisions of Section 10.3 hereof, is subsequently reemployed by the Company and five (5) consecutive Breaks in Service have not occurred, then upon such reemployment, the rehired Member's or former Member's Individual Account shall be credited with the exact amount that was nonvested at the time of separation from service.

15.4 Minority or Disability Payments. During the minority or Disability of any person entitled to receive benefits hereunder, the Committee may direct the Trustee to make payments due such person directly to him or to his spouse or a relative or to any individual or institution having custody of such person. Neither the Committee nor the Trustee shall be required to see to the application of payments so made, and the receipt of the payee (including the endorsement of a check or checks) shall be conclusive as to all interested parties.

15.5 Distributions Under Domestic Relations Orders. Nothing contained in this Plan shall prevent the Trustee, in accordance with the direction of the Committee, from complying with the provisions of a qualified domestic relations order (as defined in Section 414(p) of the Code). The Plan specifically permits distribution to an alternate payee under a qualified domestic

relations order at any time, irrespective of whether the Member or former Member has attained his earliest retirement age under the Plan, as defined in Section 414(p) of the Code; provided, however, that a distribution to an alternate payee prior to the Member or former Member's attainment of earliest retirement age is available only if: (1) the order specifies distribution at that time or permits an agreement between the Plan and the alternate payee to authorize an earlier distribution; (2) the order specifies such distribution to be in the form of a single, lump-sum payment; and (3) if the amount to which the alternate payee is entitled under the Plan exceeds \$1,000, and the order so requires, the alternate payee consents to any distribution occurring prior to the Member or former Member's attainment of earliest retirement age. If an alternate payee has not previously received a distribution of the entire interest to which such alternate payee is entitled hereunder, distribution shall be made to such alternate payee as soon as practicable following the alternate payee's attainment of age sixty-two (62). Nothing in this Section 15.5 gives a Member or former Member a right to receive distribution at a time otherwise not permitted under the Plan nor does it permit the alternate payee to receive a form of payment not otherwise permitted under the Plan.

The Plan Administrator shall establish reasonable procedures to determine the qualified status of a domestic relations order. Upon receiving a domestic relations order, the Plan Administrator shall promptly notify the Member or former Member and any alternate payee named in the order, in writing, of the receipt of the order and the Plan's procedures for determining the qualified status of the order. Within a reasonable period of time after receiving the domestic relations order, the Plan Administrator shall determine the qualified status of the order and shall notify the Member or former Member and each alternate payee, in writing, of its determination. The Plan Administrator shall provide notice under this paragraph by a mailing to the individual's address specified in the domestic relations order, or in a manner consistent with Department of Labor regulations. The Plan Administrator may treat as qualified any domestic relations order entered prior to January 1, 1985, irrespective of whether it satisfies all the requirements described in Section 414(p) of the Code.

If any portion of an Individual Account is payable during the period the Plan Administrator is making its determination of the qualified status of the domestic relations order, the Committee shall direct the Trustee to segregate the amounts that are payable into a separate account and to invest the segregated account solely in fixed income investments. If the Plan Administrator determines the order is a qualified domestic relations order within eighteen (18) months of receiving the order, the Committee shall direct the Trustee to distribute the segregated account in accordance with the order. If the Plan Administrator does not make its determination of the qualified status of the order within eighteen (18) months after receiving the order, the Committee shall direct the Trustee to distribute the segregated account in the manner in which the Plan would otherwise distribute if the order did not exist and shall apply the order prospectively if the Plan Administrator later determines the order is a qualified domestic relations order.

To the extent it is not inconsistent with the provisions of the qualified domestic relations order, the Committee may direct the Trustee to invest any amount that is subject to being paid to an alternate payee pursuant to said order into a segregated subaccount or separate account and to invest the account in federally insured, interest-bearing savings account(s) or time deposit(s) (or a combination of both), or in other fixed income investments. A segregated subaccount shall

remain a part of the Trust, but it alone shall share in any income it earns, and it alone shall bear any expense or loss it incurs.

The Trustee shall make any payments or distributions required under this Section 15.5 by separate benefit checks or other separate distribution to the alternate payee(s).

**15.6 Direct Rollover of Eligible Rollover Distributions.** Effective November 15, 2007, an individual who is entitled to a benefit hereunder (including a Participant's surviving spouse, a Participant's spouse or former spouse who is the alternate payee under a qualified domestic relation order, as defined in Section 414(p) of the Code, and a non-spouse Beneficiary designated in accordance with Section 8.2 hereof), the distribution of which would qualify as an "eligible rollover distribution", as such term is hereinafter defined, may, in lieu of receiving any payment or payments from the Plan, direct the Trustee to transfer all or any portion of such payment or payments directly to the trustee of one or more "eligible retirement plans", as such term is hereinafter defined. For purposes of this Section 15.6, the term "eligible rollover distribution" is defined as any distribution of all or any portion of the balance to the credit of the distributee, including any portion of such balance that consists of amounts that are not includible in gross income, except that an eligible rollover distribution does not include: any distribution that is one of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or life expectancy) of the distributee or the joint lives (or joint life expectancies) of the distributee and the distributee's designated beneficiary, or for a specified period of ten years or more; any distribution to the extent such distribution is required under Code Section 401(a)(9); and any hardship distribution described in Code Section 401(k)(B)(i)(IV). For purposes of this Section 15.6, the term "eligible retirement plan" shall mean (i) an individual retirement account described in Section 408(a) of the Code; (ii) an individual retirement annuity described in Section 408(b) of the Code (other than an endowment contract); (iii) a qualified trust described under Section 401(a) of the Code; (iv) an annuity plan described in Section 403(a) of the Code; (v) an annuity contract described in Section 403(b) of the Code; and (vi) an eligible plan under Section 457(b) of the Code that is maintained by a state, political subdivision of a state, or any agency or instrumentality of a state or political subdivision of a state and that agrees to separately account for amounts transferred into such plan from this Plan. Notwithstanding the foregoing, in the case of a non-spouse Beneficiary, the term "eligible retirement plan" shall refer only to a plan described in clauses (i) and (ii) above that is established on behalf of the designated Beneficiary and that is required to be treated as an inherited IRA pursuant to the provisions of Section 402(c)(11) of the Code. Also, in this case, the determination of any required minimum distribution under Section 401(a)(9) of the Code that is ineligible for rollover shall be made in accordance with IRS Notice 2007-7, Q&A 17 and 18, 2007-5 I.R.B. 395.

A portion of a distribution that consists of after-tax employee contributions may be transferred only to an individual retirement account or annuity described in Section 408(a) or (b) of the Code, or to a qualified defined contribution plan or defined benefit plan described in Section 401(a) or an annuity contract described in Section 403(b) of the Code that agrees to separately account for amounts so transferred, including separately accounting for the portion of such distribution that is includible in gross income and the portion of such distribution that is not so includible (as defined in Section 401(a)(31)(D) of the Code).

Any such election of a direct rollover must be made on a form provided by the Committee for that purpose and received by the Committee no later than the date established by the Committee preceding the date on which the distribution is to occur. Any election made pursuant to this Section 15.6 may be revoked at any time prior to the date established by the Committee preceding the date on which the distribution is to occur. If an individual who is so entitled has not elected a direct rollover within the time and in the manner set forth above, such distributee shall be deemed to have affirmatively waived a direct rollover. A distributee who wishes to elect a direct rollover shall provide to the Committee, within the time and in the manner prescribed by the Committee, such information as the Committee shall reasonably request regarding the eligible retirement plan or plans to which the payment or payments are to be transferred. The Committee shall be entitled to rely on the information so provided, and shall not be required to independently verify such information. The Committee shall be entitled to delay the transfer of any payment or payments pursuant to this Section 15.6 until it has received all of the information which it has requested in accordance with this Section 15.6.

## **ARTICLE XVI TRUSTEE**

16.1 Appointment of Trustee. A Trustee (or Trustees) shall be appointed by the Committee to administer the Trust Fund. The Trustee shall serve at the pleasure of the Committee and shall have such rights, powers, and duties as are provided to a Trustee under ERISA for the investment of assets and for the administration of the Trust Fund.

16.2 Appointment of Investment Manager. An Investment Manager (or Investment Managers) may be appointed by the Committee to manage (including the power to acquire and dispose of) any part or all of the assets of the Trust Fund. The Investment Manager shall serve at the pleasure of the Committee, and shall have the rights, powers, and duties provided to a named fiduciary under ERISA for the investment of the assets assigned to it. (The Investment Manager may be referred to from time to time hereafter as "he," "they," or "it," or may be referred to in the singular or plural, but all such references shall be to the then acting Investment Manager or Investment Managers serving hereunder.)

16.3 Responsibility of Trustee and Investment Manager. All contributions under this Plan shall be paid to and held by the Trustee. The Trustee shall have responsibility for the investment and reinvestment of the Trust Fund except with respect to the management of those assets specifically delegated to the Investment Manager and those funds invested pursuant to the provisions of Section 15.5. The Investment Manager shall have exclusive management and control of the investment and/or reinvestment of the assets of the Trust Fund assigned to it in writing by the Trustee. All property and funds of the Trust Fund, including income from investments and from all other sources, shall be retained for the exclusive benefit of Members or former Members, as provided herein, and shall be used to pay benefits to Members or former Members or their Beneficiaries, or to pay expenses of administration of the Plan and Trust Fund.

This Plan and the related Trust are intended to allocate to each fiduciary the individual responsibilities of the prudent execution of the functions assigned to each. None of the allocated responsibilities or any other responsibility shall be shared by the fiduciaries or the Trustee unless such sharing shall be provided for by a specific provision in this Plan or related Trust.

16.4 Bonding of Trustee and Investment Manager. Neither the Trustee nor the Investment Manager shall be required to furnish any bond or security for the performance of their powers and duties hereunder unless the applicable law makes the furnishing of such bond or security mandatory.

**ARTICLE XVII  
AMENDMENT AND TERMINATION OF PLAN**

17.1 Amendment of Plan. The Company may, without the assent of any other party, make from time to time any amendment or amendments to this Plan that do not cause any part of the Trust Fund to be used for, or diverted to, any purpose other than the exclusive benefit of Members or former Members of the Plan. Any such amendment shall be by a written instrument executed by the Company, and shall become effective as of the date specified in such instrument. Notwithstanding the foregoing, no amendment to the Plan shall be effective to the extent that it has the effect of decreasing a Member's or former Member's accrued benefit, except as provided in Section 412(c)(8) of the Code. For purposes of the preceding sentence, an amendment which has the effect of decreasing a Member's or former Member's Individual Account or eliminating an optional form of benefit, with respect to benefits attributable to service prior to such amendment, shall be treated as reducing an accrued benefit. If any amendment changes the vesting schedule set forth in Section 10.1, then a Member's or former Member's nonforfeitable percentage in his Individual Account because of a change to the vesting schedule shall not be less than his nonforfeitable percentage computed under the vesting schedule in effect prior to the amendment. Furthermore, if any amendment changes the vesting schedule set forth in Section 10.1, then each Member or former Member having at least three (3) Years of Vesting Service may elect to be governed under the vesting schedule set forth in the Plan without regard to the amendment. The Member or former Member must file his written election with the Committee within sixty (60) days after receipt of a copy of the amendment. The Committee shall furnish the Member or former Member with a copy of the amendment and with notice of the time within which his election must be returned to the Committee.

17.2 Termination of Plan. The Company may at any time, effective as specified, terminate the Plan by resolution of its board of directors. A certified copy of such resolution shall be delivered to the Trustee.

17.3 Suspension and Discontinuance of Contributions. In the event the Company decides it is impossible or inadvisable for it to continue to make its contributions as provided in Article IV, it shall have the power by appropriate resolution to either:

- (a) suspend its contributions to the Plan;
- (b) discontinue its contributions to the Plan; or
- (c) terminate the Plan.

Suspension shall be a temporary cessation of contributions and shall not constitute or require a termination of the Plan. Such a suspension which has not ripened into a complete discontinuance shall not constitute or require a termination of the Plan or Trust or any vesting of Individual Accounts, other than as prescribed by the provisions of Section 10.1. A complete

discontinuance of contributions by the Company shall not constitute a formal termination of the Plan and shall not preclude later contributions, but all Individual Accounts of Members or former Members not theretofore fully vested shall be and become 100% vested and nonforfeitable in the respective Members or former Members, irrespective of the provisions of Section 10.1. In such event, Employees who become eligible to enter the Plan subsequent to the discontinuance shall receive no benefit, and no additional benefits shall accrue to any of such Employees unless such contributions are resumed. After the date of a complete discontinuance of contributions, the Trust shall remain in existence as provided in this Section 17.3, and the provisions of the Plan and Trust shall remain in force as may be necessary in the sole and absolute discretion of the Committee.

17.4 Liquidation of Trust Fund. Upon termination or partial termination of the Plan, the Individual Accounts of all Members, former Members, and Beneficiaries shall thereupon be and become fully vested and nonforfeitable. Thereupon, the Trustee shall convert the Trust Fund to cash after deducting all charges and expenses. The Committee shall then adjust the balances of all Individual Accounts, as provided in Section 5.2. Thereafter, the Trustee shall distribute the amount to the credit of each affected Member, former Member, and Beneficiary, in accordance with the provisions of Article XV hereof.

17.5 Consolidation, Merger or Transfer of Plan Assets. This Plan shall not be merged or consolidated with, nor shall any assets or liabilities be transferred to, any other plan, unless the benefits payable on behalf of each Member or former Member, if the Plan were terminated immediately after such action, would be equal to or greater than the benefits to which such Member or former Member would have been entitled if this Plan had been terminated immediately before such action. Further, except to the extent such transfer constitutes a direct rollover of an “eligible rollover distribution” pursuant to Section 15.6 hereof or constitutes an elective transfer, as described in Treasury Regulations Section 1.411(d)-4, Q&A-3(b)(1), to another qualified cash or deferred arrangement under Code Section 401(k), no assets of this Plan shall be transferred to another plan unless the Committee demonstrates to the Trustee’s reasonable satisfaction that any portion of the transfer attributable to Salary Reduction Contributions, including Catch-Up Contributions, if applicable, Qualified Nonelective Contributions and Qualified Matching Contributions shall remain subject to the limitations on distributions prescribed under Treasury Regulations Section 1.401(k)-1(d). The Trustee shall not accept a direct transfer of assets from a plan subject to the requirements of Section 417 of the Code.

#### **ARTICLE XVIII GENERAL PROVISIONS**

18.1 No Employment Contract. Nothing contained in this Plan shall be construed as giving any person whomsoever any legal or equitable right against the Committee, the Company, its stockholders, officers or directors, or against the Trustee, except as the same shall be specifically provided for in this Plan. Nor shall anything in this Plan give any Member, former Member, or other Employee the right to be retained in the service of the Company, and the employment of all persons by the Company shall remain subject to termination by the Company to the same extent as if this Plan had never been executed.

18.2 Manner of Payment. Wherever and whenever it is herein provided for payments or distributions to be made, whether in money or otherwise, said payments or distributions shall be made directly into the hands of the Member or former Member, his Beneficiary, his administrator, executor or guardian, or an alternate payee pursuant to Section 15.5 herein, as the case may be. A deposit to the credit of a person entitled to payment in any bank or trust company selected by such person shall be deemed payment into his hands, and provided further that in the event any person otherwise entitled to receive any payment or distribution shall be a minor or an incompetent, such payment or distribution may be made to his guardian or other person as may be determined by the Committee.

18.3 Nonalienation of Benefits. Subject to Code Section 414(p) and Section 15.5 herein relating to qualified domestic relations orders, the interest of any Member, former Member, or Beneficiary hereunder shall not be subject in any manner to any indebtedness, judgment, process, creditors' bills, attachments, garnishment, levy, execution, seizure or receivership, nor shall such interest be in any manner reduced or affected by any transfer, assignment, conveyance, sale, encumbrance, act, omission, or mishap, voluntary or incidental, anticipatory or otherwise, of or to said Member, former Member, or Beneficiary, and they and any of them shall have no right or power to transfer, convey, assign, sell, or encumber said benefits and their interest therein, legal or equitable, during the existence of this Plan; provided, however, that a Member may assign or pledge his vested interest in the Fund as security for a loan made pursuant to the provisions of Section 11.1 hereof. Notwithstanding the foregoing, no provision of this Plan shall preclude the enforcement of a Federal tax levy made pursuant to Section 6331 of the Code or collection by the United States on a judgment resulting from an unpaid tax assessment.

18.4 Titles for Convenience Only. Titles of the Articles and Sections hereof are for convenience only and shall not be considered in construing this Plan. Also words used in the singular or the plural may be construed as though in the plural or singular where they would so apply.

18.5 Validity of Plan. This Plan and each of its provisions shall be construed and their validity determined by the laws of the State of Texas, and all provisions hereof shall be administered in accordance with the laws of said State, provided that in case of conflict, the provisions of ERISA shall control.

18.6 Plan Binding. This Plan shall be binding upon the successors and assigns of the Company and the Trustee and upon the heirs and personal representatives of those individuals who become Members hereunder.

18.7 Return of Contributions. This Plan and the related Trust are designed to qualify under Sections 401(a) and 501(a) of the Code. Anything contained herein to the contrary notwithstanding, if the initial determination letter is issued by the District Director of Internal Revenue to the effect that this Plan and related Trust hereby created, or as amended prior to the receipt of such letter, do not meet the requirements of Section 401(a) and 501(a) of the Code, the Company shall be entitled at its option to withdraw all contributions theretofore made, in which event the Plan and Trust shall then terminate.

Each contribution to the Plan is specifically conditioned on the deductibility of such contribution under the Code. The Trustee, upon written request from the Company, shall return to the Company the amount of the Company's contribution made as a result of a mistake of fact or the amount of the Company's contribution disallowed as a deduction under Section 404 of the Code. Such return of contribution must be made within one (1) year after (a) the Company made the contribution by mistake of fact or (b) the disallowance of the contribution as a deduction. The amount of contribution subject to being returned hereunder shall not be increased by any earnings attributable to the contribution, but such amount subject to being returned shall be decreased by any losses attributable to it.

18.8 Missing Members or Beneficiaries. Each Member shall file with the Committee from time to time in writing a mailing address and any change of mailing address for himself and his designated Beneficiary. Any communication, statement or notice addressed to a Member or Beneficiary at the last mailing address filed with the Committee, or if no such address is filed with the Committee, then at his last mailing address as shown on the Company's records, shall be binding on the Member or his Beneficiary for all purposes of the Plan. The Committee shall not be required to search for or locate a Member or Beneficiary. If the Committee notifies any Member or Beneficiary that he is entitled to a distribution and also notifies him of the provisions of this Section 18.8 (or makes reasonable effort to so notify such Member or Beneficiary by certified letter, return receipt requested, to the last known address, or such other further diligent effort, including consultation with the Internal Revenue Service or the Social Security Administration, to ascertain the whereabouts of such Member or Beneficiary as the Committee deems appropriate) and the Member or Beneficiary fails to claim his distributive share or make his whereabouts known to the Committee within three years thereafter, the distributive share of such Member or Beneficiary will be forfeited and applied to reduce the Company Matching Contribution. However, if the Member or his Beneficiary should, thereafter, make a proper claim for such share, it shall be distributed to him.

18.9 Qualified Military Service. Notwithstanding any provision of this Plan to the contrary, contributions, benefits, and service credit with respect to qualified military service will be provided in accordance with Section 414(u) of the Code.

## **ARTICLE XIX TOP-HEAVY RULES**

19.1 Definitions. For purposes of applying the provisions of this Article XIX:

(a) "Key Employee" shall mean, as of any Determination Date (as defined below), any Employee or former Employee (including any deceased Employee) who, at any time during the Plan Year that includes the Determination Date, was an officer of the Company having Annual Compensation greater than \$130,000 (as adjusted under section 416(i)(1) of the Code for Plan Years beginning on or after January 1, 2003), a 5-percent owner of the Company, or a 1-percent owner of the Company having Annual Compensation of more than \$150,000. For this purpose, Annual Compensation means compensation within the meaning of Section 6.5(b)(iv) of the Plan. The determination of who is a Key Employee will be made in accordance with section 416(i)(1) of the Code and the applicable regulations and other guidance of general applicability issued

thereunder. The constructive ownership rules of Section 318 of the Code will apply to determine ownership in the Company.

(b) “Non-Key Employee” is an Employee who does not meet the definition of Key Employee.

(c) “Required Aggregation Group” means:

(i) Each qualified plan of the Company or an Affiliated Entity (as defined below) in which at least one (1) Key Employee participates or participated at any time during the Plan Year that includes the Determination Date, or during the preceding four Plan Years (regardless of whether the plan has terminated); and

(ii) Any other qualified plan of the Company that enables a plan described in (1) to meet the requirements of Section 401(a)(4) or Section 410 of the Code.

(d) “Permissive Aggregation Group” is the Required Aggregation Group plus any other qualified plans maintained by the Company, but only if such group would satisfy in the aggregate the requirements of Section 401(a)(4) and Section 410 of the Code. The Committee shall determine which plans to take into account in determining the Permissive Aggregation Group.

(e) “Determination Date” for any Plan Year is the last day of the preceding Plan Year or, in the case of the first Plan Year of the Plan, the last day of that Plan Year.

(f) “Five Percent (5%) Owner” is any person who owns more than five percent (5%) of the outstanding stock of the Company or stock possessing more than five percent (5%) of the total combined voting power of all stock of the Company.

(g) “One Percent (1%) Owner” is any person who owns more than one percent (1%) of the outstanding stock of the Company or stock possessing more than one percent (1%) of the total combined voting power of all stock of the Company.

(h) “Affiliated Entity” shall mean all the members of (i) a controlled group of corporations as defined in Section 414(b) of the Code; (ii) a commonly controlled group of trades or businesses (whether or not incorporated) as defined in Section 414(c) of the Code; (iii) an affiliated service group as defined in Section 414(m) of the Code of which the Company is a part; or (iv) a group of entities required to be aggregated pursuant to Section 414(o) of the Code and the regulations issued thereunder.

19.2 Determination of Top-Heavy Status. The Plan is top heavy for a Plan Year if the top heavy ratio as of the Determination Date (as defined in Section 19.1 above) exceeds sixty percent (60%). The top heavy ratio is a fraction, the numerator of which is the sum of the present value of the Individual Accounts of all Key Employees (as defined in Section 19.1 above) as of the Determination Date and the denominator of which is a similar sum determined for all Employees in the Plan. The present value of the Individual Account balance of an Employee as

of the Determination Date shall be increased by the distributions made with respect to the Employee under the Plan and any plan aggregated with the Plan under section 416(g)(2) of the Code during the 1-year period ending on the Determination Date. The preceding sentence shall also apply to distributions under a terminated plan which, had it not been terminated, would have been aggregated with the Plan under section 416(g)(2)(A)(i) of the Code. In the case of a distribution made for a reason other than separation from service, death, or disability, this provision shall be applied by substituting "5-year period" for "1-year period." The Individual Account of any individual who has not performed services for the Employer during the 1-year period ending on the Determination Date shall not be taken into account. The Committee shall calculate the top heavy ratio without regard to any Non Key Employee (as defined in Section 19.1 above) who was formerly a Key Employee. The Committee shall calculate the top heavy ratio, including the extent to which it must take into account distributions, rollovers and transfers, in accordance with Section 416 of the Code and the regulations under that Code Section.

If the Company maintains other qualified plans (including a simplified employee pension plan), this Plan is top-heavy only if it is part of the Required Aggregation Group (as defined in Section 19.1 above), and the top-heavy ratio for both the Required Aggregation Group and the Permissive Aggregation Group (as defined in Section 19.1 above) exceeds sixty percent (60%). The Committee will calculate the top-heavy ratio in the same manner as required by the first paragraph of this Section 19.2, taking into account all plans within the aggregation group. The Committee shall calculate the present value of accrued benefits and the other amounts the Committee must take into account under defined benefit plans or simplified employee pension plans included within the group, in accordance with the terms of those plans, Section 416 of the Code, and the regulations under that Code Section. The Committee shall calculate the top-heavy ratio with reference to the Determination Dates that fall within the same calendar year.

**19.3 Minimum Company Contribution.** Notwithstanding anything contained herein to the contrary, for any Plan Year in which this Plan is determined to be top-heavy (as determined under Section 19.2 hereof), each Non-Key Employee who is an eligible Member shall be entitled to a supplemental contribution equal to three percent (3%) of such Non-Key Employee's Annual Compensation, reduced by the amount of Qualified Nonelective Contributions, if any, allocated to his Salary Reduction Contribution Account for the applicable Plan Year. For purposes of this Section 19.3, an eligible Member is a Non-Key Employee who is employed by the Company on the last day of the applicable Plan Year.

The percentage referred to in the preceding paragraph shall not exceed the percentage of Annual Compensation at which Company contributions, including Salary Reduction Contributions, are made or allocated under this Plan, and all other qualified defined contribution plans maintained by the Company, to the Key Employee for whom such percentage is the largest; provided, however, this sentence shall not apply if the Plan is required to be included in an Aggregation Group and enables a defined benefit plan required to be included in such group to meet the requirements of Code Sections 401(a)(4) or 410. If the minimum allocation is made for a Non-Key Employee pursuant to another qualified plan maintained by the Company, then the minimum allocation requirement will be considered satisfied for purposes of this Plan. Company Matching Contributions shall be taken into account for purposes of satisfying the minimum contribution requirements of Section 416(c)(2) of the Code and the Plan shall be

treated as matching contributions for purposes of the actual contribution percentage test and other requirements of Section 401(m) of the Code.

**ARTICLE XX  
FIDUCIARY PROVISIONS**

20.1 General Allocation of Duties. Each fiduciary with respect to the Plan shall have only those specific powers, duties, responsibilities, and obligations as are specifically given him under the Plan. The board of directors of the Company shall have the sole responsibility for authorizing its contributions under the Plan. The Company shall have the sole authority to appoint and remove the members of the Committee and to amend or terminate this Plan, in whole or in part. The Committee shall have the sole authority to appoint and remove the Trustee and Investment Managers. However, neither the board nor the Committee shall be liable for any acts or omissions of the Trustee or Investment Manager or be under any obligation to invest or otherwise manage any assets of the Trust Fund which are subject to the management of the Trustee or Investment Manager. Except as otherwise specifically provided, the Committee shall have the sole responsibility for the administration of the Plan, which responsibility is specifically described herein. Except as otherwise specifically provided, the Trustee shall have the sole responsibility for the administration, investment, and management of the assets held under the Plan. It is intended under the Plan that each fiduciary shall be responsible for the proper exercise of its own powers, duties, responsibilities, and obligations hereunder and shall not be responsible for any act or failure to act of another fiduciary, except to the extent provided by law or as specifically provided herein.

20.2 Fiduciary Duty. Each fiduciary under the Plan shall discharge its duties and responsibilities with respect to the Plan:

- (a) solely in the interest of the Members of the Plan, for the exclusive purpose of providing benefits to such Members and their Beneficiaries, and defraying reasonable expenses of administering the Plan;
- (b) with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
- (c) by diversifying the investments of the Plan so as to minimize the risk of large losses, unless under the circumstances it is prudent not to do so; and
- (d) in accordance with the documents and instruments governing the Plan insofar as such documents and instruments are consistent with applicable law.

20.3 Fiduciary Liability. A fiduciary shall not be liable in any way for any acts or omissions constituting a breach of fiduciary responsibility occurring prior to the date it becomes a fiduciary or after the date it ceases to be a fiduciary.

20.4 Co-Fiduciary Liability. A fiduciary shall not be liable for any breach of fiduciary responsibility by another fiduciary unless:

- (a) it participates knowingly in, or knowingly undertakes to conceal, an act or omission of such other fiduciary, knowing such act or omission is a breach;
- (b) by its failure to comply with Section 404(a)(1) of ERISA in the administration of its specific responsibilities which give rise to its status as a fiduciary, it has enabled such other fiduciary to commit a breach; or
- (c) having knowledge of a breach by such other fiduciary, it fails to make reasonable efforts under the circumstances to remedy the breach.

20.5 Delegation and Allocation. The Committee may appoint subcommittees, individuals, or any other agents as it deems advisable and may delegate to any of such appointees any or all of the powers and duties of the Committee. Such appointment and delegations must clearly specify the powers and duties delegated. Upon such appointment and delegation, the delegating Committee members shall have no liability for the acts or omissions of any such delegate, as long as the delegating Committee members do not violate their fiduciary responsibility in making or continuing such delegation.

IN WITNESS WHEREOF, Southwest Airlines Co. has caused its corporate seal to be affixed hereto and these presents to be duly executed in its name and behalf by its proper officers thereunto duly authorized this 14<sup>th</sup> day of December, 2007.

**SOUTHWEST AIRLINES CO.**

By: /s/ Gary C. Kelly  
Gary C. Kelly, Chief Executive Officer

SOUTHWEST AIRLINES CO.  
SEVERANCE PLAN FOR DIRECTORS  
May 2000

1. **Purpose.** The purpose of this Severance Plan for Directors of Southwest Airlines Co. is to improve the Company's ability to attract and retain highly qualified individuals to serve as directors of the Company; to provide competitive remuneration for Board service; and to recognize service on the Board of Directors.
2. **Effective Date.** The effective date of the Plan shall be the date of its adoption by the Board of Directors.
3. **Mandatory Retirement.** Each member of the Board of Directors shall retire no later than the first Annual Meeting of the Shareholders after such Director's 72<sup>nd</sup> birthday. The Bylaws of the Company shall reflect this policy.
4. **Severance benefits for Board Members.** Upon retirement from the Board of Directors, a Director who has served at least five years as of the date of retirement shall be entitled to a cash payment of \$35,000 and a Director who has served at least ten years shall be entitled to a cash payment of \$75,000. Further, a Director who has served at least ten years as of the date of retirement shall be entitled to an unlimited number of Nonrevenue Must Ride passes for the use of Director and his/her spouse for the remainder of the life of the Director. Use of such passes shall be subject to the regulations of the Company for nonrevenue travel.

For purposes of this paragraph 4, service on the Board shall include service on the Board of Directors of Southwest Airlines Co. and service on the Board of Directors of Morris Air Corporation.

**SOUTHWEST AIRLINES CO.  
2007 EQUITY INCENTIVE PLAN  
NOTICE OF GRANT OF STOCK OPTIONS**

Southwest Airlines Co. hereby grants to you (the "Participant") the right and option (the "Option" or "Options") to purchase shares of the Common Stock of the Company as follows:

Participant:  
Grant Date:  
Expiration Date:  
Exercise Price:  
Number of Options Granted:  
Option Type:  
Vesting Schedule: Per schedule below

*Vesting Date:*                      *Vesting Schedule*

In all cases, it will be a condition to vesting that the Participant still be an Employee or Director on the vesting date.

Participant understands and agrees that the Option described above is granted in accordance with and subject to the terms and conditions of the Southwest Airlines Co. 2007 Equity Incentive Plan (the "Plan") and the applicable terms and conditions accompanying this notice of grant (the "Terms and Conditions").

The Plan, the Terms and Conditions, and the prospectus for the Plan are enclosed with this Notice of Grant. Additional copies of these documents are available upon request to the Company's Stock Option Administration Department.

Participant is not required to exercise these Options; however, by exercising any of these Options or by asserting any other rights pursuant to the Plan, Participant will be deemed to have agreed to the terms and conditions of the Plan and the accompanying Terms and Conditions.

Southwest Airlines Co.

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**SOUTHWEST AIRLINES CO.  
2007 EQUITY INCENTIVE PLAN  
TERMS AND CONDITIONS**

**STOCK OPTIONS**

By exercising an option (an "Option") or asserting any other rights pursuant to the Southwest Airlines Co. 2007 Equity Incentive Plan (the "Plan"), you ("you" or the "Participant") will be deemed to have agreed to the terms and conditions of the Plan, which terms and conditions are incorporated herein by reference, and the terms and conditions set forth below. Capitalized terms used and not otherwise defined herein shall have the meanings assigned to them in the Plan.

1. Vesting. Subject to these Terms and Conditions and the provisions of the Plan, the Options granted to you pursuant to the Plan shall become exercisable as set forth in the Notice of Grant that you have received in connection with the Plan.

2. Term; Rights Upon Termination of Service. In the event of the termination of the Participant's service as an Employee or Director with the Company or any Affiliate, the Participant's Options that have not vested as of the date of termination shall automatically and without notice terminate and become null and void at 4:00 p.m., Eastern Time, on the date of termination. The outstanding and vested portion of the Option shall thereafter automatically and without notice terminate and become null and void at 4:00 p.m., Eastern Time, on the date that is the earliest to occur of the following (the "Option Expiration Date"):

(a) the date of the Participant's termination of service with the Company or an Affiliate for cause, including breach by the Participant of an employment agreement with the Company or an Affiliate or the Participant's commission of a felony or misdemeanor (whether or not prosecuted) against the Company or an Affiliate;

(b) The expiration of two (2) years following the date of termination of a Participant's employment with the Company or an Affiliate if the Participant is not also a Director of the Company;

(c) The expiration of five (5) years following the date of termination of a Directors' service with the Board;

(d) The expiration of such other period of time or the occurrence of such event as is provided for in the Participant's Notice of Grant;

(e) the expiration of ten (10) years from the date of grant of the Option.

Upon the occurrence of any event described in this Section 2, if the Participant desires to exercise the Option prior to the Option Expiration Date, the Participant must provide notice of exercise to the Company or the Company's designee prior to the close of trading on the New York Stock Exchange on the Option Expiration Date.

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### 3. Manner of Exercise.

(a) Procedure. The Option may be exercised by the Participant (or by the person who acquires the Option by will or the laws of descent and distribution or otherwise by reason of the death of the Participant) as to all or part of the shares covered by the Option by delivery to the Company or the Company's designee of (i) notice of the exercise in substantially the form and manner prescribed by the Company (the "Notice"), setting forth the number of shares of Common Stock with respect to which the Option is to be exercised and the date of exercise thereof, and (ii) consideration with a value equal to the aggregate exercise price for the shares to be purchased. From time to time, the Company and/or the Committee may establish procedures relating to effecting such exercises. No fractional shares shall be issued as a result of exercising an Option.

(b) Payment. In the Notice, the Participant shall elect the form of payment, which may be as follows: (i) in cash; (ii) in shares of Common Stock; (iii) by delivery (including by fax or electronic means in accordance with procedures determined by the Committee) to the Company or its designee of an irrevocable Option exercise notice together with irrevocable instructions from the Participant to a broker or dealer reasonably acceptable to the Company to sell certain of the shares of Common Stock purchased upon exercise of the Option or to pledge such shares as collateral for a loan and promptly deliver to the Company or the Company's designee the amount of sale or loan proceeds necessary to pay the exercise price; and/or (iv) in any other form of valid consideration that is acceptable to the Committee in its sole discretion; provided that, with respect to a cashless exercise of the Option (in accordance with clause (iii) above) the Option will be deemed exercised on the date of sale of the shares of Common Stock received upon exercise. The Notice shall be signed by the person(s) exercising the Option and, in the event the Option is being exercised by any person(s) other than the Participant, the Notice shall be accompanied by proof satisfactory to the Company's counsel of the right of such person(s) to exercise the Option. If payment is to be made in cash, the Participant shall deliver to the Company or the Company's designee a cashier's check or electronic funds transfer in the amount of the exercise price on or before the exercise date. If payment is to be made in shares of Common Stock, (i) it shall be valued at its fair market value on the date of the Notice; and (ii) to the extent requested by the Company, the Notice shall be accompanied by documentation, satisfactory to the Committee, proving ownership of the number of shares of Common Stock to be used as payment. For these purposes, "fair market value" shall be the mean between the highest and lowest quoted selling prices of the Common Stock on such day, as reported by the primary national stock exchange on which such stock is listed.

(c) Irrevocable Election. The giving of such Notice to the Company or its designee shall constitute an irrevocable election to purchase the number of shares specified in the Notice on the date specified in the Notice.

(d) Withholding Taxes. To the extent that the exercise of any Option or the disposition of shares of Common Stock acquired upon exercise of an Option results in compensation income to the Optionee for tax purposes, the Participant shall deliver to the Company or the Company's designee at the time of such exercise or disposition such amount of money, if any, as the Company may require to meet its obligations under applicable tax laws or regulations, and, if the Participant fails to do so, the Company shall be authorized to (i) withhold delivery of certificates upon exercise and (ii) withhold from remuneration then or thereafter payable to the Participant any tax required to be withheld by reason of such resulting

compensation income. The Company is authorized to take such other action as it deems appropriate to ensure that all applicable federal, state, local, or other income, employment, or other tax withholding obligations to which the Participant is subject in connection with the Option are withheld or collected from the Participant.

(e) Delivery of Shares. Upon satisfaction of the conditions set forth in this Section 3, the Company shall cause certificates for any shares to be delivered to the Participant or otherwise credited to the account of the Participant (or to the person exercising the Participant's Options in the event of death) as soon as practicable after the exercise date.

4. Nontransferable. The Option shall not be transferable by the Participant other than by will or the laws of descent and distribution, and during the Participant's lifetime shall be exercisable only by the Participant or the Participant's legal guardian or representative.

In the event of the Participant's death during a period during which the Participant's Options could have been exercised by the Participant, the Option shall thereafter be exercisable, to the extent exercisable at the date of death, only by his or her executors or administrators or the person(s) who acquires such Option by will or the laws of descent or distribution, or otherwise by reason of the death of the Participant.

5. Rights of Participant. Neither the Participant nor his or her executors, administrators, beneficiaries, or legal representatives shall have any of the rights of a Shareholder of the Company with respect to the shares subject to the Option until a certificate or certificates for such shares shall have been issued upon the exercise of the Option or such shares have otherwise been credited to such person's account.

6. No Rights to Continued Employment or Service as a Director. The Participant agrees that nothing herein shall be construed to confer upon the Participant any right to continue as an Employee or Director of the Company or any Affiliate or to interfere in any way with the right of the Company or any of its Affiliates to terminate the Participant's employment or other service at any time.

7. Adjustments upon Changes in Capitalization. The number and kind of shares covered by the Option, and the Option exercise price, shall be subject to adjustment in accordance with Article XI of the Plan.

8. Purchase for Investment and Legality. The Participant, by acceptance hereof, represents and warrants to the Company that the purchase of shares of Common Stock upon the exercise of the Option shall be for investment and not with a view to distribution, *provided* that this representation and warranty shall be inoperative if, in the opinion of counsel to the Company, a proposed sale or distribution of such shares is pursuant to an applicable effective registration statement under the Securities Act of 1933, as amended, or is, without such representation and warranty, exempt from registration under such Act.

The Participant agrees that the obligation of the Company to issue shares upon the exercise of an Option shall also be subject as conditions precedent to compliance with applicable provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, state securities laws, rules and regulations under any of the foregoing, and applicable requirements of any securities exchange upon which the Company's securities shall be listed.

The Company may (i) endorse an appropriate legend referring to the foregoing restrictions upon the certificate or certificates representing any shares of Common Stock issued or transferred to the Participant upon the exercise of the Option or (ii) otherwise note such restrictions with respect to shares that are not certificated.

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in the Registration Statement (Forms S-8 Nos. 33-20275, 33-57327, 33-40652, 33-40653, 333-64431, 333-67627, 333-67631, 333-82735, 333-89303, 333-52388, 333-52390, 333-53610, 333-53616, 333-57478, 333-46560, 333-98761, 333-100862, 333-104245, 333-117802, 333-139362, 333-146891 and Forms S-3 Nos. 333-126738 and 333-100861) of Southwest Airlines Co. and in the related Prospectus of our reports dated January 31, 2008, with respect to the consolidated financial statements of Southwest Airlines Co., and the effectiveness of internal control over financial reporting of Southwest Airlines Co., included in this Annual Report (Form 10-K) for the year ended December 31, 2007.

/s/Ernst & Young LLP

Dallas, Texas  
January 31, 2008

## 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 annual report on Form 10-K for the year ended December 31, 2007 of Southwest Airlines Co.;
  2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
  3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
  4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
    - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
    - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
    - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
    - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
  5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the
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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: February 1, 2008

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 annual report on Form 10-K for the year ended December 31, 2007 of Southwest Airlines Co.;
  2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
  3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
  4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
    - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
    - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
    - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
    - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
  5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the
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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: February 1, 2008

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 Annual Report on Form 10-K of Southwest Airlines Co. (the "Company") for the period ended December 31, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Gary C. Kelly, Chief Executive Officer and Vice Chairman of the Board of Directors of the Company, and Laura 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: February 1, 2008

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

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