

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, 2008

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:**

<u>Title of Each Class</u>	<u>Name of Each Exchange on Which Registered</u>
Common Stock (\$1.00 par value)	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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

The aggregate market value of the common stock held by non-affiliates of the registrant was approximately \$9,550,216,553, computed by reference to the closing sale price of the common stock on the New York Stock Exchange on June 30, 2008, 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 28, 2009: 740,146,494 shares

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the Company's Annual Meeting of Shareholders to be held May 20, 2009, are incorporated into Part III of this Annual Report on Form 10-K.

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[Table of Contents](#)

TABLE OF CONTENTS

		PART I	
Item 1.	<a href="#">Business</a>		1
Item 1A.	<a href="#">Risk Factors</a>		10
Item 1B.	<a href="#">Unresolved Staff Comments</a>		14
Item 2.	<a href="#">Properties</a>		14
Item 3.	<a href="#">Legal Proceedings</a>		15
Item 4.	<a href="#">Submission of Matters to a Vote of Security Holders</a>		15
		PART II	
Item 5.	<a href="#">Market for Registrant’s Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities</a>		17
Item 6.	<a href="#">Selected Financial Data</a>		19
Item 7.	<a href="#">Management’s Discussion and Analysis of Financial Condition and Results of Operations</a>		20
	<a href="#">Liquidity and Capital Resources</a>		30
	<a href="#">Off-Balance Sheet Arrangements, Contractual Obligations, and Contingent Liabilities and Commitments</a>		31
	<a href="#">Critical Accounting Policies and Estimates</a>		33
Item 7A.	<a href="#">Quantitative and Qualitative Disclosures About Market Risk</a>		39
Item 8.	<a href="#">Financial Statements and Supplementary Data</a>		44
	<a href="#">Southwest Airlines Co. Consolidated Balance Sheet</a>		44
	<a href="#">Southwest Airlines Co. Consolidated Statement of Income</a>		45
	<a href="#">Southwest Airlines Co. Consolidated Statement of Stockholders’ Equity</a>		46
	<a href="#">Southwest Airlines Co. Consolidated Statement of Cash Flows</a>		47
	<a href="#">Notes To Consolidated Financial Statements</a>		48
Item 9.	<a href="#">Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</a>		76
Item 9A.	<a href="#">Controls and Procedures</a>		76
Item 9B.	<a href="#">Other Information</a>		77
		PART III	
Item 10.	<a href="#">Directors, Executive Officers, and Corporate Governance</a>		77
Item 11.	<a href="#">Executive Compensation</a>		77
Item 12.	<a href="#">Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</a>		77
Item 13.	<a href="#">Certain Relationships and Related Transactions, and Director Independence</a>		78
Item 14.	<a href="#">Principal Accounting Fees and Services</a>		78
		PART IV	
Item 15.	<a href="#">Exhibits and Financial Statement Schedules</a>		79
	<a href="#">Signatures</a>		84

**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, 2008, Southwest operated 537 Boeing 737 aircraft and provided service to 64 cities in 32 states throughout the United States. In 2008, Southwest announced that it would be commencing service to Minneapolis-St. Paul in March 2009. In addition, Southwest has received initial approval to acquire 14 take-off and landing slots at New York’s LaGuardia airport from the former ATA Airlines, Inc., which filed for bankruptcy protection in April 2008.

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, 2008, Southwest served 438 nonstop city pairs. Historically, Southwest 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 Price Impact**

Fuel prices can have a significant impact on Southwest’s profitability. During 2008, the cost of fuel fluctuated greatly, as the price of a barrel of crude oil soared from near \$100 in January 2008 to almost \$150 in July 2008, then plummeted to below \$35 at one point during the fourth quarter of 2008. The table below shows Southwest’s average cost of jet fuel, net of hedging gains and including fuel taxes, over the past five years and during each quarter of 2008:

Year	Cost* (Millions)	Average Cost Per Gallon*	Percent of Operating Expenses*
2004	\$ 1,106	\$ .92	18.1%
2005	\$ 1,470	\$ 1.13	21.4%
2006	\$ 2,284	\$ 1.64	28.0%
2007	\$ 2,690	\$ 1.80	29.7%
2008	\$ 3,713	\$ 2.44	35.1%
First Quarter 2008	\$ 800	\$ 2.13	32.8%
Second Quarter 2008	\$ 944	\$ 2.42	35.5%
Third Quarter 2008	\$ 1,051	\$ 2.73	37.5%
Fourth Quarter 2008	\$ 918	\$ 2.49	34.5%

\* Southwest reclassified fuel sales and excise taxes for the years 2004 through 2007 from “Other operating expenses” to “Fuel and oil expense” in order to conform to the current year presentation. Average fuel cost per gallon figures, as well as the percent of operating expenses, have also been recalculated based on the restated information.

Volatile fuel costs, coupled with a continued domestic economic downturn, had a significant impact on Southwest and the airline industry generally during 2008. The dramatically higher fuel prices during most of the year led to significant industry-wide capacity reductions. Southwest’s fuel hedges during this time enabled it to weather fuel price increases, contributing to cash savings of almost \$1.3 billion during 2008; however, the recent significant decline in fuel prices led to Southwest’s decision to significantly reduce its net fuel hedge position in place for 2009 and beyond. 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 heavily regulated, especially by the federal government. Examples of regulations impacting Southwest and/or the industry include:

*Economic and Operational Regulation*

- *Aviation Taxes.* The statutory authority for the federal government to collect aviation

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## [Table of Contents](#)

taxes, which are used, in part, to finance the nation's airport and air traffic control systems, and the authority of the 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, 2008. However, Congress has approved a temporary extension of this authority through March 31, 2009. Similar temporary extensions or a reauthorization for a fixed term are expected to occur in 2009. Other proposals that could be considered by Congress in connection with the FAA reauthorization legislation include: (i) the imposition of new, or changes to, aviation-specific taxes; (ii) an increase in the amount of airport passenger facility charges; and (iii) the adoption of new unfunded mandates on commercial airlines such as new environmental, consumer, and labor standards, any of which could have an impact on Southwest'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 Southwest to operate among any points within the United States and its territories and possessions. Additional DOT authority, in the form of a certificate or exemption from certificate requirements, is required for a U.S. airline to serve foreign destinations either with its own aircraft or via codesharing with another airline. 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 airline codesharing, 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 "IATC Act"), imposed restrictions on the provision of air transportation to and from Dallas Love Field. The applicable portion of the IATC 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 IATC 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

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## [Table of Contents](#)

Dallas Love Field and currently 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*

Southwest and its third-party maintenance providers are subject to the jurisdiction of the FAA with respect to Southwest'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, Southwest has established, and the FAA has approved, Southwest's operations specifications and a maintenance program for Southwest'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.

Southwest 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, increased 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 Southwest'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 is expected to eventually lift its restrictions on liquids, Southwest 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, or that new restrictions will not be put in place. Southwest 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. Southwest's Automated Boarding Passes and self service kiosks have reduced the number of lines in which a Customer must wait and, during 2008, Southwest introduced priority security lane access for its Business Select and Rapid Reward A-List Customers at select airports. In addition, Southwest's gate readers at all of its airports have improved the boarding reconciliation process. Southwest 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 Southwest's business through the imposition of security fees on Southwest's Customers and on Southwest. 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

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## [Table of Contents](#)

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, and a ruling is expected during 2009.

### *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.

Southwest 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. Further 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. Southwest does not believe, however, that presently pending environmental regulatory developments will have a material impact on Southwest'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 additional 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, Southwest, as a normal course of business, undertakes voluntary investigation or remediation of soil or groundwater contamination at several airport sites. Southwest does not believe that any environmental liability associated with these airport sites will have a material adverse effect on Southwest's operations, costs, or profitability, nor has it experienced any such liability in the past that has had a material adverse effect on its operations, costs, or profitability.

Southwest has appointed a "Green Team" to target areas of environmental improvement in all aspects of Southwest's business, while at the same time remaining true to Southwest's low cost philosophy. As part of this initiative, during 2008, Southwest published an Environmental Report describing Southwest'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 Southwest 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**

During 2008, Southwest continued to implement and promote initiatives designed to enhance Customer Service and improve future revenues. Southwest's general operating strategies and specific offerings and related initiatives are discussed below.

#### *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

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## [Table of Contents](#)

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 2008 was 636 miles with an average duration of approximately 1.8 hours, as compared to an average aircraft trip stage length of 629 miles and an average duration of approximately 1.8 hours in 2007. 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, 17 weekday roundtrips; and Los Angeles International to Oakland, 18 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, Nashville and Oakland, and San Diego and Baltimore. During 2008, Southwest's schedule optimization capabilities allowed it to reduce flight frequency on less profitable routes and reallocate capacity to potentially more rewarding markets.

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 Southwest 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. Southwest 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 Southwest's ability to sustain high Employee productivity and reliable ontime performance.

### *Fare Structure and No Hidden Fees Marketing Campaign*

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 January 13, 2009, Southwest's highest non-codeshare, one-way unrestricted walkup fare offered was \$503 for its longest flights. Substantially lower walkup fares are generally available on Southwest's short and medium haul flights. Since November 2007, Southwest's fares have been bundled into three major fare columns: "Business Select," "Anytime," and "Wanna Get Away," with the goal of making it easier for Customers to choose the fare they want. Southwest's "Business Select" offering was developed to increase options 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 frequent flyer credit for the flight and a free drink. Southwest's "Business Select" program contributed approximately \$73 million in revenues during 2008.

During 2008, in response to skyrocketing fuel prices, virtually all other U.S. airlines began charging additional fees for items such as first or second checked bags, seat selection, fuel surcharges, snacks, curbside checkin, and telephone reservations. In response, Southwest adopted a No Hidden Fees marketing campaign to highlight Southwest's prioritization of high value Customer Service. As part of the campaign, Southwest launched radio, print, television, and billboard advertisements to promote Southwest's point of differentiation.

### *Enhanced Boarding Method and Updated Gate Design and Priority Security Lane*

During fourth quarter 2007, Southwest introduced an enhanced boarding method, which was 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 enhanced boarding method also allows for future enhancements, such as product customization and additional incentives for business and leisure travelers.

During 2008, Southwest completed modification of substantially all of its gate areas with columns and signage that facilitate the new boarding process. The "extreme gate makeover" was also designed to

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## Table of Contents

improve the airport experience for all of Southwest'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. In addition, during 2008, Southwest introduced priority security lane access for its Business Select and Rapid Reward A-List Customers at select airports.

### *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 Southwest Airlines Rapid Rewards Visa Card®. During 2008, Southwest introduced a new dining program for Rapid Rewards Members that enables them to earn Rapid Rewards credits when dining at more than 9,000 restaurants, bars, and clubs across the United States and Canada.

Rapid Rewards offers different types of travel award opportunities ("Award Tickets"). Rapid Rewards Members who accumulate 16 credits within 24 consecutive months are awarded a Standard Award, which is valid for one free roundtrip award to any destination available on Southwest. Rapid Rewards Members who fly at least 32 qualifying one-way flights within a 12-month period also receive reserved boarding privileges for an entire year. When these Customers purchase travel at least 36 hours prior to flight time, they 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. Southwest also offers a "Freedom Award," which allows Rapid Rewards Members the opportunity to convert two Standard Awards into a Freedom Award, which is free of seat restrictions except for a limited number of "Black-out" dates around major holidays. Southwest also offers a Rapid Rewards Companion Pass, which 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 a Standard Award. Additionally, the Rapid Rewards Member and designated companion must travel together on the same flight. Standard Awards 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.

Southwest 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.

Customers redeemed approximately 2.8 million, 2.8 million, and 2.7 million, Award Tickets during 2008, 2007, and 2006, respectively. The amount of free travel award usage as a percentage of total Southwest revenue passengers carried was 6.4 percent in 2008, 6.2 percent in 2007, and 6.4 percent in 2006. The number of fully earned Award Tickets and partially earned awards outstanding at December 31, 2008 was approximately 10.4 million, of which approximately 78 percent were partially earned awards. 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. 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 16 percent of all fully earned Award Tickets have expired without being used. The number of Companion Passes outstanding at December 31, 2008 and 2007 was approximately 67,000 and 65,000, respectively. Southwest currently estimates that an average of three to four trips will be redeemed per outstanding Companion Pass.

Southwest 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 Southwest expects to be redeemed. The estimated

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## Table of Contents

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, 2008 and 2007 was not material to Southwest's business.

### *Cashless Cabin*

During 2008, Southwest introduced "Cashless Cabin" for the purchase of food and beverages without cash. All Southwest aircraft are now equipped with handheld devices that enable Flight Attendants to accept credit and debit cards onboard the aircraft, and cash is no longer accepted. Cashless Cabin is intended to enhance Customer Service by appealing to the increasing number of Customers traveling without cash and increasing efficiencies. In addition, it allows for ancillary revenues through an increased offering of food and beverage services.

### *Southwest.com; 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 Southwest's web site at [www.southwest.com](http://www.southwest.com). For the year ended December 31, 2008, more than 89 percent of Southwest's Customers chose the Ticketless travel option, and nearly 78 percent of Southwest's passenger revenues came through its web site (including SWABiz revenues), which has become a vital part of Southwest's distribution strategy.

Southwest continues to explore selling tickets through channels in addition to its own reservation system, web site, and the Sabre System and is also continuing its efforts to provide travel agent and professional travel manager partners with increased and cost effective access to its fares and inventory. Southwest is party to an agreement with Travelport's Galileo, which includes Worldspan, another of Travelport's global distribution systems, pursuant to which 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*

In support of the FAA's Roadmap for Performance-Based Navigation, Southwest has made a commitment to invest \$175 million over the next several years to implement Required Navigation Performance ("RNP") procedures at the airports it serves. RNP is one of the cornerstones for the FAA's Next Generation Air Traffic Control System and 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. Southwest, the FAA, and an aviation consulting firm have been working together to gain Air Traffic Control support of RNP to train Southwest's pilots on RNP, equip Southwest's entire fleet to be RNP capable, and produce RNP charted procedures. In January 2009, Southwest activated autothrottles and VNAV (vertical navigation) on its aircraft for the first time in Southwest history, representing the first step in Southwest's automation transformation. VNAV is also expected to provide more nearterm benefits such as significant savings in fuel costs and reductions in fuel emissions.

### *Codesharing*

In 2008, Southwest announced its intention to enter into codeshare relationships with two different airlines — Canadian carrier WestJet and Mexican carrier Volaris. The Company and WestJet currently intend to announce codeshare flight schedules and additional features regarding the relationship by late 2009. The Company and Volaris currently intend to announce codeshare flight schedules and additional features regarding the relationship by early 2010. Certain details of these alliances are subject to approvals by both the U.S. and Canadian/Mexican governments. The Company is also continuing to consider codeshare opportunities with other carriers, both domestic and international. Southwest originally implemented codesharing in domestic operations in 2005 with ATA Airlines. Southwest's codeshare arrangement with ATA terminated during 2008 as a result of ATA's bankruptcy.

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## [Table of Contents](#)

### *Management Information Systems*

Southwest continues to invest in technology to support its initiatives and its ongoing operations. During 2008, Southwest implemented a system to replace its point of sale application in the stations and its refunds system in the back office. Additionally, Southwest has purchased technology that will replace its 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 in late 2009 or early 2010.

### **Competition**

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

- Price;
- 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 almost 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. These alliances enable these carriers to expand their destinations and marketing opportunities. Airlines that do not fly exclusively domestically are less exposed to domestic economic conditions and may be able to offset less profitable domestic fares with more profitable international fares. As discussed above, Southwest continues to address this competitive factor through its international codeshare efforts.

Southwest is also subject to varying degrees of competition from surface transportation and may have more exposure to this form of competition than airlines with longer average stage lengths. Surface competition can be more significant during economic downturns when consumers cut back on discretionary spending.

The competitive landscape for airlines continues to change. Following the terrorist attacks on September 11, 2001, the airline industry as a whole incurred substantial losses through 2005. Many carriers reduced capacity, grounded their most inefficient aircraft, cut back on unprofitable service, and furloughed employees. Significant increases in the cost of fuel through most of 2008 have continued to exacerbate industry challenges. As discussed above, during 2008, many carriers reduced capacity to cope with the spike in fuel costs. In addition, a number of carriers have sought relief from financial obligations in bankruptcy. During 2008 alone, the following airlines filed for bankruptcy: Frontier Airlines, Inc., Aloha Airlines, ATA Airlines, Skybus Airlines Inc., Eos Airlines, Inc., and Champion Air. All but Frontier also discontinued operations. Other airlines that have filed and emerged from bankruptcy in recent years include UAL Corporation, the parent of United Airlines, US Airways, Northwest Airlines Corporation, the parent of Northwest Airlines, and Delta Air Lines. In some cases, this has led to industry consolidation. For example, US Airways and America West Airlines merged in September 2005, and Delta and Northwest merged in 2008. 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. In addition, distressed carriers may price for cash flow to remain in business, which can cause a reduction in pricing in the industry generally. Southwest has nonetheless continued to maintain its cost advantage, improve Employee productivity, and provide outstanding Service to its Customers. Southwest cannot, however, predict the timing or extent of any further airline bankruptcies or consolidation or their impact (either positive or negative) on Southwest's operations or results of operations.

### **Insurance**

Southwest carries insurance of types customary in the airline industry and at amounts deemed adequate to protect Southwest and its property and to comply both with federal regulations and certain of Southwest's credit and lease agreements. The policies principally provide coverage for public and

## Table of Contents

passenger liability, property damage, cargo and baggage liability, loss or damage to aircraft, engines, and spare parts, and workers' compensation.

Following the terrorist attacks of September 11, 2001, 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 31, 2009. Although another extension beyond this date is expected, if such coverage is not extended by the government, Southwest could incur substantially higher insurance costs or unavailability of adequate coverage in future periods.

### **Seasonality**

Southwest's business 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, 2008, Southwest had 35,499 active fulltime equivalent Employees, consisting of 15,483 flight, 2,528 maintenance, 12,365 ground, Customer, and fleet service, and 5,123 management, accounting, marketing, and clerical personnel.

The Railway Labor Act ("RLA") establishes the right of airline employees to organize and bargain collectively. As of December 31, 2008, approximately 77 percent of Southwest's employees were represented by labor unions, all of which are under ten different collective-bargaining agreements. Under the RLA, collective-bargaining agreements between an airline and a labor union generally do not expire, but instead becomes amendable as of an agreed date. By the amendable date, if either party wishes 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. 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 ("PEB") is established to investigate and report on the dispute. The appointment of a PEB 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 Southwest's Employee groups and status of the collective bargaining agreements:

<u>Employee Group</u>	<u>Representatives</u>	<u>Status of Agreement</u>
Pilots	Southwest Airlines Pilots' Association ("SWAPA")	Currently in negotiations
Flight Attendants	Transportation Workers of America, AFL-CIO ("TWU 556")	Currently in negotiations
Ramp, Operations, Provisioning, Freight Agents	Transportation Workers of America, AFL-CIO, Local 555 ("TWU 555")	Currently in mediation
Customer Service Agents, Reservations Agents	International Association of Machinists and Aerospace Workers, AFL-CIO ("IAM")	Currently in negotiations
Stock Clerks	International Brotherhood of Teamsters, Local 19 ("IBT Local 19")	Currently in negotiations
Mechanics	Aircraft Mechanics Fraternal Association ("AMFA")	Agreement (ratified January 29, 2009) Amendable August 2012
Aircraft Appearance Technicians	AMFA	Amendable February 2009

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## Table of Contents

<u>Employee Group</u>	<u>Representatives</u>	<u>Status of Agreement</u>
Dispatchers	Transportation Workers of America, AFL-CIO, Local 550 (“TWU 550”)	Amendable November 2009
Flight Simulator Technicians	International Brotherhood of Teamsters (“IBT”)	Amendable October 2011
Flight Crew Training Instructors	Southwest Airlines Professional Instructor’s Association (“SWAPIA”)	Amendable December 2012

### **Additional Information About Southwest**

Southwest was incorporated in Texas in 1967. The following documents are available free of charge through Southwest’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 Securities and Exchange Commission (“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 Southwest’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 2008 Southwest’s Chief Executive Officer certified to the New York Stock Exchange (“NYSE”) that he was not aware of any violation by Southwest of the NYSE’s corporate governance listing standards.

### **DISCLOSURE REGARDING FORWARD-LOOKING INFORMATION**

Some statements in this Form 10-K (or otherwise made by Southwest or on Southwest’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 Southwest’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 Southwest’s forward-looking statements, which represent Southwest’s views only as of the date this report is filed. Southwest 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 heavily impacted by the price and availability of aircraft fuel. Continued volatility in fuel costs and/or significant disruptions in the supply of fuel could adversely affect Southwest’s results of operations.***

Airlines are inherently dependent upon energy to operate and can therefore be significantly impacted by changes in the prices of jet fuel. The cost of jet fuel, which generally has been at historically high levels over the last three years, is largely unpredictable, as is evidenced by the recent plunge in market jet fuel prices. Even a small change in fuel prices, with no other changes, can drive profitability sharply in one direction or the other. Jet fuel and oil consumed for fiscal 2008 and 2007 represented approximately 35 percent and 30 percent of

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## [Table of Contents](#)

Southwest's operating expenses, respectively, and, for 2008, constituted the largest expense incurred by Southwest. As a result, fuel costs have factored significantly into Southwest's growth decisions.

Fuel availability can also affect fuel prices and is impacted by political and economic factors beyond Southwest's control. Therefore, although Southwest does not currently anticipate a significant reduction in fuel availability, future availability is difficult to predict. Fuel availability can be impacted by factors such as 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 jet fuel could adversely affect Southwest's results of operations.

Southwest's profitability is impacted in part by its ability to adjust fares in reaction to fuel price volatility. Southwest's ability to increase fares can be limited by factors such as Southwest's low fares reputation, the percentage of its Customer base that purchases travel for leisure purposes, and the competitive nature of the airline industry generally. Fare increases are even more difficult to achieve in uncertain economic environments, as low fares are often used to stimulate demand. Additionally, Southwest has historically entered into fuel derivative contracts to protect against rising fuel costs. These contracts produced cash settlement gains of \$1.3 billion (on a cash basis, before profitsharing and income taxes) for the full year 2008. In response to the recent drop in energy prices, Southwest significantly reduced its net fuel hedge position in place for 2009 and beyond and is therefore less protected against future increases.

Changes in Southwest'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 Southwest's fuel hedges pursuant to highly complex accounting rules, are all significant factors impacting Southwest's results of operations. Southwest's fuel hedging arrangements are discussed in more detail under "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in Note 10 to the Consolidated Financial Statements.

***The airline industry is particularly sensitive to changes in economic condition; continued negative economic conditions would likely continue to negatively impact Southwest's results of operations and its ability to obtain financing on acceptable terms.***

Southwest's operations and the airline industry in general are particularly sensitive to changes in economic conditions. Unfavorable general economic conditions, such as higher unemployment rates, a constrained credit market, housing-related pressures, and increased business operating costs can reduce spending for both leisure and business travel. Unfavorable economic conditions can also impact Southwest's ability to raise fares to counteract increased fuel, labor, and other costs. Demand for air travel waned during the fourth quarter of 2008, which Southwest believes can be primarily attributed to the crisis experienced in worldwide credit markets and the domestic recessionary environment that became evident during the year. Therefore, a continued economic recessionary environment would likely continue to negatively impact Southwest's results of operations. Southwest continues to be cautious of current domestic economic conditions, as recessionary fears have continued to proliferate.

Factors such as continued unfavorable economic conditions, a significant decline in demand for air travel, or continued instability of the credit and capital markets could result in future pressure on credit ratings, which could trigger credit rating provisions in Southwest's credit card transaction processing agreements, outstanding debt agreements, and some hedging counterparty agreements (as discussed in more detail in "Item 7A. Quantitative and Qualitative Disclosures About Market Risk"). These factors could also negatively impact (a) Southwest's ability to obtain financing on acceptable terms, (b) Southwest's liquidity generally, and (c) the availability and cost of insurance.

***Southwest's business is labor intensive; Southwest could be adversely affected if it were unable to maintain satisfactory relations with its Employees or its Employees' Representatives.***

While the airline business is labor intensive and the Company's results are subject to variations in labor-related job actions, Southwest has historically maintained positive relationships with its Employees and its Employee's Representatives. Salaries, wages,

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## Table of Contents

and benefits represented 32 percent of the Company's operating expenses for the year ended December 31, 2008. In addition, as of December 31, 2008, approximately 77 percent of the Company's Employees were represented for collective bargaining purposes by labor unions. As discussed above in "Item 1. Business – Employees," the Company is currently in discussions with several Employee Representatives. Employment-related issues that may impact the Company's results of operations, some of which are negotiated items, include hiring/retention rates, pay rates, outsourcing costs, work rules, and health care costs.

***Southwest's inability to timely and effectively implement its revenue initiatives could adversely affect its results of operations.***

Southwest has implemented and intends to continue to implement revenue initiatives that are designed to help offset increasing costs and improve Customer Service. The timely and effective implementation of these initiatives has involved, and will continue to involve, significant investments by the Company of time and money and could be impacted by (i) Southwest's ability to timely and effectively implement, transition, and maintain related information technology systems and infrastructure; (ii) the timing of Southwest's investment of incremental operating expenses and capital expenditures for these purposes, while balancing the need to effectively control operating expenses; and (iii) Southwest's dependence on third parties to assist with implementation. Because Southwest has limited experience with some of its strategic initiatives, it cannot ensure the timing of their implementation or that they will be successful or profitable either over the short or long term.

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

Southwest's operations have become increasingly dependant on the use of sophisticated technology and systems, including those used for its point of sale, ticketing, revenue accounting, payroll, and financial reporting areas. Systems and technology are also crucial to the timely and effective implementation of Southwest's revenue initiatives. As discussed above under "Business – Operating Strategies and Marketing – Management Information Systems," Southwest has multiple technology projects underway, many of which are reliant upon third party performance for timely and effective completion. Any issues with transitioning to upgraded or replacement systems, or any material failure, inadequacy, interruption, or security failure of these systems, could materially impact Southwest's ability to effectively operate its business.

***The airline industry is affected by many conditions that are beyond its control.***

Southwest's business and the airline industry in general are also impacted by other conditions that are largely outside of Southwest'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 Southwest's results of operations. In addition, when the airline industry shrinks, as it did during 2008, airport operating costs are essentially unchanged and must be shared by the remaining operating carriers, which can therefore increase Southwest's costs.

***The airline industry faces on-going security concerns and related 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, and resulting aftermath materially impacted air travel and

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## [Table of Contents](#)

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;
- The adoption of statutes or regulations that impact customer service standards, including 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 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.***

Southwest's low cost structure has historically been one of its primary competitive advantages; however, it has limited control over many of its fixed costs. For example, Southwest's ability to adjust compensation and benefit costs is limited by the terms of its collective bargaining agreements. Other factors that can impact Southwest's ability to control costs include the price and availability of jet fuel, aircraft airframe or engine repairs, regulatory requirements, and ability to access capital or financing at competitive rates. Given, in particular, the recent volatility in fuel prices and the number of pending labor negotiations, Southwest cannot guarantee that it will be able to maintain its current level of low cost advantage. In addition, a key contributor to Southwest's low cost structure is its use of a single aircraft type, the Boeing 737. Although Southwest is able to purchase some of these aircraft from parties other than Boeing, most of its purchases are direct from Boeing. Therefore, if

## [Table of Contents](#)

Southwest were unable to acquire additional aircraft from Boeing, or Boeing were unable or unwilling to provide adequate support for its products, Southwest's operations could be adversely impacted. In addition, Southwest's dependence on a single aircraft type could result in downtime for part or all of its fleet if mechanical or regulatory issues relating to the Boeing 737 aircraft type were to 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.

As discussed above under "Item 1. Business-Insurance," Southwest carries insurance of types customary in the airline industry and is also provided supplemental, first-party, war-risk insurance coverage by the federal government at substantially lower premiums than prevailing commercial rates. If the supplemental coverage is not extended, Southwest could incur substantially higher insurance costs. In addition, in the event of an accident involving Southwest aircraft, Southwest could be responsible for costs in excess of its related insurance coverage, which costs could be substantial. Any aircraft accident, even if fully insured, could also have a material adverse effect on the public's perception of Southwest.

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

None.

### **Item 2. Properties**

#### **Aircraft**

Southwest operated a total of 537 Boeing 737 aircraft as of December 31, 2008, of which 82 and 9 were under operating and capital leases, respectively. The remaining 446 aircraft were owned.

The following table details information on the 537 aircraft in the Company's fleet as of December 31, 2008:

<u>737 Type</u>	<u>Seats</u>	<u>Average Age (Yrs)</u>	<u>Number of Aircraft</u>	<u>Number Owned</u>	<u>Number Leased</u>
-300	137	17.4	185	112	73
-500	122	17.7	25	16	9
-700	137	5.3	327	318	9
<b>Totals</b>		10.1	<u>537</u>	<u>446</u>	<u>91</u>

In total, at January 22, 2009, 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**

<u>Delivery Year</u>	<u>The Boeing Company</u>			<u>Total</u>
	<u>Firm Orders</u>	<u>Options</u>	<u>Purchase Rights</u>	
2009	13	—	—	13
2010	10	—	—	10
2011	10	10	—	20
2012	13	10	—	23
2013	19	4	—	23
2014	13	7	—	20
2015	14	3	—	17
2016	12	11	—	23
2017	—	17	—	17
Through 2018	—	—	54	54
<b>Total</b>	<u>104</u>	<u>62</u>	<u>54</u>	<u>220</u>

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## [Table of Contents](#)

### **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. During 2008, the City of Dallas approved the Love Field Modernization Program, an estimated \$519 million project to provide Dallas Love Field with modern, convenient facilities. Southwest is managing the project, and construction is expected to commence during the summer of 2009, with completion scheduled for October 2014. As of December 31, 2008, 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***

On March 6, 2008, the FAA notified Southwest that it was seeking to fine Southwest approximately \$10 million in connection with an incident concerning the Company's potential non-compliance with an airworthiness directive. The Company is currently in settlement discussions with the FAA.

In connection with the above incident, during the first quarter and early second quarter of 2008, the Company was named as a defendant in two putative class actions on behalf of persons who purchased air travel from the Company while the Company was allegedly in violation of FAA safety regulations. Claims alleged by the plaintiffs in these two putative class actions include breach of contract, breach of warranty, fraud/misrepresentation, unjust enrichment, and negligent and reckless operation of an aircraft. The Company believes that the class action lawsuits are without merit and intends to vigorously defend itself. Also in connection with the above incident, during the first quarter and early second quarter of 2008, the Company received four letters from Shareholders demanding the Company commence an action on behalf of the Company against members of its Board of Directors and any other allegedly culpable parties for damages resulting from an alleged breach of fiduciary duties owed by them to the Company. In August 2008, Carbon County Employees Retirement System and Mark Cristello filed a related Shareholder derivative action in Texas state court naming certain directors and officers of the Company as individual defendants and the Company as a nominal defendant. The derivative action claims breach of fiduciary duty and seeks recovery by the Company of alleged monetary damages sustained as a result of the purported breach of fiduciary duty, as well as costs of the action. A Special Committee appointed by the Independent Directors of the Company is currently evaluating the Shareholder demands.

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.

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[Table of Contents](#)

**EXECUTIVE OFFICERS OF THE REGISTRANT**

The following information regarding the Company's executive officers is as of January 1, 2009.

<u>Name</u>	<u>Position</u>	<u>Age</u>
Gary C. Kelly	Chairman of the Board, President, & Chief Executive Officer	53
Robert E. Jordan	Executive Vice President Strategy & Planning	48
Ron Ricks	Executive Vice President Corporate Services & Corporate Secretary	59
Michael G. Van de Ven	Executive Vice President & Chief Operating Officer	47
Davis S. Ridley	Senior Vice President Marketing & Revenue Management	55
Laura H. Wright	Senior Vice President Finance & Chief Financial Officer	48

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

*Gary C. Kelly* has served as Southwest's Chairman of the Board since May 2008, as its President since July 2008, and as its Chief Executive Officer since July 2004. Mr. Kelly also served as Southwest's Executive Vice President & Chief Financial Officer from June 2001 to July 2004 and as its Vice President Finance & Chief Financial Officer from 1989 to 2001. Mr. Kelly joined Southwest in 1986 as its Controller.

*Robert E. Jordan* has served as Southwest's Executive Vice President Strategy & Planning since May 2008. Mr. Jordan also served as Southwest's Executive Vice President Strategy & Technology from September 2006 to May 2008, Senior Vice President Enterprise Spend Management from August 2004 to September 2006, and Vice President Technology from October 2002 to August 2004.

*Ron Ricks* has served as Southwest's Executive Vice President Corporate Services & Corporate Secretary since May 2008. Mr. Ricks also served as Southwest's Executive Vice President Law, Airports, & Public Affairs from September 2006 to May 2008 and Senior Vice President Law, Airports, & Public Affairs from August 2004 until September 2006. Prior to 2004, Mr. Ricks served as Vice President Governmental Affairs for Southwest.

*Michael G. Van de Ven* has served as Southwest's Executive Vice President & Chief Operating Officer since May 2008. Mr. Van de Ven also served as Southwest's Chief of Operations from September 2006 to May 2008, Executive Vice President Aircraft Operations from November 2005 through August 2006, Senior Vice President Planning from August 2004 to November 2005, and Vice President Financial Planning & Analysis from June 2001 to August 2004.

*Davis S. Ridley* has served as Southwest's Senior Vice President Marketing & Revenue Management since May 2008. Mr. Ridley also served as Southwest's Senior Vice President Marketing from November 2007 to May 2008. Prior to such time, Mr. Ridley served as Southwest's Senior Vice President People & Leadership Development from August 2004 to January 2006 and as its 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 served as Southwest's Senior Vice President Finance & Chief Financial Officer since July 2004. Ms. Wright also served as Southwest's Vice President Finance & Treasurer from June 2001 to July 2004 and as its Treasurer from August 1998 to 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 Southwest's common stock, as reported on the NYSE Composite Tape, and the cash dividends per share paid on Southwest's common stock.

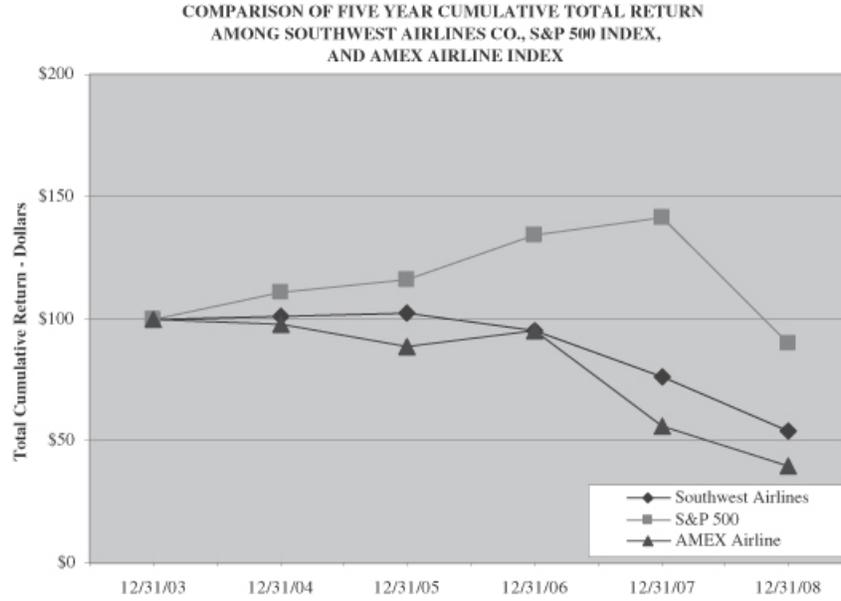
<u>Period</u>	<u>Dividend</u>	<u>High</u>	<u>Low</u>
<b>2008</b>			
1st Quarter	\$ 0.00450	\$ 13.10	\$ 11.02
2nd Quarter	0.00450	14.89	11.75
3rd Quarter	0.00450	16.77	12.68
4th Quarter	0.00450	14.97	7.05
<b>2007</b>			
1st Quarter	\$ 0.00450	\$ 16.58	\$ 14.50
2nd Quarter	0.00450	15.90	14.03
3rd Quarter	0.00450	16.96	14.21
4th Quarter	0.00450	15.06	12.12

Southwest currently intends to continue paying quarterly dividends for the foreseeable future; however, Southwest's Board of Directors may change the timing, amount, and payment of dividends on the basis of results of operations, financial condition, cash requirements, future prospects, and other factors deemed relevant by the Board. As of January 28, 2009, there were 10,624 holders of record of Southwest'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 Southwest specifically incorporates it by reference into such filing.

The following graph compares the cumulative total Shareholder return on Southwest's common stock over the five-year period ended December 31, 2008, 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, 2003, in Southwest 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.



	12/31/03	12/31/04	12/31/05	12/31/06	12/31/07	12/31/08
<b>Southwest Airlines Co.</b>	\$ 100	\$ 101	\$ 102	\$ 95	\$ 76	\$ 54
<b>S&amp;P 500</b>	\$ 100	\$ 111	\$ 116	\$ 134	\$ 142	\$ 90
<b>AMEX Airline</b>	\$ 100	\$ 98	\$ 89	\$ 95	\$ 56	\$ 40

[Table of Contents](#)

**Item 6. Selected Financial Data**

The following financial information for the five years ended December 31, 2008, 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,				
	2008	2007	2006	2005	2004
	(in millions, except per share amounts)				
<b>Financial Data:</b>					
Operating revenues	\$ 11,023	\$ 9,861	\$ 9,086	\$ 7,584	\$ 6,530
Operating expenses	10,574	9,070	8,152	6,859	6,126
Operating income	449	791	934	725	404
Other expenses (income) net	171	(267)	144	(54)	65
Income before taxes	278	1,058	790	779	339
Provision for income taxes	100	413	291	295	124
Net Income	\$ 178	\$ 645	\$ 499	\$ 484	\$ 215
Net income per share, basic	\$ .24	\$ .85	\$ .63	\$ .61	\$ .27
Net income per share, diluted	\$ .24	\$ .84	\$ .61	\$ .60	\$ .27
Cash dividends per common share	\$ .0180	\$ .0180	\$ .0180	\$ .0180	\$ .0180
Total assets at period-end	\$ 14,308	\$ 16,772	\$ 13,460	\$ 14,003	\$ 11,137
Long-term obligations at period-end	\$ 3,498	\$ 2,050	\$ 1,567	\$ 1,394	\$ 1,700
Stockholders' equity at period-end	\$ 4,953	\$ 6,941	\$ 6,449	\$ 6,675	\$ 5,527
<b>Operating Data:</b>					
Revenue passengers carried	88,529,234	88,713,472	83,814,823	77,693,875	70,902,773
Enplaned passengers	101,920,598	101,910,809	96,276,907	88,379,900	81,066,038
Revenue passenger miles (RPMs) (000s)	73,491,687	72,318,812	67,691,289	60,223,100	53,418,353
Available seat miles (ASMs) (000s)	103,271,343	99,635,967	92,663,023	85,172,795	76,861,296
Load factor(1)	71.2%	72.6%	73.1%	70.7%	69.5%
Average length of passenger haul (miles)	830	815	808	775	753
Average aircraft stage length (miles)	636	629	622	607	576
Trips flown	1,191,151	1,160,699	1,092,331	1,028,639	981,591
Average passenger fare	\$ 119.16	\$ 106.60	\$ 104.40	\$ 93.68	\$ 88.57
Passenger revenue yield per RPM	14.35¢	13.08¢	12.93¢	12.09¢	11.76¢
Operating revenue yield per ASM	10.67¢	9.90¢	9.81¢	8.90¢	8.50¢
Operating expenses per ASM	10.24¢	9.10¢	8.80¢	8.05¢	7.97¢
Fuel costs per gallon, including taxes (average)(2)	\$ 2.44	\$ 1.80	\$ 1.64	\$ 1.13	\$ 0.92
Fuel consumed, in gallons (millions)	1,511	1,489	1,389	1,287	1,201
Fulltime equivalent Employees at period-end	35,499	34,378	32,664	31,729	31,011
Size of fleet at period-end(3)	537	520	481	445	417

- (1) Revenue passenger miles divided by available seat miles
- (2) Prior year amounts have been restated to include fuel taxes
- (3) Includes leased aircraft

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## [Table of Contents](#)

### **Item 7. Management's Discussion And Analysis Of Financial Condition And Results Of Operations**

#### **Year in Review**

For the 36<sup>th</sup> consecutive year, the Company reported a net profit, earning \$178 million (\$.24 per share, diluted) in 2008. In addition, the Company recorded operating profits in all four quarters of 2008, as it has now done in 71 consecutive quarters dating back to the second quarter of 1991. Given the significance of events that took place during 2008, the Company's challenge to continue these streaks was unprecedented in recent history.

Demand for air travel, especially for the low fares offered by the Company, was strong during the first half of 2008 and through the summer months. However, demand for air travel waned, especially during fourth quarter 2008, which the Company believes was a result of the crisis experienced in worldwide credit markets and the domestic recessionary environment that became evident during the year. The Company was able to gradually raise fares throughout most of the year to combat an enormous increase in fuel prices; however, during the fourth quarter, the Company offered more discounted fares in order to stimulate demand as the number of people choosing to travel by air declined versus the prior year. The Company's ability to raise fares during 2008 (as well as to keep prior fare increases in place) was due in part to competitor capacity reductions in certain of the Company's markets — especially beginning in September 2008, but was also aided by several Company initiatives including: a slowing of internal capacity growth at times during 2008; optimizing the flight schedule to eliminate unproductive and less popular flights and reallocating capacity to fund market growth opportunities such as Denver, and the upcoming addition of the Company's newest city, Minneapolis-St. Paul (beginning service in March 2009); enhancement of revenue management technologies, processes, and techniques; and aggressive promotion of the Company's No Hidden Fees, Low Fare brand.

In addition to having a significant impact on the entire U.S. economy, energy and fuel prices were again a major story for airlines during 2008. After beginning the year at approximately \$100 per barrel, the price of crude oil skyrocketed to over \$145 in July 2008. This caused the Company, as well as all major U.S. airlines, to reconsider growth and capacity plans for the near future, as the devastating impact of these fuel prices was evident in the financial results of all domestic airlines. The summer spike in oil prices, as well as other clearly evident deteriorating economic conditions that followed, caused the Company to modify its growth and to plan for an expected decrease in demand for air travel.

Even with fuel derivative instruments in place for approximately 78 percent of the Company's fuel consumption during 2008, the Company's fuel and oil expense increased \$1.0 billion versus 2007. The fuel derivative instruments the Company had in place for 2008 resulted in settlement gains of \$1.3 billion (on a cash basis, before profitsharing and income taxes), which was an increase of \$566 million compared to the fuel derivative cash settlement gains the Company received during 2007. As a result of the rapid collapse in energy prices during fourth quarter 2008, the Company has effectively reduced its net fuel hedge position in place for the years from 2009 through 2013 to approximately ten percent of its anticipated fuel consumption in each of those years. Due to the manner in which the Company reduced its fuel hedge for these future years (primarily by selling swap instruments, which in most cases were sold at lower prices than the positions that were previously purchased), and disregarding any future potential activity involving fuel derivative instruments, the Company has fixed some losses associated with these instruments and expects to pay higher than market prices for fuel for these periods. The market value (as of December 31, 2008) of the Company's net fuel derivative contracts for 2009 through 2013 reflects a net liability of approximately \$992 million. Based on this liability at December 31, 2008 (and assuming no change to the fuel hedge portfolio), the Company's jet fuel costs per gallon would exceed market (or unhedged) prices by approximately \$.16 to \$.17 in each year from 2009 to 2011, \$.10 in 2012, and \$.08 in 2013. These estimates are based on expected future cash settlements from fuel derivatives, but exclude any Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended (SFAS 133) impact associated with the ineffectiveness of fuel hedges or fuel derivatives that are marked to market value because they do not qualify for special hedge accounting. See Note 10 to the Consolidated Financial Statements for further information.

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## Table of Contents

Although the Company's 2008 net income of \$178 million (\$.24 per share, diluted) declined compared to 2007 net income of \$645 million (\$.84 per share, diluted), much of the decline was driven by a fluctuation in certain gains and losses, recorded in accordance with SFAS 133, that relate to fuel derivatives expiring in future periods. These instruments contributed net losses totaling \$19 million in 2008, but had resulted in net gains totaling \$360 million for 2007. Operating income for 2008 was \$449 million, a 43.2 percent decrease compared to 2007. The lower 2008 operating income primarily was due to the 35.6 percent increase in the Company's average fuel cost per gallon, including hedging, which counteracted an 11.8 percent increase in operating revenues.

Looking ahead to 2009, the Company remains cautious about demand for air travel given current domestic economic conditions. However, the rapid decline in fuel prices combined with the announced cutbacks in domestic capacity by major U.S. airlines, have thus far mitigated much of the impact of fewer people flying. The Company expects its net available seat mile (ASM) capacity in first quarter 2009 to be approximately four to five percent lower than first quarter 2008. However, at this same time, competitors have reduced their seats by approximately 15 percent in certain markets where they compete with the Company. The Company has announced it will start service to Minneapolis-St. Paul, Minnesota, beginning in March 2009, representing the 65<sup>th</sup> city and 33<sup>rd</sup> state to which the Company flies. In addition, the Company has received initial approval to acquire 14 take-off and landing slots at New York's LaGuardia airport from the former ATA Airlines, Inc., which filed for bankruptcy protection in April 2008. Pending final approval by the bankruptcy court and closing of the transaction, which is currently expected to be in March 2009, the Company could begin flying up to seven daily roundtrips to LaGuardia as early as summer 2009.

The Company also announced its intention to enter into codeshare agreements with two different airlines — Canadian carrier WestJet and Mexican carrier Volaris. The Company and WestJet plan to announce codeshare flight schedules and additional features regarding the relationship by late 2009. The Company and Volaris plan to announce codeshare flight schedules and additional features regarding the relationship by early 2010. Certain details of these alliances are subject to approvals by both the U.S. and Canadian/Mexican governments. The Company is also continuing to consider codeshare opportunities with other carriers, both domestic and international.

For the year 2009, the Company currently plans to reduce its fleet by a net two aircraft. The Company plans to add 13 new 737-700 aircraft from Boeing, and plans to return from lease or retire a total of fifteen aircraft. Based on current plans, the Company's fleet is scheduled to total 535 737s by the end of 2009.

## **Results of Operations**

### *2008 compared with 2007*

The Company's net income of \$178 million (\$.24 per share, diluted) in 2008 represented a decrease of \$467 million, or 72.4 percent, compared to its 2007 net income of \$645 million (\$.84 per share, diluted). The majority of the decline in net income was due to the fluctuation of certain gains and losses, recorded in accordance with SFAS 133. These included adjustments impacting earnings through the recording of gains and/or losses in 2008 and 2007 associated with fuel derivatives expiring in future periods, and settlement/expiration of fuel derivative instruments for cash in 2008 or 2007, but for which gains and/or losses had been recorded in earnings in a prior period. See Note 10 to the Consolidated Financial Statements for further information. Both of these types of adjustments are related to the ineffectiveness of hedges and the loss of hedge accounting for certain fuel derivatives. Adjustments associated with fuel derivative instruments and SFAS 133 included \$19 million in net losses for 2008, and \$360 million in net gains for 2007. These are included in "Other (gains) losses, net," which is below the operating income line, in both periods. Due to the fact that items associated with SFAS 133 have resulted in large adjustments to "Other (gains) losses, net," the Company believes operating income provides a better indication of the Company's financial performance for both 2008 and 2007 than does net income. The Company's 2008 operating income was \$449 million, a decrease of \$342 million, or 43.2 percent, compared to 2007. The majority of this decrease in 2008 was due to the substantial increase in fuel expense, despite the fact that the Company once again benefited tremendously from its fuel hedging program. Entering 2008, the Company had instruments in place for over 75 percent of its anticipated fuel consumption needs at an average crude oil equivalent price of \$51 per

## [Table of Contents](#)

barrel. Even with this protection, however, the Company's average jet fuel cost per gallon increased from \$1.80 in 2007 to \$2.44 in 2008.

### **Operating Revenues**

Consolidated operating revenues increased \$1.2 billion, or 11.8 percent, primarily due to a \$1.1 billion, or 11.5 percent, increase in passenger revenues. Despite carrying approximately the same number of passengers as 2007, the Company was able to generate an 11.8 percent increase in average fares. The Company raised fares several times during 2008 in an attempt to keep up with rapidly increasing jet fuel prices. This strategy was aided by the Company's own slowdown in growth as well as significant capacity reductions by competitors in certain of the Company's markets. The Company purchased a total of 26 new Boeing 737-700 aircraft during 2008, and returned nine 737-300s from lease, resulting in the net addition of 17 aircraft for the year. This fleet growth enabled the Company to fly 3.6 percent more ASMs in 2008 versus the prior year. However, as a result of higher fares and general economic conditions, revenue passenger miles (RPMs) increased only 1.6 percent, resulting in a load factor decrease of 1.4 points to 71.2 percent. As a result of the Company's management of fares, passenger revenue yield per RPM (passenger revenues divided by RPMs) increased 9.7 percent compared to 2007. Unit revenue (operating revenues divided by ASMs) also increased 7.8 percent compared to 2007 levels, primarily as a result of the higher RPM yield. Based on weak economic conditions, which are expected to persist at least in the short term, the Company had previously made the decision to further reduce its future capacity. The Company expects a four to five percent reduction in ASMs in first quarter 2009 compared to first quarter 2008 and approximately a four percent year-over-year decline in ASMs for full year 2009. Although recent unit revenue trends continue to be above prior year levels, there is no assurance this trend will continue. Because of the uncertainty surrounding the nation's overall economy, it is difficult for the Company to precisely predict first quarter 2009 revenues.

Consolidated freight revenues increased \$15 million, or 11.5 percent, versus 2007. This increase primarily was due to higher rates charged for cargo and freight during 2008. The Company currently expects a slight increase in consolidated freight revenues during first quarter 2009 versus first quarter 2008, primarily due to higher rates charged. "Other revenues" increased \$55 million, or 20.1 percent, compared to 2007. Approximately half of the increase was due to an increase in charter revenues versus 2007 as the Company flew charters that were not operated by competitors due to capacity reductions and/or bankruptcy. The majority of the remainder of the increase was 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 a slight year-over-year decrease in first quarter 2009 "Other revenues" compared to first quarter 2008 primarily due to lower expected charter revenues.

### **Operating Expenses**

Consolidated operating expenses for 2008 increased \$1.5 billion, or 16.6 percent, compared to a 3.6 percent increase in capacity. Historically, except for changes in the price of fuel, changes in operating expenses for airlines are typically driven by changes in capacity, or ASMs. The following presents the Company's operating expenses per ASM for 2008 and 2007 followed by explanations of these changes on a per-ASM basis and/or on a dollar basis (in cents, except for percentages):

	<u>2008</u>	<u>2007</u>	<u>Increase (decrease)</u>	<u>Percent change</u>
Salaries, wages, and benefits	3.23¢	3.22¢	.01¢	.3%
Fuel and oil	3.60	2.70	.90	33.3
Maintenance materials and repairs	.70	.62	.08	12.9
Aircraft rentals	.15	.16	(.01)	(6.3)
Landing fees and other rentals	.64	.56	.08	14.3
Depreciation and amortization	.58	.56	.02	3.6
Other	1.34	1.28	.06	4.7
Total	<u>10.24¢</u>	<u>9.10¢</u>	<u>1.14¢</u>	<u>12.5%</u>

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## Table of Contents

The Company's 2008 CASM (cost per available seat mile) increased 12.5 percent compared to 2007. Approximately 80 percent of this increase was due to the increase in fuel expense, net of gains from the Company's fuel hedging program. The majority of the remainder of the increase was due to higher airport costs and maintenance expense. As a result of higher fuel prices throughout much of 2008, the Company has continued its diligent focus on improving fuel efficiency and controlling non-fuel costs. The Company has implemented various technology improvements, which have improved efficiency and enabled the Company to grow headcount at either the same or a slower rate than capacity. Based on current cost trends, the Company expects first quarter 2009 unit costs to increase from first quarter 2008's 9.69 cents, excluding any impact associated with the ineffectiveness of fuel hedges or fuel derivatives that are marked to market value because they do not qualify for special hedge accounting, primarily due to higher salaries, wages, and benefits and the continuation of higher maintenance costs. Unit costs will be negatively impacted due to the Company's decision to decrease its capacity versus first quarter 2008, as it will have similar or higher fixed costs that are spread over fewer ASMs.

Salaries, wages, and benefits increased \$127 million on an absolute dollar basis. Nearly the entire increase was from higher salaries and wages, primarily as a result of higher average wage rates. An increase in health and workers compensation benefits primarily caused by inflationary increases in the cost of medical care was mostly offset by a \$46 million decrease in profitsharing, attributable to lower income available for profitsharing. The Company's profitsharing expense excludes the unrealized gains and/or losses the Company records in its fuel hedging program as a result of SFAS 133. See Note 10 to the Consolidated Financial Statements for further information on SFAS 133 and fuel hedging. Salaries, wages, and benefits expense per ASM was basically flat compared to 2007. Salaries and wages per ASM increased primarily due to higher wage rates, but were almost completely offset by a decline in profitsharing expense per ASM, as capacity grew 3.6 percent, but profitsharing expense declined 34.7 percent versus 2007. Based on current trends, the Company expects salaries, wages, and benefits per ASM in first quarter 2009 to slightly increase from fourth quarter 2008's unit cost of 3.32 cents, but not exceed 3.40 cents per ASM.

The Company's Pilots are subject to an agreement between the Company and 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 between the Company and the Transport Workers Union of America, AFL-CIO Local 556 ("TWU 556"), which became amendable in June 2008. The Company and TWU are currently in discussions on a new agreement.

The Company's Ramp, Operations, Provisioning, and Freight Agents are subject to an agreement between the Company and the Transport Workers Union of America, AFL-CIO Local 555 ("TWU 555"), which became amendable in July 2008. The Company and TWU are currently in mediation.

The Company's Stock Clerks are subject to an agreement between the Company and the International Brotherhood of Teamsters, Local 19 ("IBT Local 19"), and the Company's Mechanics are subject to an agreement between the Company and the Aircraft Mechanics Fraternal Association ("AMFA"). Both of these agreements became amendable in August 2008. The Company and AMFA reached a Tentative Agreement on behalf of the Southwest Mechanics in fourth quarter 2008, which was ratified by the Mechanics during January 2009. The Company and IBT Local 19 remain in discussions on a new agreement for the Company's Stock Clerks.

The Company's Customer Service and Reservations Agents are subject to an agreement between the Company and the International Association of Machinists and Aerospace Workers, AFL-CIO ("IAM"), which became amendable in November 2008. The Company and IAM are currently in discussions on a new agreement.

The Company's Aircraft Appearance Technicians and Flight Dispatchers are subject to agreements between the Company and AMFA and the Company and the Transportation Workers of America, AFL-CIO, Local 550, which will become amendable in February 2009 and November 2009, respectively.

Fuel and oil expense increased \$1.0 billion, or 38.0 percent, and on a per-ASM basis increased 33.3

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## [Table of Contents](#)

percent versus 2007. Both the dollar and the per-ASM increase were driven primarily by a 35.6 percent increase in the average price per gallon for jet fuel, including the impact of fuel derivatives used in hedging, and including related taxes. As a result of the Company's fuel hedging program and inclusive of the impact of SFAS 133, the Company recognized net gains totaling \$1.1 billion in 2008 relating to fuel derivative instruments versus \$686 million of net gains recognized in 2007. Cash settlements realized from the expiration/settlement of fuel derivatives were \$1.3 billion in 2008 versus \$727 million for 2007. The primary reason that gains recognized in Fuel and oil expense during 2008 were less than the cash settlement of fuel derivatives was due to the fact that a portion of the gains associated with these settlements had already been recognized in earnings in prior periods, as they were associated with ineffective hedges or derivatives that did not qualify for SFAS 133 special hedge accounting. See Note 10 to the Consolidated Financial Statements. The 2008 increase in fuel prices was partially offset by steps the Company has taken to improve the fuel efficiency of its aircraft, its aircraft engines, and its flight plans and procedures. These steps resulted in a 2.1 percent reduction in fuel gallons consumed per ASM flown for 2008 versus 2007.

As of December 31, 2008, the Company holds fuel hedge positions for the years from 2009 through 2013. For each of these years, the Company has a net fuel hedge position for approximately ten percent of its currently forecasted fuel consumption for those periods. As of October 15, 2008, the Company had more significant fuel derivative positions related to these future periods, but during fourth quarter 2008, made the decision to reduce such positions to the current levels. The Company accomplished this reduced hedge by entering into additional derivative contracts — through selling primarily fixed-price swap derivatives. The Company believes this strategy enables it to participate in further price declines via the sold derivatives, which should materially offset further declines in value of the Company's previously purchased derivatives. This decision also benefitted the Company by reducing its exposure to cash collateral requirements the Company would be required to post with its counterparties if market prices continued to fall. Since, in many cases, fuel derivatives were sold at lower prices than the positions that were previously purchased, and disregarding any future potential activity involving fuel derivative instruments, the Company has fixed some losses associated with these instruments and currently expects to pay higher than market prices for fuel for these future periods.

Maintenance materials and repairs per ASM increased 12.9 percent compared to 2007, while increasing \$105 million on a dollar basis. On both a dollar basis and a per ASM basis, engine expense accounted for almost 60 percent of the increase and airframe expense accounted for approximately 40 percent of the increase. The majority of the increase in engine costs related to the Company's 737-700 aircraft. For all of 2007 and the first half of 2008, these aircraft engines were accounted for on a time and materials basis. During the first half of 2008, there were significantly more repair events for these engines than in the first half of 2007. This was due to the fact that the 737-700 is the newest aircraft type in the Company's fleet, and, as this fleet has matured, the number of engines on these aircraft undergoing their first major overhaul has increased. As further discussed below, in June 2008, the Company transitioned to a new engine repair agreement for these aircraft and, as noted below, expense is now based on flight hours associated with 737-700 engines. The expense for 737-700 engines recognized in the second half of 2008 associated with the current agreement also exceeded the expense recognized in the second half of 2007, when repairs were still being accounted for on a time and materials basis. The increase in airframe expense primarily was due to 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.

In June 2008, the Company transitioned from its previous 737-700 engine repair agreement with GE Engines Services, Inc. (GE Engines), under which repairs were done pursuant to a combination of fixed pricing and time and material terms, to a new agreement with GE Engines that provides for engine repairs to be done on a rate per flight hour basis. The previous agreement was set to expire in 2013, while the new agreement will expire in 2018. The new agreement covers all engines currently in the Company's 737-700 fleet as well as future firm deliveries for this aircraft type. Under this new agreement, the Company has effectively transferred risk for specified future repairs and maintenance on

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## Table of Contents

these engines to the service provider and will pay GE Engines a contractual rate per hour flown, as stated in the agreement. Since expense for these engine repairs is now based on engine hours flown, as it is for the Company's 737-300 and 737-500 fleet, this new agreement allows the Company to more reliably predict future engine repair costs. Considering the new agreement, the Company expects Maintenance materials and repairs per ASM for first quarter 2009 to be similar to the .78 cents per ASM experienced in fourth quarter 2008, based on currently scheduled airframe maintenance events and projected engine hours flown.

Aircraft rentals expense per ASM decreased 6.3 percent and, on a dollar basis, decreased slightly. Both decreases primarily were due to the fact that the Company returned nine operating lease aircraft to lessors during 2008 while the Company's overall ASM capacity increased 3.6 percent — through purchases of new aircraft from Boeing. The Company executed a sale and leaseback of five of its 737-700 aircraft during December 2008, and the leases qualified as operating leases. The Company also executed a sale and leaseback of an additional five of its 737-700 aircraft during first quarter 2009, and has determined that these leases will be classified as operating leases. As a result of these transactions, the Company currently expects rental expense per ASM for first quarter 2009 to be in the .18 cent range.

Landing fees and other rentals increased \$102 million on a dollar basis and increased 14.3 percent on a per-ASM basis, compared to 2007. The majority of both the dollar increase and per ASM increase was due to higher space rentals in airports as a result of both space increases by the Company to accommodate new flight activity and higher rates charged by those airports for gate and terminal space. A portion of these higher rates charged by airports was due to other airlines' reduced capacity, as airport costs are then allocated among a fewer number of total flights. As a consequence of this continued rate inflation at various airports, the Company currently expects Landing fees and other rentals per ASM in first quarter 2009 to be in the low .70 cents per ASM range.

Depreciation and amortization expense increased \$44 million on a dollar basis compared to 2007, and was up 3.6 percent on a per-ASM basis. The dollar increase primarily was due to the 26 new 737-700 aircraft purchased during 2008. On a per ASM basis, the increase was due to a higher proportion of the Company's 2008 growth being accomplished through owned aircraft. Prior to the sale and leaseback of five aircraft executed during December 2008, the Company had purchased the 26 new aircraft received during 2008 and had returned nine previously leased aircraft back to lessors, thereby increasing the percentage of the fleet owned. Taking into account the sale and leaseback transactions completed in December 2008 and January 2009, the Company expects an increase in depreciation expense for first quarter 2009 on a per-ASM basis compared to fourth quarter 2008, due to approximately the same number of owned aircraft spread over a reduced number of ASMs. See Note 4 to the Consolidated Financial Statements for further information on the Company's future aircraft deliveries and Note 8 for further information on the sale and leaseback transactions.

Other operating expenses increased \$105 million and were up 4.7 percent on a per-ASM basis, compared to 2007. The majority of the increases on both a dollar basis and a per ASM basis were due to an increase in revenue-related costs associated with the 11.5 percent increase in passenger revenues (such as credit card processing fees). Taking into account the reclassification of fuel taxes into "Fuel and oil" expense as noted in Note 1 to the Consolidated Financial Statements, the Company currently expects other operating expenses on a per-ASM basis for first quarter 2009 to be in the 1.50 cents range, primarily due to higher costs related to marketing and advertising initiatives.

### *Other*

"Other expenses (income)" included interest expense, capitalized interest, interest income, and other gains and losses. Interest expense increased by \$11 million, or 9.2 percent, primarily due to the Company's issuance of \$500 million Pass Through Certificates in October 2007, the Company's borrowing under its \$600 million term loan in May 2008, and its borrowing of \$400 million of the available \$600 million under its revolving credit facility in October 2008. These issuances were partially offset by declines in floating interest rates associated with the Company's floating rate debt. The Company currently expects an increase in first

## [Table of Contents](#)

quarter 2009 interest expense compared to first quarter 2008, primarily due to a higher average debt balance associated with borrowings in 2008. See Note 7 to the Consolidated Financial Statements for more information on long-term debt transactions. Capitalized interest declined 50.0 percent, or \$25 million, compared to 2007, due to a reduction in progress payment balances for scheduled future aircraft deliveries and lower interest rates. Interest income decreased \$18 million, or 40.9 percent, primarily due to a decrease in average rates earned on invested cash and short-term investment balances. 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 the first half of 2008, 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 did not qualify for SFAS 133 hedge accounting, as commodity prices rose during that period. During the second half of 2008, when commodity prices fell, the Company recorded significant losses from hedge ineffectiveness and derivatives not qualifying for SFAS 133 hedge accounting, thereby more than offsetting the gains previously recorded during the first half of the year. 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 did not qualify for SFAS 133 hedge accounting. The gains resulted from the increase in the fair value of the Company’s portfolio of fuel derivative instruments as commodity prices rose. The following table displays the components of “Other (gains) losses, net,” for the years ended December 31, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
	<u>(In millions)</u>	
Mark-to-market impact from fuel contracts settling in future periods — included in Other (gains) losses, net	\$ (6)	\$(219)
Ineffectiveness from fuel hedges settling in future periods — included in Other (gains) losses, net	106	(51)
Realized ineffectiveness and mark-to-market (gains) or losses — included in Other (gains) losses, net	(80)	(90)
Premium cost of fuel contracts included in Other (gains) losses, net	69	58
Other	3	10
	<u>\$ 92</u>	<u>\$(292)</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 35.9 percent in 2008 from 39.0 percent in 2007. The lower 2008 rate included an \$12 million (\$.01 per share, diluted) net reduction related to the first quarter 2008 reversal of a 2007 revision in Illinois income tax laws. The 2007 rate included an \$11 million addition to taxes from the enactment of the Illinois tax law. The Company currently expects its 2009 effective tax rate to be between 37 and 38 percent.

### ***2007 Compared With 2006***

The Company’s profit of \$645 million (\$.84 per share, diluted) in 2007 was an increase of \$146 million, or 29.3 percent, compared to its 2006 net income of \$499 million (\$.61 per share, diluted). However, the Company’s net profit results in both 2007 and 2006 included 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, the Company believes operating income provides a better indication of its financial

## [Table of Contents](#)

performance for both 2007 and 2006 than does net income. The Company's 2007 operating income was \$791 million, a decrease of \$143 million, or 15.3 percent, compared to 2006. The decrease in operating income primarily was driven 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, including fuel-related taxes, increased from \$1.64 in 2006 to \$1.80 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 higher than \$2.85 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 primarily was 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.

Consolidated freight revenues decreased \$4 million, or 3.0 percent, versus 2006. A \$10 million, or 8.5 percent, increase in freight revenues, primarily resulting 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. "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.

### *Operating Expenses*

Consolidated operating expenses for 2007 increased \$918 million, or 11.3 percent, compared to a 7.5 percent increase in capacity. Historically, except for changes in the price of fuel, changes in operating expenses for airlines are typically driven by changes in capacity, or ASMs. The following presents the Company'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	<u>3.22¢</u>	<u>3.29¢</u>	<u>(.07)¢</u>	<u>(2.1)%</u>
Fuel and oil	<u>2.70</u>	<u>2.47</u>	<u>.23</u>	<u>9.3</u>
Maintenance materials and repairs	<u>.62</u>	<u>.51</u>	<u>.11</u>	<u>21.6</u>
Aircraft rentals	<u>.16</u>	<u>.17</u>	<u>(.01)</u>	<u>(5.9)</u>
Landing fees and other rentals	<u>.56</u>	<u>.53</u>	<u>.03</u>	<u>5.7</u>
Depreciation and amortization	<u>.56</u>	<u>.56</u>	<u>—</u>	<u>—</u>
Other	<u>1.28</u>	<u>1.27</u>	<u>.01</u>	<u>0.8</u>
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 due to the increase in fuel expense, net of gains from the

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## Table of Contents

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 intensified its focus on controlling non-fuel costs and continued 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 December 31, 2006 level of 68. From the end of 2003 to the end of 2007, the Company's headcount per aircraft decreased 22 percent, as it implemented various technology improvements, which improved efficiency and enabled the Company to grow capacity without a commensurate increase in headcount.

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 primarily was due to a 5.2 percent headcount increase, and the dollar decrease in benefits primarily was due 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 14 for further information on share-based compensation.

Fuel and oil expense increased \$406 million, and on a per-ASM basis increased 9.3 percent versus 2006. Approximately 55 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 9.8 percent versus 2006. The average cost per gallon of jet fuel in 2007 was \$1.80 compared to \$1.64 in 2006, including 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 and a significant number of its 737-300 aircraft.

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 2006. 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.

Aircraft rentals expense per ASM decreased 5.9 percent and, on a dollar basis, decreased slightly. The decrease per ASM primarily was due to the fact that the Company increased overall ASMs by 7.5 percent,

## [Table of Contents](#)

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.

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 primarily was due 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 primarily was 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 primarily was due to 37 new 737-700 aircraft purchased during 2007. See Note 4 to the Consolidated Financial Statements for further information on the Company's future aircraft deliveries.

Other operating expenses increased \$100 million but were relatively flat on a per-ASM basis, compared to 2006. On a dollar basis, over 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 over 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.

### **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. 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:

	<u>2007</u>	<u>2006</u>
	(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)
	<u>\$(292)</u>	<u>\$151</u>

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

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## [Table of Contents](#)

### *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. As a result of the January 2008 reversal of the 2007 Illinois tax law change, the Company reversed the previously mentioned \$11 million net charge during first quarter 2008.

### **Liquidity And Capital Resources**

Net cash used in operating activities was \$1.5 billion in 2008 compared to \$2.8 billion provided by operations in 2007. 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. Operating cash flows over the past three years have also been significantly impacted by the Company's fuel hedge positions and the significant fluctuation in fair value of those positions. During 2006, 2007, and the first ten months of 2008, the value of the Company's fuel derivative instruments was positive, resulting in the Company holding counterparty cash deposits — at times significant amounts. These cash deposits held were reflected as an increase to Cash and a corresponding increase to Accrued liabilities. In the Consolidated Statement of Cash Flows, increases and/or decreases to these cash deposits have been reflected in operating cash flows within the changes to "Accounts payable and accrued liabilities" line item. In late 2008, the net fair value of fuel derivative instruments held became a liability, requiring the Company to post cash collateral with a counterparty. As of December 31, 2008, the amount of cash posted with this counterparty was \$240 million, and is reflected as a decrease to Cash and a corresponding increase to "Prepaid expenses and other current assets." Increases or decreases to cash deposits posted to counterparties are reflected in operating cash flows within the changes to "Other current assets" line item. Since the amount of cash collateral deposits held by the Company at December 31, 2007 was \$2.0 billion, the net change in cash deposits for 2008 was a net operating outflow of \$2.2 billion. This compares to an increase in counterparty deposits (operating inflow) of \$1.5 billion for 2007. 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 (in conjunction with rising energy prices). Cash flows associated with purchasing derivatives, which are also classified as operating cash flows, were a net outflow of \$418 million in 2008, but were immaterial for 2007. Cash flows from operating activities for 2008 were also driven by the \$178 million in net income, plus noncash depreciation and amortization expense of \$599 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. Operating cash generated primarily is used to finance aircraft-related capital expenditures and to provide working capital.

Net cash flows used in investing activities in 2008 totaled \$978 million, versus \$1.5 billion used in 2007. 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 26 new 737-700 aircraft in 2008 versus the purchase of 37 737-700s in 2007. See Note 4 to the Consolidated Financial Statements. Investing activities for 2008 and 2007 were also reduced by \$55 million and \$198 million, respectively, related to changes in the balance of the Company's short-term investments.

Net cash provided by financing activities was \$1.7 billion in 2008. During 2008, the Company borrowed \$600 million under a Term Loan Agreement, borrowed \$400 million under its revolving credit facility, sold \$400 million of Secured Notes, and raised approximately \$173 million from a sale and leaseback transaction involving five of the Company's 737-700 aircraft. The Company also received \$117 million in proceeds from Employees' exercise of stock options and \$91 million from a credit line borrowing. These inflows were partially offset by the Company's repurchase of \$54 million of its Common Stock, representing a total of 4.4 million shares. Net cash used in financing activities was \$493 million in 2007, primarily from the Company's repurchase of \$1.0 billion of its common stock. The Company repurchased a total of 66 million shares of outstanding common

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## [Table of Contents](#)

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. See Note 7 to the Consolidated Financial Statements for more information on the issuance and redemption of long-term debt.

The Company recently amended one of its counterparty agreements, and the amendment became effective in January 2009. This amendment significantly reduced the Company's current exposure to cash collateral requirements. Previously, if the Company became obligated to post collateral as security for its potential obligations under the agreement, all such collateral was required to be cash. Under the amendment, until January 1, 2010, if the Company becomes obligated to post collateral for obligations in amounts of up to \$300 million and in excess of \$700 million, the Company will continue to be required to post cash collateral; however, if the Company becomes obligated to post collateral for obligations in amounts between \$300 million and \$700 million, the Company has pledged 20 of its Boeing 737-700 aircraft as collateral in lieu of cash.

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

The Company has contractual obligations and commitments primarily with regard to future purchases of aircraft, payment of debt, and lease arrangements. The Company received 26 Boeing 737-700 aircraft in 2008, all of which were new aircraft from Boeing. Three additional Boeing 737-700 aircraft were scheduled to be received during 2008; however, due to a strike by machinists at Boeing during the second half of the year, these aircraft were deferred until 2009. The Company also retired nine of its older leased 737-300 aircraft during 2008 and executed a sale and leaseback transaction for five of its owned 737-700 aircraft. Due to the collapse of the credit market in 2008 and the severe economic recession, the Company evaluated its future aircraft needs based on a projected decline in demand for air travel. This led the Company to revise its future firm commitments for new aircraft from Boeing. As of December 31, 2008, the Company had reduced its firm orders to a total of 99 737-700 aircraft for the years 2009 through 2016. The Company also had reduced its options to 67 737-700 aircraft from 2010 through 2015, with an additional 54 purchase rights for 737-700 aircraft through 2018 as set forth in Note 4 to the Consolidated Financial Statements. In January 2009, the Company further revised its firm orders to 104 737-700 aircraft and its options to 62 737-700 aircraft as set forth in "Part I, Item 2" of this filing. 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 (including the sale and leaseback 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 leased aircraft, and retains the risk of loss for these 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. As of December 31, 2008, the Company operated 91 leased aircraft, of which 82 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 are off-balance sheet, the majority of obligations to which they relate are reflected as liabilities in the Consolidated Balance Sheet. Outstanding letters of credit totaled \$222 million at December 31, 2008.

## Table of Contents

The following table aggregates the Company's material expected contractual obligations and commitments as of December 31, 2008:

Contractual obligations	Obligations by period (in millions)				
	2009	2010 - 2011	2012 - 2013	Beyond 2013	Total
Long-term debt (1)	\$ 58	\$ 1,028	\$ 523	\$ 1,879	\$ 3,488
Interest commitments (2)	188	376	271	668	1,503
Capital lease commitments (3)	16	27	—	—	43
Operating lease commitments	376	573	355	728	2,032
Aircraft purchase commitments (4)	393	937	1,135	769	3,234
Other purchase commitments	50	117	52	—	219
<b>Total contractual obligations</b>	<b>\$ 1,081</b>	<b>\$ 3,058</b>	<b>\$ 2,336</b>	<b>\$ 4,044</b>	<b>\$ 10,519</b>

- (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

In addition to the above contractual fixed obligations, the Company also had estimated obligations at December 31, 2008, related to its fuel derivative positions for the years 2009 through 2013 (based on the contractual settlement date of those derivative instruments). Although the fair value of these positions can fluctuate significantly based on forward market prices for crude oil, heating oil, and unleaded gasoline, the following table displays these estimated obligations as of December 31, 2008 (in millions):

	2009	2010	2011	2012	2013	Total
Fuel derivative obligations	\$ 246	\$ 239	\$ 236	\$ 146	\$ 125	\$ 992

Available to the Company at December 31, 2008, was cash on hand and short-term investments totaling \$1.8 billion, present and future internally generated funds, and \$200 million remaining under its \$600 million bank revolving line of credit. The Company's October 2008 \$400 million borrowing under its revolving credit facility is being used for general corporate purposes and was done in order to enhance the Company's liquidity as a result of the current instability of the credit market. Unless extended or renewed, the revolving credit facility expires and would require full repayment by August 2010. Subsequent to December 31, 2008, the Company executed the second tranche of a sale and leaseback transaction generating approximately \$173 million in cash for the Company. In addition, the Company will also consider various borrowing or leasing options to maximize earnings and supplement cash requirements. Notwithstanding current economic conditions and the current liquidity environment, the Company believes it has access to financing arrangements because of its current investment grade credit ratings, unencumbered assets, modest leverage, and consistent profitability, which should enable it to meet its 2009 capital and operating requirements. However, given the current environment, interest rates on borrowing are significantly higher than levels experienced in recent history. As of December 31, 2008, the book value of the Company's unencumbered aircraft totaled approximately \$7.5 billion.

Standard & Poor's and Fitch both recently downgraded the Company's credit rating from "A-" to "BBB+" based on the volatility of fuel prices, current economic conditions, and a more negative assessment of the long-term fundamentals of the U.S. airline industry. While the Company's credit rating remains "investment grade," as defined, the lower rating will likely result in a slight increase in its borrowing costs on a prospective basis. Moody's has also recently reaffirmed the Company's "Baa1" rating, which is also considered "investment grade."

In 2006 and 2007, the Company's Board of Directors authorized five separate programs for the

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## [Table of Contents](#)

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 have been and 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. The Company repurchased 4.4 million shares for a total of \$54 million as part of this program through February 15, 2008; however, the Company has not repurchased any additional shares from that date through the date of this filing. The Company does not believe it is prudent to repurchase shares at the current time considering today's unstable financial markets and volatile fuel prices.

### **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, 2008 was \$963 million, compared to \$931 million as of December 31, 2007.

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 2008 would have resulted in a \$21 million, or .2 percent, 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

## [Table of Contents](#)

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 the years 2008, 2007, or 2006.

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, 2008, the Company had approximately \$15.9 billion (at cost) of long-lived assets, including \$13.7 billion (at cost) in flight equipment and related assets. Flight equipment primarily relates to the 455 Boeing 737 aircraft in the Company’s fleet at December 31, 2008, which are either owned or on capital lease. The remaining 82 Boeing 737 aircraft in the Company’s fleet at December 31, 2008, 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:

	<u>Estimated Useful Life</u>	<u>Estimated Residual value</u>
Aircraft and engines	23 to 25 years	10%-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, current and projected future market information, 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, the company 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

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## [Table of Contents](#)

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, 2008, the Company was a party to over 536 financial derivative instruments, related to its fuel hedging program, for the years from 2009 through 2013. The fair value of the Company's fuel hedging financial derivative instruments recorded on the Company's Consolidated Balance Sheet as of December 31, 2008, was a net liability of \$992 million, compared to an asset of \$2.4 billion at December 31, 2007. The large decrease in fair value primarily was due to the significant decrease in energy prices in the fourth quarter of 2008, net of the expiration (i.e., settlement in which the Company received cash proceeds) of approximately \$1.3 billion in fuel derivative instruments that related to 2008 and net of new derivative instruments the Company added for future years. Of the \$992 million liability in fair value of fuel hedging financial derivative instruments at December 31, 2008, approximately \$246 million is expected to settle, or expire during 2009. Changes in the fair values of these instruments can vary dramatically, as was evident during 2008, based on changes in the underlying commodity prices. During 2008, market "spot" prices for crude oil peaked at a high of over \$147 per barrel and hit a low price of under \$35 per barrel—both within a period of approximately five months. 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. Based on these updates, in certain prior periods, the Company has in fact lost SFAS 133 hedge accounting for all unleaded gasoline derivative instruments. At such times, the Company has marked all such derivatives to market value in each quarterly period, with all changes in value reflected as a component of "Other (gains) losses, net" in the Consolidated Statement of Income. Although

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## Table of Contents

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 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 in recent years, primarily due to these reasons. Depending on the level at which the Company is hedged at any point in time, as the fair value of the Company's hedge positions fluctuate in amount from period to period, there could be continued variability recorded in the income statement, and furthermore, the amount of hedge ineffectiveness and unrealized gains or losses recorded in earnings may be material. This is primarily because small differences in the correlation of crude oil related products could be leveraged over large dollar volumes.

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. The current methodology used by the Company in forecasting forward jet fuel prices is primarily based on the idea 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 methodology for estimating future cash flows (i.e., jet fuel prices) has been consistently applied during 2008, 2007, and 2006, in accordance with the Company's interpretation of SFAS 133. The Company also has not changed its method for either assessing or measuring hedge ineffectiveness during these periods.

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## [Table of Contents](#)

At times, the Company also utilizes financial derivative instruments in the form of interest rate swap agreements. Prior to 2008, the Company had entered into 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 primary objective for the Company's use of these interest rate hedges was to reduce the volatility of net interest income by better matching the repricing of its assets and liabilities. These 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.

During 2008, the Company entered into an interest rate swap agreement concurrent with its entry into a twelve-year, \$600 million floating-rate Term Loan Agreement. Under this swap agreement, which is accounted for as a cash flow hedge, the interest rate on the term loan is essentially fixed for its entire term at 5.223 percent and ineffectiveness is required to be measured each reporting period.

The fair values of the Company's interest rate swap agreements are adjusted regularly and are recorded in the Consolidated Balance Sheet. If the interest rate hedge is accounted for as a fair value hedge, the corresponding offsetting adjustment is to the carrying value of the long-term debt. For the interest rate hedge accounted for as a cash flow hedge, the corresponding offsetting adjustment is to "Accumulated other comprehensive income (loss)", net of appropriate taxes. The total fair value of all interest rate swap agreements, excluding accrued interest, at December 31, 2008, was an asset of approximately \$81 million. The total fair value of the swap agreements held at December 31, 2007, was an asset of \$16 million. 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 previously awarded share-based compensation pursuant to 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 Chairman Emeritus of the Company.

The Company accounts for share-based compensation in accordance with SFAS No. 123R, "Share-Based Payment," which 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. 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. In estimating expected stock price volatility at the time of a particular stock option grant, the Company relies 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 2008, 2007, and 2006 option grants, the Company has consistently utilized a weighted-average approach that calculates expected volatility using two-thirds implied volatility and one-third historical volatility. 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

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## [Table of Contents](#)

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 grants to other Employees, 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.

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.

### ***Fair value measurements***

The Company adopted the provisions of Statement of Financial Accounting Standards No. 157 (SFAS 157) effective January 1, 2008. The Company has determined that it utilizes unobservable (Level 3) inputs in determining the fair value of certain assets and liabilities. At December 31, 2008, these included auction rate security investments, valued at \$200 million, a portion of its fuel derivative option contracts, which were a net liability of \$864 million, and \$8 million in other investments.

All of the Company's auction rate security instruments are reflected at estimated fair value in the Consolidated Balance Sheet. At December 31, 2008, approximately \$109 million of these instruments are classified as available for sale securities and \$91 million are classified as trading securities. In prior periods, due to the auction process which took place every 30-35 days for most securities, quoted market prices were readily available, which would have qualified as Level 1 under SFAS 157. However, due to events in credit markets beginning during first quarter 2008, the auction events for most of these instruments failed, and, therefore, the Company has determined the estimated fair values of these securities utilizing a discounted cash flow analysis or other type of valuation model as of December 31, 2008. In addition, the Company obtained an independent valuation of a selected number of auction rate security instruments and has considered these valuations in determining estimated fair values of other similar instruments within its portfolio. The Company's analyses consider, among other items, the collateralization underlying the security investments, the expected future cash flows, including the final maturity, associated with the securities, and estimates of the next time the security is expected to have a successful auction or return to full par value. These securities were also compared, when possible, to other securities not owned by the Company, but with similar characteristics. Due to these events, the Company reclassified these instruments as Level 3 during first quarter 2008.

In association with this estimate of fair value, the Company has recorded a temporary unrealized decline in fair value of \$11 million, with an offsetting entry to "Accumulated other comprehensive income (loss)." Given the quality and backing of the Company's auction rate securities held, the fact that the Company has not yet recorded a loss on the sale of any of these instruments, and the fact that it has been able to periodically sell instruments in the periodic auction process, it believes it can continue to account for the estimated reduction in fair value of its remaining securities as temporary. These conclusions will also continue to be evaluated and challenged in subsequent periods. The Company currently believes that this temporary decline in fair value is due entirely to liquidity issues, because the underlying assets for the majority of securities are almost entirely backed by the U.S. Government. In addition, for the \$109 million in instruments classified as available for sale, these auction rate securities represented approximately six percent of the Company's total cash, cash equivalent, and investment balance at December 31, 2008, which it believes allows it sufficient time for the securities to return to full value. For the \$91 million in instruments classified as trading securities, the Company has entered into an agreement with the counterparty that allows the Company to put the

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## Table of Contents

instruments back to the counterparty at full par value in June 2010. As part of this agreement, the Company has entered into a line of credit in which it has received a \$91 million loan that is secured by the auction rate security instruments from that counterparty. At the time of the first failed auctions during first quarter 2008, the Company held a total of \$463 million in securities. Since that time, the Company has been able to sell \$252 million of these instruments at par value, in addition to the \$91 million subject to the agreement to be sold at par in June 2010. The Company is also in discussions with other counterparties to determine whether mutually agreeable decisions can be reached regarding the effective repurchase of its remaining securities.

The Company determines the value of fuel derivative option contracts utilizing a standard option pricing model based on inputs that are either readily available in public markets, can be derived from information available in publicly quoted markets, or are quoted by its counterparties. In situations where the Company obtains inputs via quotes from its counterparties, it verifies the reasonableness of these quotes via similar quotes from another counterparty as of each date for which financial statements are prepared. The Company has consistently applied these valuation techniques in all periods presented and believes it has obtained the most accurate information available for the types of derivative contracts it holds. Due to the fact that certain inputs used in determining estimated fair value of its option contracts are considered unobservable (primarily volatility), as defined in SFAS 157, the Company has categorized these option contracts as Level 3.

As discussed in Note 10 to the consolidated financial statements, any changes in the fair values of fuel derivative instruments are subject to the requirements of SFAS 133. Any changes in fair value of cash flow hedges that are considered to be effective, as defined, are offset within "Accumulated other comprehensive income (loss)" until the period in which the expected cash flow impacts earnings. Any changes in the fair value of fuel derivatives that are ineffective, as defined, or do not qualify for special hedge accounting, are reflected in earnings within "Other (gains)/losses, net", in the period of the change. Because the Company has extensive historical experience in valuing the derivative instruments it holds, and such experience is continually evaluated against its counterparties each period when such instruments expire and are settled for cash, the Company believes it is unlikely that an independent third party would value the Company's derivative contracts at a significantly different amount than what is reflected in the Company's financial statements. In addition, the Company also has bilateral credit provisions in some of its counterparty agreements, which provide for parties (or the Company) to provide cash collateral when the fair values of fuel derivatives with a single party exceeds certain threshold levels. Since this cash collateral is based on the estimated fair value of the Company's outstanding fuel derivative contracts, this provides further validation to the Company's estimate of fair values.

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

The Company has interest rate risk in its floating rate debt obligations and interest rate swaps, commodity price risk in jet fuel required to operate its aircraft fleet, and market risk in the derivatives used to manage its fuel hedging program. The Company purchases jet fuel at prevailing market prices, but seeks to manage market risk through execution of a documented hedging strategy. The Company 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 91 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 the potential for significant increases in fuel prices. The Company believes there is significant risk in not hedging against the possibility of such fuel price increases.

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## [Table of Contents](#)

The Company expects to consume approximately 1.5 billion gallons of jet fuel in 2009. 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.

As of December 31, 2008, the Company held a net position of fuel derivative instruments that effectively represented a hedge of approximately ten percent of its anticipated jet fuel purchases for each year from 2009 through 2013. Prior to fourth quarter 2008, the Company had held fuel derivative instruments for a much larger portion of its anticipated fuel purchases for these years; however, due to the recent precipitous decline in fuel prices, the Company significantly reduced its hedge in order to minimize fuel hedging losses related to further oil price declines and to minimize the potential for the Company to provide additional cash collateral deposits to counterparties. The Company accomplished this reduced hedge by entering into additional derivative contracts—through selling primarily fixed-price swap derivatives. The Company believes this strategy enables it to participate in further price declines via the sold derivatives, which should materially offset further declines in value of the Company's previously purchased derivatives. The total net fair value of outstanding financial derivative instruments related to the Company's jet fuel market price risk at December 31, 2008, was a net liability of \$992 million. The current portion of these financial derivative instruments, or \$246 million, is classified as a component of "Accrued liabilities" in the Consolidated Balance Sheet. The long-term portion of these financial derivative instruments, or \$746 million, is included in "Other deferred liabilities." 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, 2008 (for all years from 2009 through 2013), prices would correspondingly change the fair value of the commodity derivative instruments in place by up to approximately \$90 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, 2008, levels, except underlying futures prices.

The Company's credit exposure related to fuel derivative instruments is represented by the fair value of contracts with a net positive fair value to the Company at the reporting date. At such times, these outstanding instruments expose the Company to credit loss in the event of nonperformance by the counterparties to the agreements. However, in such cases, the Company does not expect any of the counterparties to fail to meet their obligations and has not experienced any significant credit loss as a result of counterparty nonperformance in the past. 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. However, if one or more of these counterparties were in a liability position to the Company and were unable to meet their obligations, any open derivative contracts with the counterparty could be subject to early termination, which could result in substantial losses for the Company. At December 31, 2008, the Company had agreements with eight counterparties containing early termination rights and/or bilateral collateral provisions whereby security is required if market risk exposure exceeds a specified threshold amount or credit ratings fall below certain levels. As of December 31, 2008, the Company had active portfolios with three of these counterparties. Based on the Company's current investment grade credit rating, for one counterparty, these collateral provisions require cash deposits to be posted whenever the net fair value of derivatives associated with that counterparty exceed a specific threshold—cash is either posted by the counterparty if the value of derivatives is an asset to the Company, or posted by the Company if the value of derivatives is a liability to the Company.

During fourth quarter 2008, the modification of the Company's fuel hedge portfolio, in combination with the amendment to one of the Company's counterparty agreements that became effective in January 2009, significantly reduced the Company's current exposure to cash collateral requirements. Prior to the amendment, if the Company became

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## [Table of Contents](#)

obligated to post collateral as security for its potential obligations under this counterparty agreement, all such collateral was required to be cash. Under the agreement, as amended, until January 1, 2010, if the Company becomes obligated to post collateral for obligations in amounts of up to \$300 million and in excess of \$700 million, the Company will continue to be required to post cash collateral; however, if the Company becomes obligated to post collateral for obligations in amounts between \$300 million and \$700 million, the Company has pledged 20 of its Boeing 737-700 aircraft as collateral in lieu of cash. As of January 20, 2009, assuming no changes to the Company's current net fuel hedge position, the forward market price of crude oil would have to fall to approximately \$10 per barrel for each year from 2009 to 2013 before the Company would exceed the \$700 million threshold that would require additional cash collateral beyond the initial \$300 million level.

At December 31, 2008, the Company had posted \$240 million in cash collateral deposits with a counterparty under these bilateral collateral provisions. The deposits are classified as a component of "Prepaid expenses and other current assets" in 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 under the right conditions. While the Company uses financial leverage, it has maintained a strong balance sheet and a "BBB+" rating with Fitch and Standard & Poor's, and a "Baa1" credit rating with Moody's as of December 31, 2008. 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.

## [Table of Contents](#)

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, 2008 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 following table displays the characteristics of the Company's secured fixed rate debt as of December 31, 2008:

	Principal amount (in millions)	Effective fixed rate	Final maturity	Underlying collateral
Secured Notes	\$ 400	10.500%	12/15/2011	17 specified Boeing 737-700 aircraft
Pass Through Certificates	500	6.240%	8/1/2022	16 specified Boeing 737-700 aircraft
Term Loan Agreement	600	5.223%	5/9/2020	21 specified Boeing 737-700 aircraft

The carrying value of the Company's floating rate debt totaled \$1.4 billion, and this debt had a weighted-average maturity of 6.9 years at floating rates averaging 4.0 percent for the twelve months ended December 31, 2008. In total, the Company's fixed rate debt and floating rate debt represented 14.7 percent and 12.3 percent, respectively, of total noncurrent assets at December 31, 2008.

The Company also has some risk associated with changing interest rates due to the short-term nature of its invested cash, which totaled \$1.4 billion, and short-term investments, which totaled \$435 million, at December 31, 2008. 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, depending on market conditions and operating cash requirements. However, as a result of recent turmoil in credit markets, the Company has discontinued further investments in auction rate securities. 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, 2008, 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 held, if applicable), and short-term investments because of the floating-rate nature of these items. Assuming floating market rates in effect as of December 31, 2008, 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 the impact of cash collateral deposits held or provided to counterparties, if applicable), short-term investments, and floating-rate debt outstanding at December 31, 2008, an increase in rates would have a net negative effect on the Company's earnings and cash flows, while a decrease in rates would have a net positive 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 a financial covenant included in its revolving credit facility, and is subject to credit rating triggers related to its credit card transaction processing agreements, its outstanding debt agreements, and some of its hedging counterparty agreements. Certain covenants include the maintenance of minimum credit ratings and/or triggers that are based on changes in these ratings. For the revolving credit facility, of which \$400 million of the available \$600 million had been drawn as of December 31, 2008, the Company must also maintain, at all times, a Coverage Ratio, as defined in the agreement, of not less than 1.25 to 1.00. The Company met this condition as of December 31, 2008. However, if conditions change and the Company fails to meet the minimum standards set forth in the agreement, there could be a reduction in

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## [Table of Contents](#)

the availability of cash under the agreement, or an increase in the costs to keep the agreement intact as written. Two of the Company's hedging counterparty agreements contain ratings triggers in which cash collateral would be required to be posted with the counterparty if the Company's credit rating falls below investment grade by two of the three major rating agencies. As of December 31, 2008, there was no cash posted with these counterparties. Given the Company's net fuel hedge liability with these counterparties at December 31, 2008, and assuming its credit rating were below investment grade as of that date, the Company would have been required to post approximately \$700 million in cash collateral deposits with the counterparties. However, these cash collateral deposit requirements would be correspondingly reduced as the underlying fuel derivative instruments settle—including by approximately \$244 million in 2009.

The Company currently has processing agreements with organizations that process credit card transactions arising from purchases of air travel tickets by its Customers utilizing American Express, Discover and MasterCard/VISA. Credit card processors have financial risk associated with tickets purchased for travel because, although the processor generally forwards the cash related to the purchase to the Company soon after the purchase is completed, the air travel generally occurs after that time, and the processor would have liability if the Company does not ultimately provide the air travel. Under these processing agreements, and based on specified conditions, increasing amounts of cash reserves could be required to be posted with the counterparty.

A majority of the Company's sales transactions are processed by Chase Paymentech. Should chargebacks processed by Chase Paymentech reach a certain level, proceeds from advance ticket sales could be held back and used to establish a reserve account to cover such chargebacks and any other disputed charges that might occur. Additionally, cash reserves are required to be established if the Company's credit rating falls to specified levels below investment grade. Cash reserve requirements are based on the Company's public debt rating and a corresponding percentage of the Company's "Air traffic liability."

As of December 31, 2008 the Company was in compliance with all credit card processing agreements. However, the inability to enter into credit card processing agreements would have a material adverse effect on the business of the Company. The Company believes that it will be able to continue to renew its existing credit card processing agreements or will be able to enter into new credit card processing agreements with other processors in the future.

[Table of Contents](#)Item 8. *Financial Statements and Supplementary Data*SOUTHWEST AIRLINES CO.  
CONSOLIDATED BALANCE SHEET

	December 31,	
	2008	2007
	(In millions, except share data)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,368	\$ 2,213
Short-term investments	435	566
Accounts and other receivables	209	279
Inventories of parts and supplies, at cost	203	259
Fuel derivative contracts	—	1,069
Deferred income taxes	365	—
Prepaid expenses and other current assets	3 13	57
Total current assets	<u>2,893</u>	<u>4,443</u>
Property and equipment, at cost:		
Flight equipment	13,722	13,019
Ground property and equipment	1,769	1,515
Deposits on flight equipment purchase contracts	380	626
	<u>15,871</u>	<u>15,160</u>
Less allowance for depreciation and amortization	<u>4,831</u>	<u>4,286</u>
	<u>11,040</u>	<u>10,874</u>
Other assets	375	1,455
	<u>\$14,308</u>	<u>\$16,772</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 668	\$ 759
Accrued liabilities	1,012	3,107
Air traffic liability	963	931
Current maturities of long-term debt	163	41
Total current liabilities	<u>2,806</u>	<u>4,838</u>
Long-term debt less current maturities	3,498	2,050
Deferred income taxes	1,904	2,535
Deferred gains from sale and leaseback of aircraft	105	106
Other deferred liabilities	1,042	302
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$1.00 par value; 2,000,000,000 shares authorized; 807,611,634 shares issued in 2008 and 2007	808	808
Capital in excess of par value	1,215	1,207
Retained earnings	4,919	4,788
Accumulated other comprehensive income (loss)	(984)	1,241
Treasury stock, at cost: 67,619,062 and 72,814,104 shares in 2008 and 2007, respectively	<u>(1,005)</u>	<u>(1,103)</u>
Total stockholders' equity	<u>4,953</u>	<u>6,941</u>
	<u>\$14,308</u>	<u>\$16,772</u>

See accompanying notes.

[Table of Contents](#)

**SOUTHWEST AIRLINES CO.**  
**CONSOLIDATED STATEMENT OF INCOME**

	Years Ended December 31,		
	2008	2007	2006
	(In millions, except per share amounts)		
<b>OPERATING REVENUES:</b>			
Passenger	\$ 10,549	\$ 9,457	\$ 8,750
Freight	145	130	134
Other	329	274	202
Total operating revenues	<u>11,023</u>	<u>9,861</u>	<u>9,086</u>
<b>OPERATING EXPENSES:</b>			
Salaries, wages, and benefits	3,340	3,213	3,052
Fuel and oil	3,713	2,690	2,284
Maintenance materials and repairs	721	616	468
Aircraft rentals	154	156	158
Landing fees and other rentals	662	560	495
Depreciation and amortization	599	555	515
Other operating expenses	1,385	1,280	1,180
Total operating expenses	<u>10,574</u>	<u>9,070</u>	<u>8,152</u>
<b>OPERATING INCOME</b>	449	791	934
<b>OTHER EXPENSES (INCOME):</b>			
Interest expense	130	119	128
Capitalized interest	(25)	(50)	(51)
Interest income	(26)	(44)	(84)
Other (gains) losses, net	92	(292)	151
Total other expenses (income)	<u>171</u>	<u>(267)</u>	<u>144</u>
<b>INCOME BEFORE INCOME TAXES</b>	278	1,058	790
<b>PROVISION FOR INCOME TAXES</b>	100	413	291
<b>NET INCOME</b>	<u>\$ 178</u>	<u>\$ 645</u>	<u>\$ 499</u>
<b>NET INCOME PER SHARE, BASIC</b>	<u>\$ .24</u>	<u>\$ .85</u>	<u>\$ .63</u>
<b>NET INCOME PER SHARE, DILUTED</b>	<u>\$ .24</u>	<u>\$ .84</u>	<u>\$ .61</u>

See accompanying notes.

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

	Years Ended December 31, 2008, 2007, and 2006					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, 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
<b>Purchase of shares of treasury stock</b>	—	—	—	—	(54)	(54)
<b>Issuance of common and treasury stock pursuant to Employee stock plans</b>	—	—	(34)	—	152	118
<b>Tax benefit of options exercised</b>	—	(10)	—	—	—	(10)
<b>Share-based compensation</b>	—	18	—	—	—	18
<b>Cash dividends, \$.018 per share</b>	—	—	(13)	—	—	(13)
<b>Comprehensive income (loss)</b>						
Net income	—	—	178	—	—	178
Unrealized (loss) on derivative instruments	—	—	—	(2,166)	—	(2,166)
Other	—	—	—	(59)	—	(59)
Total comprehensive income (loss)						(2,047)
Balance at December 31, 2008	<u>\$ 808</u>	<u>\$ 1,215</u>	<u>\$ 4,919</u>	<u>\$ (984)</u>	<u>\$(1,005)</u>	<u>\$ 4,953</u>

See accompanying notes.

[Table of Contents](#)

**SOUTHWEST AIRLINES CO.**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**

	Years Ended December 31,		
	2008	2007 (In millions)	2006
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income	\$ 178	\$ 645	\$ 499
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	599	555	515
Deferred income taxes	56	328	277
Amortization of deferred gains on sale and leaseback of aircraft	(12)	(14)	(16)
Share-based compensation expense	18	37	80
Excess tax benefits from share-based compensation arrangements	—	(28)	(60)
Changes in certain assets and liabilities:			
Accounts and other receivables	71	(38)	(5)
Other current assets	(384)	(229)	87
Accounts payable and accrued liabilities	(1,853)	1,609	(223)
Air traffic liability	32	131	150
Other, net	(226)	(151)	102
Net cash provided by (used in) operating activities	<u>(1,521)</u>	<u>2,845</u>	<u>1,406</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchases of property and equipment, net	(923)	(1,331)	(1,399)
Purchases of short-term investments	(5,886)	(5,086)	(4,509)
Proceeds from sales of short-term investments	5,831	4,888	4,392
Debtor in possession loan to ATA Airlines, Inc.	—	—	20
Other, net	—	—	1
Net cash used in investing activities	<u>(978)</u>	<u>(1,529)</u>	<u>(1,495)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Issuance of long-term debt	1,000	500	300
Proceeds from credit line borrowing	91	—	—
Proceeds from revolving credit agreement	400	—	—
Proceeds from sale and leaseback transactions	173	—	—
Proceeds from Employee stock plans	117	139	260
Payments of long-term debt and capital lease obligations	(55)	(122)	(607)
Payments of cash dividends	(13)	(14)	(14)
Repurchase of common stock	(54)	(1,001)	(800)
Excess tax benefits from share-based compensation arrangements	—	28	60
Other, net	(5)	(23)	—
Net cash provided by (used in) financing activities	<u>1,654</u>	<u>(493)</u>	<u>(801)</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>(845)</b>	<b>823</b>	<b>(890)</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>	<b>2,213</b>	<b>1,390</b>	<b>2,280</b>
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b><u>\$ 1,368</u></b>	<b><u>\$ 2,213</u></b>	<b><u>\$ 1,390</u></b>
<b>SUPPLEMENTAL DISCLOSURES</b>			
Cash payments for:			
Interest, net of amount capitalized	\$ 100	\$ 63	\$ 78
Income taxes	\$ 71	\$ 94	\$ 15

See accompanying notes.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2008**

**1. Summary of Significant Accounting Policies**

***Basis of Presentation***

Southwest Airlines Co. (the Company) is a major domestic airline that provides point-to-point, low-fare service. The Consolidated Financial Statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated. The preparation of financial statements in conformity with generally accepted accounting principles 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.

Certain prior period amounts have been reclassified to conform to the current presentation. In the Consolidated Statement of Income for the years ended December 31, 2007 and 2006, jet fuel sales taxes and jet fuel excise taxes are both presented as a component of "Fuel and oil" instead of being included in "Other operating expenses" as previously presented. For the years ended December 31, 2007 and 2006, the Company reclassified a total of \$154 million and \$146 million, respectively, in jet fuel sales taxes and jet fuel excise taxes as a result of this change in presentation. For the year ended December 31, 2008, "Fuel and oil" includes \$187 million in jet fuel sales taxes and jet fuel excise taxes.

***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 investments with maturities of greater than three months but less than twelve months. These are primarily money market funds and investment grade commercial paper issued by major corporations and financial institutions, short-term securities issued by the U.S. Government, and certain auction rate securities with auction reset periods of less than 12 months for which auctions have been successful or are expected to be successful within the following 12 months. All of these investments are classified as available-for-sale securities and are stated at fair value, except for \$17 million in auction rate securities that are classified as trading securities as discussed in Note 11. For all short-term investments, 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 net gains on specific investments, which totaled \$13 million in 2008, \$17 million in 2007, and \$17 million in 2006, are reflected in "Interest income" in the accompanying Consolidated Statement of Income.

The Company's cash and cash equivalents and short-term investments as of December 31, 2007 included \$2.0 billion in collateral deposits received from a counterparty of the Company's fuel derivative instruments. As of December 31, 2008, the Company did not hold any cash collateral deposits from counterparties, but had \$240 million of its cash on deposit with a counterparty. Although amounts provided or held are not restricted in any way, investment earnings from these deposits generally must be remitted back to the entity that provided the deposit. Depending on the fair value of the Company's fuel derivative instruments, the amounts of collateral deposits held or provided at any point in time can fluctuate significantly. Therefore, the Company generally excludes cash collateral deposits held, but includes deposits provided, 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

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

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, 2008, 2007, and 2006 was immaterial. In addition, the provision for doubtful accounts and write-offs for 2008, 2007, and 2006 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, 2008, 2007, and 2006. In addition, the Company's provision for obsolescence and write-offs for 2008, 2007, and 2006 was 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 10 to 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 the lease. Amortization of property under capital leases is on a straight-line basis over the lease term and is included in depreciation expense.

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, and operating or cash flow losses associated with the use of the long-lived asset. Excluding the impact of cash collateral deposits with counterparties based on the fair value of the Company's fuel derivative instruments, the Company continues to experience positive cash flow associated with its aircraft fleet, and there have been no impairments of long-lived assets recorded during 2008, 2007, or 2006.

***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, 2008, and 2007, was \$12 million and \$9 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.

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

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 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 81 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 19 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 the Company 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, 2008, 2007, and 2006 was \$199 million, \$191 million, and \$182 million, respectively.

***Share-based Employee compensation***

The Company has share-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 Chairman Emeritus of the Company. The Company accounts for share-based compensation utilizing the fair value recognition provisions of SFAS No. 123R, "Share-Based Payment." See Note 14.

***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 and one floating-rate debt issuance to a fixed-rate. These interest rate hedges are accounted for as fair value hedges or as cash flow 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

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

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 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, within "Changes in certain assets and liabilities." See Note 10 for further information on SFAS 133 and financial derivative instruments.

***Software capitalization***

The Company capitalizes certain costs related to the acquisition and development of software in accordance with Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." The Company amortizes these costs using the straight-line method over the estimated useful life of the software which is generally five years.

***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.

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, 2008, the Company recorded no interest related to the settlement of audits for certain prior periods.

***Concentration Risk***

Approximately 77 percent of the Company's Employees are unionized and are covered by collective bargaining agreements. Historically, the Company has managed this risk by maintaining positive relationships with its Employees and its Employee's Representatives. The following Employee groups are under agreements that have become amendable and are currently in negotiations: Pilots, Flight Attendants, Ramp, Operations, Provisioning, and Freight Agents, Stock Clerks, and Customer Service and Reservations Agents. The Company reached a Tentative Agreement with its Mechanics during fourth quarter 2008, and the agreement was ratified by this group during January 2009. The Company's Aircraft Appearance Technicians and its Flight Dispatchers are subject to agreements that become amendable during 2009.

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. The Company also has agreements with

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

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, 2008, the Company had provided \$240 million in cash collateral deposits to one of its counterparties under these bilateral collateral provisions. The cash collateral provided to the counterparty has been recorded as a reduction to “Cash and cash equivalents” and an increase to “Prepaid expenses and other current assets.” Cash collateral deposits serve to decrease, but not totally eliminate, the credit risk associated with the Company’s hedging program. See Note 10 for further information.

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 excellent and believes the advantages of operating a single fleet type outweigh the risks of such a strategy.

**2. Recent Accounting Developments**

In March 2008, the Financial Accounting Standards Board (FASB) issued Statement No. 161, “Disclosures about Derivative Instruments and Hedging Activities — an amendment of FASB Statement No. 133” (Statement 161). Statement 161 requires entities that utilize derivative instruments to provide qualitative disclosures about their objectives and strategies for using such instruments, as well as any details of credit-risk-related contingent features contained within derivatives. Statement 161 also requires entities to disclose additional information about the amounts and location of derivatives located within the financial statements, how the provisions of SFAS 133 have been applied, and the impact that hedges have on an entity’s financial position, financial performance, and cash flows. Statement 161 is effective for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company currently does not anticipate the adoption of Statement 161 will have a material impact on the disclosures already provided.

In June 2008, the FASB issued an exposure draft of a proposed amendment to SFAS 133. As proposed, this amendment would make several significant changes to the way in which entities account for hedging activities involving derivative instruments. Financial derivative instruments and hedging are one of the Company’s Critical Accounting Policies and Estimates as disclosed in “Part II, Item 7,” and, as such, the proposed amendment could have a significant impact on the timing of potential gains and/or losses recognized in the Company’s future earnings. However, the Company does not believe the proposed amendment would have a significant impact on the economic benefit provided by its hedging activities or its decision to utilize derivative instruments in managing its risk associated with changing jet fuel prices. The FASB has not yet issued a final Statement.

In October 2008, the FASB issued Staff Position No. FAS 157-3, “Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active” (FSP 157-3). FSP 157-3 clarifies the application of SFAS 157, which the Company adopted as of January 1, 2008, in cases where a market is not active. The Company has considered the guidance provided by FSP 157-3 in its determination of estimated fair values as of December 31, 2008, and the impact was not material.

**3. Acquisition of Certain Assets And Codeshare Relationship**

In fourth quarter 2004, the Company was selected as the winning bidder at a bankruptcy-court approved auction for certain ATA Airlines, Inc. (ATA) assets. As part of the transaction, the Company acquired the leasehold rights to six of ATA’s leased Chicago Midway Airport gates. In addition, the Company 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.

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

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

transaction, the Company 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 the Company's obligation under the construction loan to the City of Chicago.

The Company and ATA also had agreed on a codeshare arrangement, under which each carrier could exchange passengers on certain designated flights beginning first quarter 2005. The Company also marketed and sold ATA-only flights. In early April 2008, ATA declared bankruptcy and discontinued all scheduled passenger service, effectively ending codeshare operations between the companies. During third quarter 2008, the bankruptcy court approved the termination of the codeshare agreement between ATA and the Company. Operating revenues from the Company's codeshare and marketing relationship with ATA were approximately \$40 million in 2007 and \$6 million in 2008.

The Company offered assistance to all Customers who purchased a ticket on [www.southwest.com](http://www.southwest.com) and were scheduled to travel on ATA, which included rebooking them or offering a refund for any unused portion of a ticket. The cost incurred by the Company related to ATA's discontinuation of service was approximately \$8 million, the majority of which is reflected as a reduction to 2008 operating income.

**4. Commitments**

The Company's contractual purchase commitments primarily consist of scheduled aircraft acquisitions from Boeing. As of December 31, 2008, the Company had the following contractual purchase commitments with Boeing for aircraft deliveries:

	<u>Firm</u>	<u>Options</u>	<u>Purchase Rights (In millions)</u>	<u>Total</u>	<u>Commitment</u>
2009	13	—	—	13	\$ 393
2010	16	5	—	21	472
2011	11	17	—	28	465
2012	13	27	—	40	553
2013	19	4	—	23	583
2014	12	8	—	20	445
2015	11	6	—	17	250
2016	4	—	—	4	73
Through 2018	—	—	54	54	—
Total	<u>99</u>	<u>67</u>	<u>54</u>	<u>220</u>	<u>\$ 3,234</u>

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.

During January 2009, the Company revised its schedule of future deliveries from Boeing. As a result of the change, the dollar commitment above did not change materially in total, but the amounts allocated to individual years did decline approximately commensurate with the change in the number of anticipated firm deliveries.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

5. Accrued Liabilities

	2008	2007
	(In millions)	
Retirement plans (Note 15)	\$ 86	\$ 132
Aircraft rentals	118	125
Vacation pay	175	164
Advances and deposits (Note 10)	23	2,020
Fuel derivative contracts	246	—
Deferred income taxes	36	370
Other	328	296
Accrued liabilities	<u>\$ 1,012</u>	<u>\$ 3,107</u>

6. Revolving Credit Facility And Short Term-borrowing

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. During fourth quarter 2008, as a result of instability in the credit market, the Company borrowed \$400 million under this facility to be used for general corporate purposes, including enhancing the Company's liquidity. At the Company's option, interest on the facility can be calculated on one of several different bases. For the \$400 million outstanding at December 31, 2008, the Company has chosen a floating rate based upon an annual prime rate as defined in the agreement. 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, 2008, the Company was in compliance with this covenant.

During 2008, as part of the Company's agreement with a counterparty in which it has invested in auction rate security instruments, it has received a \$91 million loan that is secured by the auction rate security instruments from that counterparty. See Note 11 for further information on the instruments and the agreement. The loan is callable by the counterparty at any time and was made to the Company at a cost that effectively offsets the interest earned on the auction rate security instruments. As a result of this callable feature, the loan is classified as a component of "Current maturities of long-term debt" in the accompanying Consolidated Balance Sheet, even though the loan does not expire until June 2010.

7. Long-term Debt

	2008	2007
	(In millions)	
Credit line borrowing (Note 6)	\$ 91	\$ —
Revolving Credit Facility (Note 6)	400	—
10.5% Notes due 2011	400	—
Term Loan Agreement due 2020	585	—
French Credit Agreements due 2012	26	32
6.5% Notes due 2012	410	386
5.25% Notes due 2014	391	352
5.75% Notes due 2016	300	300
5.125% Notes due 2017	358	311
French Credit Agreements due 2017	87	94
Pass Through Certificates	464	480
7.375% Debentures due 2027	133	103
Capital leases (Note 8)	39	52
	<u>3,684</u>	<u>2,110</u>
Less current maturities	163	41
Less debt discount and issuance costs	23	19
	<u>\$ 3,498</u>	<u>\$ 2,050</u>

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

On December 30, 2008, the Company sold \$400 million of secured notes due 2011 (the “Notes”) in a private placement. The Notes will mature on December 15, 2011, and bear interest at a fixed rate of 10.5 percent per annum. Interest on the Notes will be payable semi-annually, beginning June 15, 2009. The Notes are secured by a first priority perfected security interest in a specified pool of 17 Boeing 737-700 aircraft granted under a single mortgage. The Notes cannot be called by the Company prior to stated maturity. However, they are subject to redemption at par in certain circumstances involving a casualty loss of an aircraft securing the Notes. The Notes contain conventional events of default and acceleration provisions, but have no financial covenants. The Company used the net proceeds from the sale of the Notes for general corporate purposes, including using a portion of the proceeds to provide cash collateral for some of the Company’s fuel hedging arrangements. See Note 10.

On May 6, 2008, the Company entered into a Term Loan Agreement providing for loans to the Company aggregating up to \$600 million, to be secured by first-lien mortgages on 21 of the Company’s 737-700 aircraft. On May 9, 2008, the Company borrowed the full \$600 million and secured these loans with the requisite 21 aircraft mortgages. The loans mature on May 9, 2020, and are repayable quarterly in installments of principal, with the first payment made on August 9, 2008. The loans bear interest at the LIBO rate (as defined in the Term Loan Agreement) plus .95 percent, and interest is payable quarterly. Concurrent with its entry into the Term Loan Agreement, the Company entered into an interest rate swap agreement that effectively fixes the interest rate on the term loan for its entire term at 5.223 percent. The Company used the net proceeds from the term loan for general corporate purposes.

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 the Company 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 the Company and are secured by a mortgage on each aircraft. Interest on the equipment notes held for the certificates is payable semi-annually, with the first payment made on 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. The Company 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. 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.

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

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

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.

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. 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 7.375% 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 \$222 million at December 31, 2008.

The net book value of the assets pledged as collateral for the Company’s secured borrowings, primarily aircraft and engines, was \$1.8 billion at December 31, 2008. In addition, the Company has pledged a total of 20 of its Boeing 737-700 aircraft as collateral in the case that it has obligations related to its fuel derivative instruments with a specific counterparty that are valued in excess of \$300 million, but below \$700 million. At December 31, 2008, the Company’s net collateral obligation to this counterparty was \$240 million, all of which was in cash.

As of December 31, 2008, 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, 2013, were \$72 million in 2009, \$574 million in 2010, \$479 million in 2011, \$453 million in 2012, \$70 million in 2013, and \$1.9 billion thereafter.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

8. Leases

The Company had nine aircraft classified as capital leases at December 31, 2008. The amounts applicable to these aircraft included in property and equipment were:

	<u>2008</u>	<u>2007</u>
	(In millions)	
Flight equipment	\$168	\$168
Less accumulated depreciation	144	133
	<u>\$ 24</u>	<u>\$ 35</u>

On December 23, 2008, the Company entered into a two tranche sale and leaseback transaction with a third party aircraft lessor for the sale and leaseback of ten of the Company's Boeing 737-700 aircraft. Under the first tranche of the transaction, which closed on December 23, 2008, the Company sold five of its Boeing 737-700 aircraft for a total of approximately \$173 million and immediately leased the aircraft back for twelve years. The leases are accounted for as operating leases. Under the terms of the lease agreements, the Company will continue to operate and maintain the aircraft. Payments under the lease agreements will be reset every six months based on changes in the six-month LIBOR rate. The lease agreements contain standard termination events, including termination upon a breach of the Company's obligations to make rental payments and upon any other material breach of the Company's obligations under the leases, and standard maintenance and return condition provisions. Upon a termination of the lease upon a breach by the Company, the Company would be liable for standard contractual damages, possibly including damages suffered by the lessor in connection with remarketing the aircraft or while the aircraft is not leased to another party. The first tranche of the sale and leasebacks resulted in a deferred gain of \$11 million, which will be amortized over the twelve-year term of the leases. The Company closed the second tranche of the transaction, providing for the sale and 16-year leaseback of the remaining five Boeing 737-700 aircraft upon similar terms (including proceeds), in January 2009.

Total rental expense for operating leases, both aircraft and other, charged to operations in 2008, 2007, and 2006 was \$527 million, \$469 million, and \$433 million, respectively. The majority of the Company's terminal operations space, as well as 82 aircraft, were under operating leases at December 31, 2008. Future minimum lease payments under capital leases and noncancelable operating leases with initial or remaining terms in excess of one year at December 31, 2008, were:

	<u>Capital leases</u>	(In millions)	<u>Operating leases</u>
2009	\$ 16		\$ 376
2010	15		324
2011	12		249
2012	—		203
2013	—		152
After 2013	—		728
Total minimum lease payments	<u>43</u>		<u>\$ 2,032</u>
Less amount representing interest	4		
Present value of minimum lease payments	<u>39</u>		
Less current portion	14		
Long-term portion	<u>\$ 25</u>		

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

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 participants' last day of work fell between September 30, 2007 and April 30, 2008, based on the operational needs of particular work locations and departments. Project Early Departure resulted in a pre-tax, pre-profitsharing, charge of approximately \$25 million during third quarter 2007. The remaining amount to be paid was not significant as of December 31, 2008.

**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 2008, 2007, and 2006 represented approximately 35.1 percent, 29.7 percent, and 28.0 percent of the Company's operating expenses, respectively. The primary reason that fuel and oil has become an increasingly larger portion of the Company's operating expenses has been due to the dramatic increase in all energy prices in recent years. 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, and typically utilizes a mixture of purchased call options, collar structures, and fixed price swap agreements in its portfolio. In recent years, as fuel prices have risen, the Company has held fuel derivative positions that have resulted in significant gains recognized in earnings. However, as of December 31, 2008, the Company held a net position of fuel derivative instruments that effectively represented a hedge of approximately 10 percent of its anticipated jet fuel purchases for the years from 2009 through 2013. Prior to fourth quarter 2008, the Company had held fuel derivative instruments for a much larger portion of its anticipated fuel purchases for these years; however, due to the recent precipitous decline in fuel prices, the Company significantly reduced its hedge in order to minimize fuel hedging losses related to further oil price declines and to minimize the potential for the Company to provide additional cash collateral deposits to counterparties. The Company accomplished this reduced hedge by entering into additional derivative contracts—basically by selling zero-cost collars and fixed-price swap derivatives. This strategy enables the Company to participate in further price declines via the sold derivatives, which should materially offset further declines in value of the Company's previously purchased derivatives. If prices rise, the Company no longer has the protection it had in place prior to reducing its hedge.

The total net fair value of outstanding financial derivative instruments related to the Company's jet fuel market price risk at December 31, 2008, was a net liability of \$992 million. The current portion of these financial derivative instruments, or \$246 million, is classified as a component of "Accrued liabilities" in the Consolidated Balance Sheet. The long-term portion of these financial derivative instruments, or \$746 million, is included in "Other deferred liabilities."

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

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

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 (loss)” until the underlying jet fuel is consumed. See Note 12 for further information on “Accumulated other comprehensive income (loss).” 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) losses, net” in the income statement. Likewise, if a hedge ceases to qualify for hedge accounting, any change in the fair value of derivative instruments since the last period is recorded to “Other (gains) losses, net” 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 (loss)” 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 (loss)” would be required to be immediately reclassified into earnings. The Company did not have any such situations occur in 2008, 2007, or 2006.

Ineffectiveness is inherent in hedging jet fuel with derivative positions based in other crude oil related commodities, especially given the magnitude of the changes in 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 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 the production of refined products, and the volatility of the different types of products the Company uses in hedging. The number of instances in which the Company has discontinued hedge accounting for specific hedges and for specific refined products, such as unleaded gasoline, has increased recently, primarily due to these reasons. 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.

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.

[Table of Contents](#)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

All cash flows associated with purchasing and selling derivatives are classified as operating cash flows in the Consolidated Statement of Cash Flows. The following table presents the location of pre-tax gains and/or losses on derivative instruments within the Consolidated Statement of Income.

	<u>2008</u>	<u>2007</u> (In millions)	<u>2006</u>
Fuel hedge (gains) included in Fuel and oil expense	\$ (1,106)	\$ (686)	\$ (634)
Mark-to-market impact from fuel contracts settling in future periods—included in Other (gains) losses, net	(6)	(219)	42
Ineffectiveness from fuel hedges settling in future periods— included in Other (gains) losses, net	106	(51)	39
Realized ineffectiveness and mark-to-market (gains) or losses—included in Other (gains) losses, net	(80)	(90)	20
Premium cost of fuel contracts included in Other (gains) losses, net	69	58	52

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 (loss)" related to fuel hedges within the Consolidated Balance Sheet.

	<u>2008</u>	<u>2007</u>
	(In millions)	
Fair value of current fuel contracts-(Accrued liabilities)/Fuel derivative contracts	\$ (246)	\$ 1,069
Fair value of noncurrent fuel contracts-(Other deferred liabilities)/Other assets	(746)	1,318
	<u>2008</u>	<u>2007</u>
	(In millions)	
Due (to) from third parties for settled fuel contracts-(Accrued liabilities)/Accounts and other receivables	(16)	109
Net unrealized (losses) gains from fuel hedges, net of tax- Accumulated other comprehensive income (loss)	(946)	1,220

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 losses from fuel hedges as of December 31, 2008, are approximately \$341 million in net unrealized losses that are expected to be realized in earnings during 2009. In addition, as of December 31, 2008, the Company had already recognized cumulative net gains due to ineffectiveness and derivatives that do not qualify for hedge accounting totaling \$32 million, net of taxes. These gains were recognized in 2008 and prior periods, and are reflected in "Retained earnings" as of December 31, 2008, but the underlying derivative instruments will not expire/settle until 2009 or future periods.

**Interest rate swaps**

Prior to 2008, the Company had entered into 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 primary objective for the Company's use of these interest rate hedges was to reduce the volatility of net interest income by better matching the repricing of its assets and liabilities. 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. These interest rate swap agreements qualify as fair value hedges, as defined by SFAS 133. In addition, these interest rate swap agreements qualify for the

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

“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 following table contains the floating rates paid during 2008, based on actual and forward rates at December 31, 2008, under these agreements:

<u>Debt instrument</u>	<u>Fixed rate associated with debt instrument</u>	<u>Average floating rate paid in 2008</u>
\$385 million Notes due 2012	6.5%	4.72%
\$350 million Notes due 2014	5.25%	4.29%
\$300 million Notes due 2017	5.125%	2.95%
\$100 million Debentures due 2027	7.375%	4.70%

During 2008, the Company also entered into an interest rate swap agreement concurrent with its entry into a twelve-year, \$600 million floating-rate Term Loan Agreement. Under this swap agreement, which is accounted for as a cash flow hedge, the interest rate on the term loan is effectively fixed for its entire term at 5.223 percent and ineffectiveness is required to be measured each reporting period.

The fair values of the interest rate swap agreements, which are adjusted regularly, have been aggregated by counterparty for classification in the Consolidated Balance Sheet. Agreements totaling an asset of \$84 million are classified as a component of “Other assets” with a corresponding adjustment to the carrying value of the long-term debt. Agreements totaling a net liability of \$3 million are classified as a component of “Other deferred liabilities.” The corresponding adjustment related to the net liability associated with the Company’s fair value hedges, is to the carrying value of the long-term debt. The corresponding adjustment related to the net liability associated with the Company’s cash flow hedge is to “Accumulated other comprehensive income (loss).” This adjustment totaled \$46 million, net of tax, at December 31, 2008. See Note 7.

***Credit risk and collateral***

The Company’s credit exposure related to fuel derivative instruments is represented by the fair value of contracts with a net positive fair value to the Company at the reporting date. At such times, these outstanding instruments expose the Company to credit loss in the event of nonperformance by the counterparties to the agreements. However, in such cases, the Company does not expect any of the counterparties to fail to meet its obligations and has not experienced any significant credit loss as a result of counterparty nonperformance in the past. 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, 2008, the Company had agreements with eight counterparties containing early termination rights and/or bilateral collateral provisions whereby security is required if market risk exposure exceeds a specified threshold amount or credit ratings fall below certain levels. As of December 31, 2008, the Company had active portfolios with three of these counterparties. Based on the Company’s current investment grade credit rating, for one counterparty, these collateral provisions require cash deposits to be posted whenever the net fair value of derivatives associated with that counterparty exceed a specific threshold pursuant to which cash is either posted by the counterparty if the value of derivatives is an asset to the Company, or posted by the Company if the value of derivatives is a liability to the Company.

During fourth quarter 2008, the modification of the Company’s fuel hedge portfolio, in combination with the amendment to one of the Company’s counterparty agreements, has significantly reduced the Company’s current exposure to cash collateral requirements. Previously, if the Company became obligated to post collateral as security for its potential obligations under the agreement, all such collateral was required to be cash. Under the agreement, as amended, until January 1, 2010, if the Company becomes obligated to post collateral for obligations in amounts of up to \$300 million and in excess of \$700 million, the Company will continue to be required to post cash collateral; however, if the Company becomes obligated to post collateral for obligations in amounts between \$300 million and \$700 million, the Company has pledged 20 of its Boeing 737-700 aircraft as collateral in lieu of cash.

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

At December 31, 2008, the Company had posted \$240 million in cash collateral deposits with a counterparty under these bilateral collateral provisions. The deposits are included in “Prepaid expenses and other current assets” on the Consolidated Balance Sheet.

**11. Fair Value Measurements**

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, “Fair Value Measurements” (SFAS 157). SFAS 157 does not establish requirements for any new fair value measurements, but it does apply to existing accounting pronouncements in which fair value measurements are already required. 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 has adopted the provisions of SFAS 157 as of January 1, 2008, for financial instruments. Although the adoption of SFAS 157 has not materially impacted its financial condition, results of operations, or cash flow, the Company is now required to provide additional disclosures as part of its financial statements.

SFAS 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

As of December 31, 2008, the Company held certain items that are required to be measured at fair value on a recurring basis. These included cash equivalents, short-term investments, certain noncurrent investments, interest rate derivative contracts, fuel derivative contracts, and available-for-sale securities. Cash equivalents consist of short-term, highly liquid, income-producing investments, all of which have maturities of 90 days or less, including money market funds, U.S. Government obligations, and obligations of U.S. Government backed agencies. Short-term investments consist of short-term, highly liquid, income-producing investments, which have maturities of greater than 90 days but less than one year, including U.S. Government obligations, obligations of U.S. Government backed agencies, and certain non-taxable auction rate securities. Derivative instruments are related to the Company’s attempts to hedge fuel costs and interest rates. Noncurrent investments consist of auction rate securities collateralized by student loan portfolios, which are guaranteed by the U.S. Government. Other available-for-sale securities primarily consist of investments associated with the Company’s Excess Benefit Plan.

The Company’s fuel derivative instruments consist of over-the-counter (OTC) contracts, which are not traded on a public exchange. These contracts include both swaps as well as different types of option contracts. See Note 10 for further information on the Company’s derivative instruments and hedging activities. The fair values of swap contracts are determined based on inputs that are readily available in public markets or can be derived from information available in publicly quoted markets. Therefore, the Company has categorized these swap contracts as Level 2. The Company determines the value of option contracts utilizing a standard option pricing model based on inputs that are either readily available in public markets, can be derived from information available in publicly quoted markets, or are quoted by financial institutions that trade these contracts. In situations where the Company obtains inputs via quotes from financial institutions, it verifies the reasonableness of these quotes via similar quotes from another financial institution as of each date for which financial statements are prepared. The Company also considers counterparty credit risk and its own credit risk in its determination of all estimated fair values. The Company has consistently applied these valuation techniques in all periods presented and believes it has obtained the most accurate information available for the types of derivative contracts it holds. Due to the fact that certain of the inputs utilized to determine the fair value of option contracts are unobservable (principally implied volatility), the Company has categorized these option contracts as Level 3.

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

The Company's interest rate derivative instruments also consist of OTC swap contracts. The inputs utilized to determine the fair values of these contracts are obtained in quoted public markets. The Company has consistently applied these valuation techniques in all periods presented.

The Company's investments associated with its Excess Benefit Plan consist of mutual funds that are publicly traded and for which market prices are readily available.

All of the Company's auction rate security instruments are reflected at estimated fair value in the Consolidated Balance Sheet. At December 31, 2008, approximately \$109 million of these instruments are classified as available for sale securities and \$91 million are classified as trading securities. The \$91 million classified as trading securities are subject to an agreement the Company entered into in December 2008, as discussed below. The current portion of these securities, totaling \$17 million, are included in "Short-term investments." The noncurrent portion of these securities, totaling \$74 million, are included in "Other assets" in the Consolidated Balance Sheet. In prior periods, due to the auction process which took place every 30-35 days for most securities, quoted market prices were readily available, which would have qualified as Level 1 under SFAS 157. However, due to events in credit markets beginning during first quarter 2008, the auction events for most of these instruments failed, and, therefore, the Company has determined the estimated fair values of these securities utilizing a discounted cash flow analysis or other type of valuation model as of December 31, 2008. In addition, the Company obtained an independent valuation of a selected number of auction rate security instruments and has considered these valuations in determining estimated fair values of other similar instruments within its portfolio. The Company's analyses consider, among other items, the collateralization underlying the security investments, the expected future cash flows, including the final maturity, associated with the securities, and estimates of the next time the security is expected to have a successful auction or return to full par value. These securities were also compared, when possible, to other securities not owned by the Company, but with similar characteristics.

In association with this estimate of fair value, the Company has recorded a temporary unrealized decline in fair value of \$11 million, with an offsetting entry to "Accumulated other comprehensive income (loss)." The Company currently believes that this temporary decline in fair value is due entirely to liquidity issues, because the underlying assets for the majority of securities are almost entirely backed by the U.S. Government. In addition, for the \$109 million in instruments classified as available for sale, these auction rate securities represented approximately six percent of the Company's total cash, cash equivalent, and investment balance at December 31, 2008, which it believes allows it sufficient time for the securities to return to full value. For the \$91 million in instruments classified as trading securities, the Company has entered into an agreement with the counterparty that allows the Company to put the instruments back to the counterparty at full par value in June 2010. In conjunction with this agreement, the Company has elected to apply the provisions of SFAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities" to this put option. Also as part of this agreement, the Company has entered into a line of credit in which it has received a \$91 million loan that is secured by the auction rate security instruments from that counterparty. Both the put option and the instruments are being marked to market value through earnings each period; however, these adjustments exactly offset and had no net earnings impact for 2008. At the time of the first failed auctions during first quarter 2008, the Company held a total of \$463 million in securities. Since that time, the Company has been able to sell \$252 million of these instruments at par value, in addition to the \$91 million subject to the agreement to be sold at par in June 2010. The Company is also in discussions with its other counterparties to determine whether mutually agreeable decisions can be reached regarding the effective repurchase of its remaining securities. The Company has continued to earn interest on virtually all of its auction rate security instruments. Any future fluctuation in fair value related to these instruments that the Company deems to be temporary, including any recoveries of previous write-downs, would be recorded to "Accumulated other comprehensive income (loss)." If the Company determines that any future valuation adjustment was other than temporary, it would record a charge to earnings as appropriate.

[Table of Contents](#)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following items are measured at fair value on a recurring basis subject to the disclosure requirements of SFAS 157 at December 31, 2008:

Description	December 31, 2008	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(in millions)				
<b>Assets</b>				
Cash equivalents	1,368	\$ 1,368	\$ —	\$ —
Short-term investments	435	397	—	38
Noncurrent investments(a)	162	—	—	162
Interest rate derivatives	83	—	83	—
Fuel derivatives	788	—	406	382
Other available-for-sale securities	32	24	—	8
<b>Total assets</b>	<b>\$ 2,868</b>	<b>\$ 1,789</b>	<b>\$ 489</b>	<b>\$ 590</b>
<b>Liabilities</b>				
Fuel derivatives	\$ (1,780)		\$ (534)	\$ (1,246)

(a) Included in “Other assets” in the Consolidated Balance Sheet

Based on market conditions, the Company changed its valuation methodology for auction rate securities to a discounted cash flow analysis during first quarter 2008. Accordingly, these securities changed from Level 1 to Level 3 within SFAS 157’s hierarchy since the Company’s initial adoption of SFAS 157 at January 1, 2008.

The following table presents the Company’s activity for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in SFAS 157 for the year ended December 31, 2008:

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)			Total
	Fuel Derivatives	Auction Rate Securities (a) (in millions)	Other Securities	
Balance at December 31, 2007	\$ 1,725	\$ —	\$ 12	\$ 1,737
Transfers to Level 3	—	463	—	463
Total gains or (losses) (realized or unrealized) Included in earnings	205	—	(4)	201
Included in other comprehensive income	(2,233)	(11)	—	(2,244)
Purchases and settlements (net)	(561)	(252)	—	(813)
Balance at December 31, 2008	\$ (864)	\$ 200(b)	\$ 8	\$ (656)
The amount of total gains or (losses) for the period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at December 31, 2008	\$ 105	\$ —	\$ (4)	\$ 101

(a) Includes those classified as short-term investments and noncurrent investments

(b) Includes \$91 classified as trading securities

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

All settlements from fuel derivative contracts that are deemed “effective,” as defined in SFAS 133, are included in “Fuel and oil” expense in the period that the underlying fuel is consumed in operations. Any “ineffectiveness” associated with derivative contracts, as defined in SFAS 133, including amounts that settled in the current period (realized), and amounts that will settle in future periods (unrealized), is recorded in earnings immediately, as a component of “Other (gains) losses, net.” See Note 10 for further information on SFAS 133 and hedging.

Gains and losses (realized and unrealized) included in earnings related to other investments for the year ended December 31, 2008, are reported in “Other operating expenses.”

The carrying amounts and estimated fair values of the Company’s long-term debt and fuel derivative contracts at December 31, 2008 were as follows:

	<u>Carrying value</u>	(In millions)	<u>Estimated fair value</u>
Credit line borrowing (Note 6)	\$ 91		\$ 91
Revolving Credit Facility (Note 6)	400		400
10.5% Notes due 2011	400		410
Term Loan Agreement due 2027	585		467
French Credit Agreements due 2012	26		26
6.5% Notes due 2012	410		353
5.25% Notes due 2014	391		314
5.75% Notes due 2016	300		238
5.125% Notes due 2017	358		268
French Credit Agreements due 2017	87		87
Pass Through Certificates	464		395
7.375% Debentures due 2027	133		114
Fuel derivative contracts	(992)		(992)

The estimated fair values of the Company’s publicly held long-term debt were based on quoted market prices.

**12. Comprehensive Income (loss)**

Comprehensive income (loss) 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 15 for further information on Employee retirement plans. Comprehensive income (loss) totaled \$(2.0) billion, \$1.3 billion, and \$189 million for 2008, 2007, and 2006, respectively. The differences between “Net income” and “Comprehensive income (loss)” for these years are as follows:

	<u>2008</u>	<u>2007</u> (In millions)	<u>2006</u>
Net income	\$ 178	\$ 645	\$ 499
Unrealized gain (loss) on derivative instruments, net of deferred taxes of (\$1,358), \$408 and (\$201)	(2,166)	636	(306)
Other, net of deferred taxes of (\$38), \$14 and (\$2)	(59)	23	(4)
Total other comprehensive income (loss)	(2,225)	659	(310)
<b>Comprehensive income (loss)</b>	<b><u>\$ (2,047)</u></b>	<b><u>\$ 1,304</u></b>	<b><u>\$ 189</u></b>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

A rollforward of the amounts included in “Accumulated other comprehensive income (loss)”, net of taxes for 2008, 2007, and 2006, is shown below:

	Fuel hedge derivatives	Other (In millions)	Accumulated other comprehensive income (loss)
Balance at December 31, 2006	\$ 584	\$ (2)	\$ 582
2007 changes in fair value	1,039	23	1,062
Reclassification to earnings	(403)	—	(403)
Balance at December 31, 2007	1,220	21	1,241
<b>2008 changes in fair value</b>	<b>(1,528)</b>	<b>(59)</b>	<b>(1,587)</b>
<b>Reclassification to earnings</b>	<b>(638)</b>	<b>—</b>	<b>(638)</b>
<b>Balance at December 31, 2008</b>	<b>\$ (946)</b>	<b>\$ (38)</b>	<b>\$ (984)</b>

**13. 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, 2008, the Company had 69 million shares of common stock reserved for issuance pursuant to Employee stock benefit plans (of which 28 million shares had not been granted.)

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 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 have been or 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. The Company had repurchased 4.4 million shares for a total of \$54 million as part of this program through February 15, 2008; however, the Company has not repurchased any additional shares from that date through the date of this filing. The Company does not believe it is prudent to repurchase shares at the current time considering today’s unstable financial markets and volatile fuel prices.

**14. Stock Plans**

*Share-based Compensation*

The Company has previously awarded share-based compensation pursuant to 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 Chairman Emeritus of the Company. The Company accounts for share-based compensation utilizing the fair value recognition provisions of SFAS No. 123R, “Share-Based Payment.”

The Consolidated Statement of Income for the years ended December 31, 2008, 2007, and 2006 reflects share-based compensation cost of \$18 million, \$37 million, and \$80 million, respectively. The total tax benefit recognized in earnings from

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

share-based compensation arrangements for the years ended December 31, 2008, 2007, and 2006, was \$4 million, \$11 million, and \$27 million, respectively.

***Stock Plans***

The Company has previously awarded stock options under plans covering Employees subject to collective bargaining agreements (collective bargaining plans) and 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 4.8 million shares of the Company's common stock as of December 31, 2008. The Company also has a plan related to a past employment agreement with its Chairman Emeritus in which 556,000 stock options were outstanding as of December 31, 2008, 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, 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.

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. The Company estimates expected stock price volatility via observations of both historical volatility trends as well as implied future volatility observations as determined by independent third parties. For 2008, 2007, and 2006 stock option grants, the Company has consistently estimated expected volatility utilizing two-thirds of implied future volatility and one-third historical volatility as of the grant date. 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 were actual U.S. Treasury zero-coupon rates for bonds matching the expected term of the option as of the option grant date.

[Table of Contents](#)

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 table provides the ranges of assumptions and weighted-average assumptions used for grants made under the fixed option plans for the current and prior years, as well as the range of fair values and weighted-average fair value of options granted for 2008, 2007, and 2006:

	2008	2007	2006
Wtd-average risk-free interest rate	4.2%	3.7%	4.6%
Range of risk-free interest rates	0.9% - 5.13%	0.5% - 5.37%	4.26% - 5.24%
Wtd-average expected life of option (years)	5.1	4.9	5.0
Range of expected life of options (years)	1.0 - 6.0	0.5 - 8.0	1.5 - 8.0
Wtd-average expected stock volatility	25%	26%	26%
Range of expected stock volatilities	24% - 36%	24% - 27%	25% - 27%
Wtd-average expected dividend yield	0.11%	0.09%	0.07%
Range of expected dividend yields	0.10% - 0.20%	0.07% - 0.12%	0.06% - 0.10%
Wtd-average stock option fair value	\$ 3.59	\$ 4.28	\$ 5.47
Range of stock option fair values	\$ 1.69 - \$4.04	\$ 0.67 - \$6.33	\$ 2.48 - \$6.99

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

	Collective bargaining plans			
	Options (000)	Wtd. average exercise price	Wtd. average remaining contractual term	Aggregate intrinsic value (millions)
Outstanding December 31, 2005	105,244	\$ 11.65		
Granted	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		
Granted	505	12.71		
Exercised	(5,933)	13.06		
Surrendered	(2,536)	16.45		
Outstanding December 31, 2008	55,412	\$ 13.90	3.0	\$ —
Vested or expected to vest at December 31, 2008	55,348	\$ 13.90	3.0	\$ —
Exercisable at December 31, 2008	54,950	\$ 13.90	3.0	\$ —

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, 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		
Granted	1,642	12.13		
Exercised	(2,447)	10.64		
Surrendered	(1,233)	16.05		
Outstanding December 31, 2008	<u>26,489</u>	\$ 15.57	4.5	\$ —
Vested or expected to vest at December 31, 2008	25,003	\$ 15.57	4.5	\$ —
Exercisable at December 31, 2008	19,760	\$ 15.82	4.0	\$ —

The total aggregate intrinsic value of options exercised during the years ended December 31, 2008, 2007, and 2006, was \$24 million, \$137 million, and \$262 million, respectively. The total fair value of shares vesting during the years ended December 31, 2008, 2007, and 2006, was \$12 million, \$64 million, and \$112 million, respectively. As of December 31, 2008, there was \$28 million of total unrecognized compensation cost related to share-based compensation arrangements, which is expected to be recognized over a weighted-average period of 2.1 years. The total recognition period for the remaining unrecognized compensation cost is approximately seven 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 5.2 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, 2008, 2007, and 2006, participants under the plan purchased 1.3 million shares, 1.3 million shares, and 1.2 million shares at average prices of \$11.29, \$13.30, and \$14.86, respectively. The weighted-average fair value of each purchase right under the ESPP granted for the years ended December 31, 2008, 2007, and 2006, which is equal to the ten percent discount from the market value of the Common Stock at the end of each monthly purchase period, was \$1.25, \$1.48, and \$1.65, respectively.

**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. Grants of non-qualified stock 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.

**15. Employee Retirement Plans**

**Defined contribution plans**

The Company has defined contribution plans covering substantially all its Employees. The Southwest Airlines Co. Profit Sharing Plan (Profit Sharing Plan) is a defined contribution plan to which the Company contributes 15 percent of its eligible pre-tax profits, as defined, on an annual basis. No Employee contributions to the Profit Sharing Plan are allowed.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

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 2008, 2007, and 2006 were \$243 million, \$279 million, and \$301 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, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
	(In millions)	
APBO at beginning of period	\$ 88	\$111
Service cost	14	16
Interest cost	5	6
Benefits paid	(3)	(6)
Actuarial (gain) loss	(3)	(39)
APBO at end of period	<u>\$101</u>	<u>\$ 88</u>

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, 2008, would have the following effects:

	<u>1% increase</u>	<u>1% decrease</u>
	(In millions)	
Increase (decrease) in total service and interest costs	\$ 2	\$ (2)
Increase (decrease) in the APBO	\$ 8	\$ (7)

The Company's plans are unfunded, and benefits are paid as they become due. For 2008, both benefits paid and Company contributions to the plans were each \$3 million. For 2007, both benefits paid and Company contributions to the plans were each \$6 million. Estimated future benefit payments expected to be paid for each of the next five years are \$7 million in 2009, \$8 million in 2010, \$9 million in 2011, \$10 million in 2012, \$11 million in 2013, and \$95 million for the next five years thereafter.

On December 31, 2006, the Company adopted the recognition and disclosure provisions of SFAS 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" (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 (loss)," 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, 2008 and 2007.

	<u>2008</u>	<u>2007</u>
	(In millions)	
Funded status	\$ (101)	\$ (88)
Unrecognized net actuarial (gain) loss	(32)	(31)
Unrecognized prior service cost	1	3
Accumulated other comprehensive income (loss)	31	28
Cost recognized on Consolidated Balance Sheet	<u>\$ (101)</u>	<u>\$ (88)</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 (loss)." 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. Because 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.

[Table of Contents](#)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Company's periodic postretirement benefit cost for the years ended December 31, 2008, 2007, and 2006, included the following:

	<u>2008</u>	<u>2007</u> (In millions)	<u>2006</u>
Service cost	\$14	\$16	\$15
Interest cost	5	6	5
Amortization of prior service cost	2	2	2
Recognized actuarial loss	(3)	—	(1)
Net periodic postretirement benefit cost	<u>\$18</u>	<u>\$24</u>	<u>\$21</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>2008</u>	<u>2007</u>	<u>2006</u>
Wtd-average discount rate	6.13%	5.75%	5.50%
Assumed healthcare cost trend rate(1)	8.00%	8.00%	8.50%

(1) The assumed healthcare cost trend rate is assumed to remain at to 8.0% for 2009, then decline gradually to 5% by 2023 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.

**16. 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, 2008 and 2007, are as follows:

	<u>2008</u>	<u>2007</u>
	(In millions)	
<b>DEFERRED TAX LIABILITIES:</b>		
Accelerated depreciation	\$ 2,760	\$ 2,612
Fuel derivative instruments	—	884
Other	29	19
Total deferred tax liabilities	<u>2,789</u>	<u>3,515</u>
<b>DEFERRED TAX ASSETS:</b>		
Fuel derivative instruments	567	—
Deferred gains from sale and leaseback of aircraft	60	65
Capital and operating leases	47	58
Accrued employee benefits	211	187
Stock-based compensation	93	110
State taxes	69	75
Business partner income	81	78
Other	86	37
Total deferred tax assets	<u>1,214</u>	<u>610</u>
Net deferred tax liability	<u>\$ 1,575</u>	<u>\$ 2,905</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The provision for income taxes is composed of the following:

	<u>2008</u>	<u>2007</u> (In millions)	<u>2006</u>
<b>CURRENT:</b>			
Federal	\$ 23	\$108	\$ 64
State	10	9	15
Total current	<u>33</u>	<u>117</u>	<u>79</u>
<b>DEFERRED:</b>			
Federal	80	246	220
State	(13)	50	(8)
Total deferred	<u>67</u>	<u>296</u>	<u>212</u>
	<u>\$100</u>	<u>\$413</u>	<u>\$291</u>

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

	<u>2008</u>	<u>2007</u> (In millions)	<u>2006</u>
Tax at statutory			
U.S. tax rates	\$ 97	\$370	\$276
Nondeductible items	10	6	10
State income taxes, net of federal benefit	(2)	38	4
Other, net	(5)	(1)	1
Total income tax provision	<u>\$100</u>	<u>\$413</u>	<u>\$291</u>

No reserves for uncertain income tax positions have been recorded pursuant to FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109" (FIN 48).

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 through 2008 tax years. The periods subject to examination for the Company's state tax returns in California and Texas are years 2003 through 2007.

**17. Net Income Per Share**

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

	<u>2008</u>	<u>2007</u> (In millions, except per share amounts)	<u>2006</u>
Net income	<u>\$178</u>	<u>\$645</u>	<u>\$499</u>
Weighted-average shares outstanding, basic	<u>735</u>	<u>757</u>	<u>795</u>
Dilutive effect of Employee stock options	<u>4</u>	<u>11</u>	<u>29</u>
Adjusted weighted-average shares outstanding, diluted	<u>739</u>	<u>768</u>	<u>824</u>
Net income per share, basic	<u>\$ .24</u>	<u>\$ .85</u>	<u>\$ .63</u>
Net income per share, diluted	<u>\$ .24</u>	<u>\$ .84</u>	<u>\$ .61</u>

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

The Company has excluded 82 million, 49 million, and 20 million shares from its calculations of net income per share, diluted, in 2008, 2007, and 2006, respectively, as they represent antidilutive stock options for the respective periods presented.

**18. Contingencies**

On March 6, 2008, the F.A.A. notified the Company that it was seeking to fine the Company approximately \$10 million in connection with an incident concerning the Company's potential non-compliance with an airworthiness directive. The Company accrued the proposed fine as an operating expense in first quarter 2008 and is currently in settlement discussions with the F.A.A.

In connection with the above incident, during the first quarter and early second quarter of 2008, the Company was named as a defendant in two putative class actions on behalf of persons who purchased air travel from the Company while the Company was allegedly in violation of F.A.A. safety regulations. Claims alleged by the plaintiffs in these two putative class actions include breach of contract, breach of warranty, fraud/misrepresentation, unjust enrichment, and negligent and reckless operation of an aircraft. The Company believes that the class action lawsuits are without merit and intends to vigorously defend itself. Also in connection with the above incident, during the first quarter and early second quarter of 2008, the Company received four letters from Shareholders demanding the Company commence an action on behalf of the Company against members of its Board of Directors and any other allegedly culpable parties for damages resulting from an alleged breach of fiduciary duties owed by them to the Company. In August 2008, Carbon County Employees Retirement System and Mark Cristello filed a related Shareholder derivative action in Texas state court naming certain directors and officers of the Company as individual defendants and the Company as a nominal defendant. The derivative action claims breach of fiduciary duty and seeks recovery by the Company of alleged monetary damages sustained as a result of the purported breach of fiduciary duty, as well as costs of the action. A Special Committee appointed by the Independent Directors of the Company is currently evaluating the Shareholder demands.

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 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 STOCKHOLDERS  
SOUTHWEST AIRLINES CO.

We have audited the accompanying consolidated balance sheet of Southwest Airlines Co. as of December 31, 2008 and 2007, and the related consolidated statement of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2008. 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, 2008 and 2007, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 11 to the consolidated financial statements, on January 1, 2008, the Company adopted the provisions of Statement of Financial Accounting Standards No. 157, "Fair Value Measurements," for financial instruments.

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, 2008, 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 29, 2009 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Dallas, Texas  
January 29, 2009

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

THE BOARD OF DIRECTORS AND STOCKHOLDERS  
SOUTHWEST AIRLINES CO.

We have audited Southwest Airlines Co.'s internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Southwest Airline 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, 2008, 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 sheet of Southwest Airlines Co. as of December 31, 2008 and 2007, and the related consolidated statement of income, stockholders' equity, and cash flows for the each of the three years in the period ended December 31, 2008 of Southwest Airlines Co. and our report dated January 29, 2009 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Dallas, Texas  
January 29, 2009

[Table of Contents](#)**QUARTERLY FINANCIAL DATA**  
**(Unaudited)**

<u>(In millions except per share amounts)</u>	<u>Three Months Ended</u>			
	<u>March 31</u>	<u>June 30</u>	<u>Sept. 30</u>	<u>Dec. 31</u>
<b>2008</b>				
Operating revenues	\$ 2,530	\$2,869	\$2,891	\$2,734
Operating income	88	205	86	70
Income (loss) before income taxes	37	529	(205)	(83)
Net income (loss)	34	321	(120)	(56)
Net income (loss) per share, basic	.05	.44	(.16)	(.08)
Net income (loss) per share, diluted	.05	.44	(.16)	(.08)
	<u>March 31</u>	<u>June 30</u>	<u>Sept. 30</u>	<u>Dec. 31</u>
<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

**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.* Southwest 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 Southwest 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 Southwest'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 Officer and Chief Financial Officer, evaluated the effectiveness of Southwest's disclosure controls and procedures as of December 31, 2008. Based on this evaluation, Southwest's Chief Executive Officer and Chief Financial Officer have concluded that Southwest's disclosure controls and procedures were effective as of December 31, 2008 at the reasonable assurance level.

*Management's Annual Report on Internal Control over Financial Reporting.* Management of Southwest is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act). Southwest'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 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 Officer and Chief Financial Officer, evaluated the effectiveness of Southwest's internal control over financial reporting as of December 31, 2008. 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 Officer and Chief Financial Officer,

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## Table of Contents

concluded that, as of December 31, 2008, Southwest's internal control over financial reporting was effective.

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

*Changes in Internal Control over Financial Reporting.* There were no changes in Southwest's internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) during the quarter ended December 31, 2008, that have materially affected, or are reasonably likely to materially affect, Southwest'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 Southwest's directors will be set forth under the heading "Election of Directors" in the Proxy Statement for Southwest's 2009 Annual Meeting of Shareholders and is incorporated herein by reference. The information required by this Item 10 regarding Southwest'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 Southwest's 2009 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 Southwest's 2009 Annual Meeting of Shareholders and is incorporated herein by reference.

Southwest has adopted a Code of Ethics that applies to its principal executive officer, principal financial officer, and principal accounting officer or controller. Southwest'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 Southwest'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. Southwest intends to disclose any amendments to or waivers of its Code of Ethics on behalf of Southwest's Chief Executive Officer, Chief Financial Officer, Controller, and persons performing similar functions on Southwest'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 Southwest's 2009 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 Southwest's 2009 Annual Meeting of Shareholders and is incorporated herein by reference.

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[Table of Contents](#)**Securities Authorized for Issuance under Equity Compensation Plans**

The following table provides information as of December 31, 2008, regarding compensation plans (including individual compensation arrangements) under which equity securities of Southwest are authorized for issuance.

**Equity Compensation Plan Information**

<u>Plan Category</u>	<u>Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants, and Rights (a) (In thousands)</u>	<u>Weighted-Average Exercise Price of Outstanding Options, Warrants, and Rights* (b)</u>	<u>Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (c) (In thousands)</u>
Equity Compensation Plans Approved by Security Holders	22,243	\$12.82	4,075
Equity Compensation Plans not Approved by Security Holders	60,213	\$13.92	18,308
<b>Total</b>	<b>82,456</b>	<b>\$13.62</b>	<b>22,383</b>

\* As adjusted for stock splits.

See Note 14 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 Southwest's 2009 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 Southwest's 2009 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. 1-7259)).
- 3.2 Amended and Restated Bylaws of Southwest, effective January 15, 2009 (incorporated by reference to Exhibit 3.1 to Southwest's Current Report on Form 8-K dated January 15, 2009 (File No. 1-7259)).
- 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)).
- 4.2 Specimen certificate representing common stock of Southwest (incorporated by reference to Exhibit 4.2 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1994 (File No. 1-7259)).
- 4.3 Indenture dated as of February 14, 2005, between Southwest Airlines Co. and The Bank of New York Trust Company, N.A., Trustee (incorporated by reference to Exhibit 4.2 to Southwest's Current Report on Form 8-K dated February 14, 2005 (File No. 1-7259)).
- 4.4 Indenture dated as of September 17, 2004 between Southwest Airlines Co. and Wells Fargo Bank, N.A., Trustee (incorporated by reference to Exhibit 4.1 to Southwest's Registration Statement on Form S-3 dated October 30, 2002 (File No. 1-7259)).
- 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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## Table of Contents

- 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 (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 (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 (incorporated by reference to Exhibit 10.1 to Southwest's Annual Report on Form 10-K for the year ended December 31, 2004 (File No. 1-7259)); Supplemental Agreements 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 Agreements 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 Agreements 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 (incorporated by reference to Exhibit 10.1 to Southwest's Annual Report on Form 10-K for the year ended December 31, 2007 (File No. 1-7259)); Supplemental Agreements Nos. 57, 58, and 59 (incorporated by reference to Exhibits 10.1, 10.2, and 10.3, respectively, to Southwest's Quarterly Report on Form 10-Q for the quarter ended March 31, 2008 (File No. 1-7259)); Supplemental Agreement No. 60 (incorporated by reference to Exhibit 10.1 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2008 (File No. 1-7259)); Supplemental Agreement No. 61 (incorporated by reference to Exhibit 10.1 to Southwest's Quarterly Report on Form 10-Q for the quarter ended September 30, 2008 (File no. 1-7259)).

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## [Table of Contents](#)

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

10.2	Form of Amended and Restated Executive Service Recognition Plan Executive Employment Agreement between Southwest and certain Southwest officers.*
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)).*
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. ProfitSharing 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 between Southwest and Herbert D. Kelleher, effective as of July 15, 2007, and amended and restated November 20, 2008.*
10.13	Employment Contract between Southwest and Gary C. Kelly, effective as of July 15, 2007, and amended and restated November 20, 2008.*
10.14	Employment Contract between Southwest and Colleen C. Barrett, effective as of July 15, 2007, and amended and restated November 20, 2008.*
10.15	Southwest Airlines Co. Severance Plan for Directors (incorporated by reference to Exhibit 10.15 to Southwest's Annual Report on Form 10-K for the year ended December 31, 2007 (File No. 1-7259)).
10.16	Southwest Airlines Co. Outside Director Incentive Plan (as amended and restated effective May 16, 2007) (incorporated by reference to Exhibit 10.2 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 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)).*

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## Table of Contents

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)).
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 Grant (incorporated by reference to Exhibit 10.31 to Southwest's Annual Report on Form 10-K for the year ended December 31, 2007 (File No. 1-7259)).*
10.32	Southwest Airlines Co. Excess Benefit Plan.*
10.33	Amendment No. 1 to Southwest Airlines Co. Excess Benefit Plan.*
10.34	Amendment No. 2 to Southwest Airlines Co. Excess Benefit Plan.*
10.35	Amended and Restated Southwest Airlines Co. 2005 Excess Benefit Plan (as amended and restated effective for plan years beginning on and after January 1, 2009).*
10.36	Form of Indemnification Agreement between the Company and its Directors (incorporated by reference to Exhibit 10.1 to Southwest's Current Report on Form 8-K dated January 23, 2009 (File No. 1-7259)).

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**Table of Contents**

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.

\* Management contract or compensatory plan or arrangement.

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.



**INDEX TO THE 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. 1-7259)).
- 3.2 Amended and Restated Bylaws of Southwest, effective January 15, 2009 (incorporated by reference to Exhibit 3.1 to Southwest's Current Report on Form 8-K dated January 15, 2009 (File No. 1-7259)).
- 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)).
- 4.2 Specimen certificate representing common stock of Southwest (incorporated by reference to Exhibit 4.2 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1994 (File No. 1-7259)).
- 4.3 Indenture dated as of February 14, 2005, between Southwest Airlines Co. and The Bank of New York Trust Company, N.A., Trustee (incorporated by reference to Exhibit 4.2 to Southwest's Current Report on Form 8-K dated February 14, 2005 (File No. 1-7259)).
- 4.4 Indenture dated as of September 17, 2004 between Southwest Airlines Co. and Wells Fargo Bank, N.A., Trustee (incorporated by reference to Exhibit 4.1 to Southwest's Registration Statement on Form S-3 dated October 30, 2002 (File No. 1-7259)).
- 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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## Table of Contents

- 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 (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 (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 (incorporated by reference to Exhibit 10.1 to Southwest's Annual Report on Form 10-K for the year ended December 31, 2004 (File No. 1-7259)); Supplemental Agreements 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 Agreements 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 Agreements 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 (incorporated by reference to Exhibit 10.1 to Southwest's Annual Report on Form 10-K for the year ended December 31, 2007 (File No. 1-7259)); Supplemental Agreements Nos. 57, 58, and 59 (incorporated by reference to Exhibits 10.1, 10.2, and 10.3, respectively, to Southwest's Quarterly Report on Form 10-Q for the quarter ended March 31, 2008 (File No. 1-7259)); Supplemental Agreement No. 60 (incorporated by reference to Exhibit 10.1 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2008 (File No. 1-7259)); Supplemental Agreement No. 61 (incorporated by reference to Exhibit 10.1 to Southwest's Quarterly Report on Form 10-Q for the quarter ended September 30, 2008 (File no. 1-7259)).

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## [Table of Contents](#)

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

- 10.2 Form of Amended and Restated Executive Service Recognition Plan Executive Employment Agreement between Southwest and certain Southwest Officers.\*
- 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)).\*
- 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. ProfitSharing 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 between Southwest and Herbert D. Kelleher, effective as of July 15, 2007, and amended and restated November 20, 2008.\*
- 10.13 Employment Contract between Southwest and Gary C. Kelly, effective as of July 15, 2007, and amended and restated November 20, 2008.\*
- 10.14 Employment Contract between Southwest and Colleen C. Barrett, effective as of July 15, 2007, and amended and restated November 20, 2008.\*
- 10.15 Southwest Airlines Co. Severance Plan for Directors (incorporated by reference to Exhibit 10.15 to Southwest's Annual Report on Form 10-K for the year ended December 31, 2007 (File No. 1-7259)).
- 10.16 Southwest Airlines Co. Outside Director Incentive Plan (as amended and restated effective May 16, 2007) (incorporated by reference to Exhibit 10.2 to Southwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 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)).\*

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## Table of Contents

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)).
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 Grant (incorporated by reference to Exhibit 10.31 to Southwest's Annual Report on Form 10-K for the year ended December 31, 2007 (File No. 1-7259)).*
10.32	Southwest Airlines Co. Excess Benefit Plan.*
10.33	Amendment No. 1 to Southwest Airlines Co. Excess Benefit Plan.*
10.34	Amendment No. 2 to Southwest Airlines Co. Excess Benefit Plan.*
10.35	Amended and Restated Southwest Airlines Co. 2005 Excess Benefit Plan (as amended and restated effective for plan years beginning on and after January 1, 2009).*

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[Table of Contents](#)

10.36	Form of Indemnification Agreement between the Company and its Directors (incorporated by reference to Exhibit 10.1 to Southwest's Current Report on Form 8-K dated January 23, 2009 (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.

\* Management contract or compensatory plan or arrangement.

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.

AMENDED AND RESTATED EXECUTIVE SERVICE RECOGNITION PLAN

EXECUTIVE EMPLOYMENT AGREEMENT

between

SOUTHWEST AIRLINES CO.

and

\_\_\_\_\_, 200\_\_

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TABLE OF CONTENTS

	<u>Page</u>
PARTIES	1
RECITALS	1
SEC. 1. Operation of Agreement	1
SEC. 2. Change of Control	2
SEC. 3. Employment Period	3
SEC. 4. Position and Duties	3
SEC. 5. Compensation	5
SEC. 6. Termination	7
SEC. 7. Obligations of the Corporation upon Termination	9
SEC. 8. Non-exclusivity of Rights	13
SEC. 9. Full Settlement	13
SEC. 10. Certain Reduction of Payments by the Corporation	14
SEC. 11. Confidential Information	16
SEC. 12. Successors	17
SEC. 13. Miscellaneous	17
TESTIMONIUM	19
SIGNATURES	19

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**EXECUTIVE EMPLOYMENT AGREEMENT**

THIS EXECUTIVE EMPLOYMENT AGREEMENT (this "Agreement") between SOUTHWEST AIRLINES CO., a Texas corporation (the "Corporation"), and \_\_\_\_\_ (the "Executive"), is dated effective the \_\_\_\_\_ day of \_\_\_\_\_, 200\_\_.

**W I T N E S S E T H:**

WHEREAS, the Corporation, on behalf of itself and its shareholders, wishes to (i) continue to attract and retain well qualified executive and key personnel who are an integral part of the management of the Corporation, such as the Executive, and (ii) to assure both itself of continuity of management and the Executive of continued employment in the event of any actual or threatened Change of Control (as defined in Section 2 of this Agreement) of the Corporation and, to such end, the Corporation has established the Amended and Restated Executive Service Recognition Plan Executive Employment Agreement for entry into between the Corporation and certain executive employees of the Corporation, including the Executive;

NOW, THEREFORE, in consideration of the premises and for other good and valuable consideration, the parties hereto agree as follows:

**1. Operation of Agreement.**

(a) Definition. The "Effective Date" shall be the date during the "Change of Control Period" (as defined in Section 1(b)) on which a Change of Control first occurs.

(b) Additional Definitions. The "Change of Control Period" is the period commencing on the date hereof and ending on the earlier to occur of (i) the second anniversary of such date or (ii) the first day of the month coinciding with or next following the Executive's 70th birthday ("Outside Retirement Date"); provided, however, that commencing on the date one year

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after the date hereof, and on each annual anniversary of such date (the date one year after the date hereof and each annual anniversary of such date is hereinafter referred to as the "Renewal Date"), the Change of Control Period shall be automatically extended so as to terminate on the earlier of (x) two years from such Renewal Date or (y) the first day of the month coinciding with or next following the Executive's Outside Retirement Date, unless at least 60 days prior to the Renewal Date the Corporation shall give notice to the Executive that the Change of Control Period shall not be so extended; and provided further, that this provision for automatic extension shall have no application following a Change of Control.

**2. Change of Control.** For the purpose of this Agreement, a "Change of Control" shall mean a change of control during the Change of Control Period of a nature that would be required to be reported on a Current Report on Form 8-K, pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act"); provided that, without limitation, such a "Change of Control" shall be deemed to have occurred if: (i) a third person, including a "group" as such term is used in Section 13(d)(3) of the Exchange Act, becomes the beneficial owner, directly or indirectly, of 20% or more of the combined voting power of the Corporation's outstanding voting securities ordinarily having the right to vote for the election of directors of the Corporation; or (ii) individuals who, as of the date hereof, constitute the Board of Directors of the Corporation (the "Board" generally and, as of the date hereof, the "Incumbent Board") cease for any reason to constitute at least a majority of the Board, provided that any person becoming a director subsequent to the date hereof whose election, or nomination for election by the Corporation's shareholders, was approved by a vote of at least three-quarters of the directors comprising the Incumbent Board (other than an election or nomination of an individual whose initial assumption of office is in connection with an actual or threatened election contest relating to the election of the directors of the Corporation, shall be, for purposes of this Agreement, considered as though such person were a member of the Incumbent Board.

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**3. Employment Period.** The Corporation hereby agrees to continue the Executive in its employ, and the Executive hereby agrees to remain in the employ of the Corporation, for the period commencing on the Effective Date and ending on the earlier to occur of (i) the first anniversary of such date or (ii) the first day of the month coinciding with or next following the Executive's Outside Retirement Date (the "Employment Period").

**4. Position and Duties.**

(a) Position, etc. During the Employment Period, (i) the Executive's position (including status, offices, titles and reporting requirements), authority, duties and responsibilities shall be at least commensurate in all material respects with those held, exercised and assigned at any time during the 90-day period immediately preceding the Effective Date and (ii) the Executive's services shall be performed at the location where the Executive was employed immediately preceding the Effective Date. Such position, authority, duties and responsibilities shall be regarded as not commensurate if, as a result of a Change of Control, (i) the Corporation becomes a direct or indirect subsidiary of another corporation or corporations or becomes controlled, directly or indirectly, by one or more unincorporated entities (such other corporation or unincorporated entity owning or controlling, directly or indirectly, the greatest amount of equity (by vote) of the Corporation is hereinafter referred to as a "Parent Company"), or (ii) all or substantially all of the assets of the Corporation are acquired by another corporation or unincorporated entity or group of corporations or unincorporated entities owned or controlled, directly or indirectly, by another corporation or unincorporated entity (such other acquiring or controlling corporation or unincorporated entity is hereinafter referred to as a "successor"), unless, in the case of either (i) or

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(ii), (x) the second paragraph of Section 12 of this Agreement shall have been complied with and (y) the Executive's position, authority, duties and responsibilities with such parent company or successor, as the case may be, are at least commensurate in all material respects with those held, exercised and assigned with the Corporation at any time during the 90-day period immediately preceding the Effective Date, or (iii) more than one unrelated corporation or unincorporated entity acquires a significant portion of the assets of the Corporation.

(b) Extent of Efforts. Excluding periods of vacation and sick leave to which the Executive is entitled, the Executive agrees to devote during the Employment Period reasonable attention and time during normal business hours to the business and affairs of the Corporation and, to the extent necessary to discharge the responsibilities assigned to the Executive hereunder, to use reasonable best efforts to perform faithfully and efficiently such responsibilities. The Executive may (i) serve on corporate, civic or charitable boards or committees, (ii) deliver lectures, fulfill speaking engagements or teach at educational institutions and (iii) manage personal investments, so long as such activities do not significantly interfere with the performance of the Executive's responsibilities. It is expressly understood and agreed that to the extent that any such activities have been conducted by the Executive prior to the Effective Date, such prior conduct of activities, and any subsequent conduct of activities similar in nature and scope, shall not thereafter be deemed to interfere with the performance of the Executive's responsibilities to the Corporation.

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**5. Compensation.** Subject to Section 7 hereof (which section shall govern Executive's compensation in the event of Executive's termination of employment during the Employment Period), while employed during the Employment Period, Executive shall be entitled to the following compensation and benefits under this Agreement.

(a) **Base Salary.** The Executive shall receive a base salary (the "Base Salary") at a monthly rate at least equal to the highest monthly salary paid to the Executive by the Corporation, together with any of its affiliated companies, during the twelve-month period immediately preceding the month in which the Effective Date occurs. The Base Salary shall be increased at any time and from time to time to reflect increases in base salary awarded in the ordinary course of business to other key executives. Any increase in the Base Salary shall not serve to limit or reduce any other obligation to the Executive under this Agreement. The Base Salary shall not be reduced after any such increase. As used in this Agreement, the term "affiliated companies" includes any company controlling, controlled by or under common control with the Corporation.

(b) **Annual Bonus.** In addition to the Base Salary, the Executive shall be awarded, for any fiscal year that ends during the Employment Period, an annual bonus (the "Annual Bonus") (which may be pursuant to an established bonus or incentive plan or program of the Corporation) in cash at least equal to the highest bonus paid or payable to the Executive in respect of either of the two fiscal years of the Corporation (annualized with respect to either such fiscal year for which the Executive has been employed only during a portion thereof) immediately prior to the fiscal year in which the Effective Date occurs. The Annual Bonus shall be payable in January of the fiscal year next following the fiscal year for which the Annual Bonus is awarded.

(c) **Profit Sharing Incentive and Retirement Plans.** In addition to the Base Salary and Annual Bonus payable as hereinabove provided, the Executive shall be entitled to participate in all profit sharing, incentive and retirement plans and programs applicable to other key executives, but in no event shall such plans and programs, in the aggregate, provide the Executive with compensation, benefits and reward opportunities less favorable than those provided by the Corporation and its affiliated companies for the Executive under such plans and programs as in effect at any time during the 90-day period immediately preceding the Effective Date.

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(d) Welfare Benefit Plans. The Executive and/or the Executive's family, as the case may be, shall be eligible for participation in (and shall receive all benefits under) each welfare benefit plan of the Corporation, including, without limitation, all medical, dental, disability, group life, accidental death and travel accident insurance plans and programs of the Corporation and its affiliated companies, as in effect at any time during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive, as in effect at any time thereafter with respect to other key executives.

(e) Expenses. The Executive shall be entitled to receive prompt reimbursement for all reasonable expenses incurred by the Executive in accordance with the policies and procedures of the Corporation as in effect at any time during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive, as in effect at any time thereafter with respect to other key executives.

(f) Fringe Benefits. The Executive shall be entitled to fringe benefits, including use of a luncheon club membership and payment of related expenses, in accordance with the policies of the Corporation as in effect at any time during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive, as in effect at any time thereafter with respect to other key executives.

(g) Office and Support Staff. The Executive shall be entitled to an office or offices of a size and with furnishings and other appointments, and to secretarial and other assistance, at least equal to those provided to the Executive at any time during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive, as provided at any time thereafter with respect to other key executives.

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(h) Vacation. The Executive shall be entitled to paid vacation in accordance with the policies of the Corporation as in effect at any time during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive, as in effect at any time thereafter with respect to other key executives.

**6. Termination.**

(a) Death or Disability. This Agreement shall terminate automatically upon the Executive's death. The Corporation may terminate the Executive's employment during the Employment Period, after having established the Executive's Disability (pursuant to the definition of "Disability" set forth below), by giving notice to the Executive of its intention to terminate the Executive's employment. In such a case, the Executive's employment with the Corporation shall terminate effective on the 30th day after receipt of such notice (the "Disability Effective Date"), provided that, within 30 days after such receipt, the Executive shall fail to return to full-time performance of the Executive's duties. For purposes of this Agreement, "Disability" means disability which, after the expiration of more than 26 weeks after its commencement, is determined to be total and permanent by a physician selected by the Corporation or its insurers and acceptable to the Executive or the Executive's legal representative (such agreement to acceptability not to be withheld unreasonably).

(b) Cause. The Corporation may terminate the Executive's employment for Cause during the Employment Period. For purposes of this Agreement, "Cause" means (i) an act or acts of dishonesty taken by the Executive and intended to result in substantial personal enrichment of the Executive at the expense of the Corporation or (ii) violations by the Executive of the Executive's obligations under Section 4 of this Agreement which are (A) grossly negligent or (B) willful and deliberate on the Executive's part and which, in any case, result in material injury to the Corporation.

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(c) Good Reason. The Executive's employment may be terminated by the Executive for Good Reason during the Employment Period. For purposes of this Agreement, "Good Reason" means

(i)(A) the assignment to the Executive of any duties inconsistent in any respect with the Executive's position (including status, offices, titles and reporting requirements), authority, duties or responsibilities as contemplated by Section 4 of this Agreement or (B) any other action by the Corporation which results in a diminishment in such position, authority, duties or responsibilities, other than an insubstantial and inadvertent action which is remedied by the Corporation promptly after receipt of notice thereof given by the Executive;

(ii) any failure by the Corporation to comply with any of the provisions of Section 5 of this Agreement, other than an insubstantial and inadvertent failure which is remedied by the Corporation promptly after receipt of notice thereof given by the Executive;

(iii) the Corporation's requiring the Executive to be based at any office or location other than that at which the Executive is based at the Effective Date, except for travel reasonably required in the performance of the Executive's responsibilities;

(iv) any purported termination by the Corporation of the Executive's employment otherwise than as permitted by this Agreement, it being understood that any such purported termination shall not be effective for any purpose of this Agreement; or

(v) Any failure by the Corporation to comply with and satisfy the second paragraph of Section 12 of this Agreement.

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For purposes of this Section 6(c), any good faith determination of “Good Reason” made by the Executive shall be conclusive.

(d) Notice of Termination. Any termination by the Corporation for Cause or by the Executive for Good Reason shall be communicated by Notice of Termination to the other party hereto given in accordance with Section 13(b) of this Agreement. For purposes of this Agreement, a “Notice of Termination” means a written notice which (i) indicates the specific termination provision in this Agreement relied upon, (ii) sets forth in reasonable detail the facts and circumstances claimed to provide a basis for termination of the Executive’s employment under the provision so indicated and (iii) if the termination date is other than the date of receipt of such notice, specifies the termination date (which date shall be not more than 15 days after the giving of such notice).

(e) Date of Termination. “Date of Termination” means the date of receipt of the Notice of Termination or any later date specified therein, as the case may be. If the Executive’s employment is terminated by the Corporation in breach of this Agreement, the Date of Termination shall be the date on which the Corporation notifies the Executive of such termination.

**7. Obligations of the Corporation upon Termination.**

(a) Death. If the Executive’s employment is terminated by reason of the Executive’s death, this Agreement shall terminate without further obligations under this Agreement to the Executive’s legal representatives other than those obligations accrued hereunder at the date of the Executive’s death. Anything in this Agreement to the contrary notwithstanding, the Executive’s family shall be entitled to receive benefits at least equal to those provided by the Corporation to surviving families of executives of the Corporation under such plans, programs and policies relating to family death benefits, if any, as in effect at any time during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive and/or the Executive’s family, as in effect at any time thereafter with respect to other key executives and their families.

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(b) Disability. If the Executive's employment is terminated by reason of the Executive's Disability, the Executive shall be entitled after the Disability Effective Date to receive disability and other benefits at least equal to those provided by the Corporation to disabled employees and/or their families in accordance with such plans, programs and policies relating to disability, if any, as in effect during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive and/or the Executive's family, as in effect at any time thereafter with respect to other key executives and their families.

(c) Cause. If the Executive's employment shall be terminated for Cause, the Corporation shall pay the Executive his full Base Salary through the Date of Termination at the rate in effect at the time Notice of Termination is given and shall have no further obligations to the Executive under this Agreement.

(d) Good Reason; Other Than for Cause or Disability. If, during the Employment Period, the Corporation shall terminate the Executive's employment other than for Cause or Disability, or the employment of the Executive shall be terminated by the Executive for Good Reason, then in either event:

(i) the Corporation shall pay to the Executive in a lump sum in cash during the 30-day period following the date of Executive's termination of employment (with the actual date during such 30-day period being in the sole discretion of the Corporation) the aggregate of the following amounts:

(A) if not theretofore paid, the Executive's Base Salary through the Date of Termination at the rate in effect on the Date of Termination or, if higher, at the highest rate in effect at any time within the 90-day period preceding the Effective Date; and

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(B) the product of (x) the annual bonus paid to the Executive (whether pursuant to Section 5(b) of this Agreement or otherwise) for the last full fiscal year of the Corporation prior to the fiscal year in which the Date of Termination occurred, and (y) the fraction obtained by dividing (1) the number of days elapsed in the then current fiscal year through the Date of Termination and (2) 365; and

(C) the sum of (x) the Executive's annual Base Salary at the rate in effect at the time Notice of Termination was given or, if higher, at the highest rate in effect at any time within the 90-day period preceding the Effective Date and (y) the Annual Bonus paid to the Executive for the last full fiscal year of the Corporation (being the fiscal year in which the Effective Date but not the Date of Termination occurred) pursuant to Section 5(b) of this Agreement, or if no Annual Bonus shall have been paid, the Annual Bonus which would have been payable to the Executive for the then current fiscal year (being the fiscal year in which the Date of Termination occurred) pursuant to Section 5(b) of this Agreement, provided that in no event shall the Executive be entitled to receive under this clause (C) more than the product obtained by multiplying the amount determined as hereinabove provided in this clause (C) by a fraction the numerator of which shall be the number of months (including fractions of a month) which at the Date of Termination remain until the first day of the month coinciding with or next following the Executive's Outside Retirement Date and the denominator of which shall be 12; and

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(ii) until the earlier of (A) the first day of the month coinciding with or next following the Executive's Outside Retirement Date or (B) the first anniversary of the Effective Date (such number of months remaining until the earlier of clause (A) or (B) is hereinafter referred to as the "Unexpired Term"), the Corporation shall, promptly upon submission by the Executive of supporting documentation (but in no event later than 30 days following the end of the fiscal year in which any costs or expenses are incurred), pay or reimburse to the Executive any costs and expenses (including moving and relocation expenses) paid or incurred by the Executive which would have been payable under Section 5(e) if the Executive's employment had not terminated; and

(iii) for the Unexpired Term, the Corporation shall continue benefits to the Executive and/or the Executive's family at least equal to those which would have been provided to them in accordance with the plans, programs and policies described in Sections 5(d) and 5(f) of this Agreement if the Executive's employment had not been terminated, if and as in effect at any time during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive, as in effect at any time thereafter with respect to other key executives and their families.

With the exception of the foregoing, if the Corporation shall terminate the Executive's employment other than for Cause or Disability, or the employment of the Executive shall be terminated by the Executive for Good Reason, the Corporation will have no further obligations to Executive under this Agreement.

(e) Compliance with Section 409A of the Internal Revenue Code. The payments under this Agreement are intended to comply with the requirements of Section 409A of the Internal Revenue Code of 1986, as amended (the "Code"), and this Agreement will be interpreted in accordance with Section 409A and the regulations promulgated thereunder. For purposes of any payment to which Executive becomes entitled on account of termination of employment under Section 7(d) of this Agreement, such termination of employment shall be deemed to refer only to a termination of employment that constitutes a Separation from Service. In addition, payment of any

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amounts under Section 7(d) will be deferred to the extent necessary to cause such payment to comply with the six month deferral rule described in Section 409A(a)(2)(B) of the Internal Revenue Code if Executive is at the time of termination of employment a “specified employee” within the meaning of such section. “Separation from Service” shall mean a reasonably anticipated permanent reduction in the level of bona fide services performed by the Executive for the Corporation and all Affiliates to 20% or less of the average level of bona fide services performed by the Executive for the Corporation and all Affiliates (whether as an employee or an independent contractor) over the immediately preceding thirty-six (36) months (or the full period of service to the Company and all Affiliates if less than thirty-six (36) months). For purposes of this paragraph, the term “Affiliate” means each entity that would be considered a single employer with the Corporation under Section 414(b) or Section 414(c) of the Internal Revenue Code, except that the phrase “at least 50%” shall be substituted for the phrase “at least 80%” as used therein.

**8. Non-exclusivity of Rights.** Nothing in this Agreement shall prevent or limit the Executive’s continuing or future participation in any benefit, bonus, incentive or other plan or program provided by the Corporation or any of its affiliated companies and for which the Executive may qualify, nor shall anything herein limit or otherwise affect such rights as the Executive may have under any stock option or other agreements with the Corporation or any of its affiliated companies. Amounts which are vested benefits or which the Executive is otherwise entitled to receive under any plan or program of the Corporation or any of its affiliated companies at or subsequent to the Date of Termination shall be payable in accordance with such plan or program.

**9. Full Settlement.** The Corporation’s obligation to make the payments provided for in this Agreement and otherwise to perform its obligations hereunder shall not be affected by any circumstances, including, without limitation, any set-off, counterclaim, recoupment, defense or other

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right which the Corporation may have against the Executive or others. In no event shall the Executive be obligated to seek other employment by way of mitigation of the amounts payable to the Executive under any of the provisions of this Agreement. The Corporation agrees to pay, to the full extent permitted by law, all legal fees and expenses which the Executive may reasonably incur as a result of any contest (regardless of the outcome thereof) by the Corporation or others of the validity or enforceability of, or liability under, any provision of this Agreement or any guarantee of performance thereof or as a result of any contest by the Executive against the amount of any reduction pursuant to Section 10 of this Agreement, plus in each case interest during the period of such nonpayment on the total unpaid amount determined to be payable under this Agreement, such interest to be calculated based upon the rate of interest publicly announced by Bank One Dallas, N.A. (or its successor) from time to time in Dallas, Texas, as its general reference rate of interest (which rate may not be the lowest rate of interest charged by such bank).

**10. Certain Reduction of Payments by the Corporation.** Anything in this Agreement to the contrary notwithstanding, in the event it shall be determined that any payment or distribution by the Corporation to or for the benefit of the Executive (whether paid or payable or distributed or distributable pursuant to the terms of this Agreement or otherwise) (a "Payment") would be nondeductible by the Corporation for Federal income tax purposes because of Section 280G of the Internal Revenue Code of 1986, as amended (the "Code"), then the aggregate present value of amounts payable or distributable to or for the benefit of the Executive pursuant to this Agreement (such payments or distributions pursuant to this Agreement are hereinafter referred to as "Agreement Payments") shall be reduced (but not below zero) to the Reduced Amount. The "Reduced Amount" shall be an amount expressed in present value which maximizes the aggregate present value of Agreement Payments without causing any Payment to be non-deductible by the Corporation because

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of Section 280G of the Code. Anything to the contrary notwithstanding, if the Reduced Amount is zero and it is determined further that any Payment which is not an Agreement Payment would nevertheless be nondeductible by the Corporation for Federal income tax purposes because of Section 280G of the Code, then the aggregate present value of Payments which are not Agreement Payments shall also be reduced (but not below zero) to an amount expressed in present value which maximizes the aggregate present value of Payments without causing any Payment to be nondeductible by the Corporation because of Section 280G of the Code. For purposes of this Section 10, present value shall be determined in accordance with Section 280G(d)(4) of the Code.

All determinations required to be made under this Section 10 shall be made (at the Corporation's expense) by the Dallas office of Ernst & Young or its successor (the "Accounting Firm"), which shall provide detailed supporting calculations both to the Corporation and the Executive within 15 business days of the termination of employment of the Executive or such earlier time as is requested by the Corporation. Any such determination by the Accounting Firm shall be binding upon the Corporation and the Executive absent manifest error. The Corporation shall determine which and how much of the Agreement Payments and other Payment (after Agreement Payments have been reduced to zero) shall be eliminated or reduced consistent with the requirements of this Section 10.

Within five business days thereafter, the Corporation shall pay to or distribute to or for the benefit of the Executive such amounts as are then due to the Executive under this Agreement and shall promptly pay to or distribute for the benefit of the Executive in the future such amounts as become due to the Executive under this Agreement.

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As a result of the uncertainty in the application of Section 280G of the Code at the time of the initial determination by the Accounting Firm hereunder, it is possible that Payments will have been made by the Corporation which should not have been made ("Overpayment") or that additional Payments which will have not been made by the Corporation could have been made ("Underpayment"), in each case, consistent with the calculations required to be made hereunder. In the event that the Accounting Firm determines that an Overpayment has been made, the Executive shall repay such Overpayment to the Corporation together with interest at the applicable Federal rate provided for in Section 7872(f)(2) of the Code; provided, however, that no amount shall be payable by the Executive to the Corporation (or if paid by the Executive to the Corporation shall be returned to the Executive) if and to the extent such payment would not reduce the amount which is subject to taxation under Section 4999 of the Code. In the event that the Accounting Firm determines that an Underpayment has occurred, any such Underpayment shall be promptly paid by the Corporation during the year of determination to or for the benefit of the Executive together with interest at the applicable Federal rate provided for in Section; 7872(f)(2) of the Code.

**11. Confidential Information.** The Executive shall hold in a fiduciary capacity for the benefit of the Corporation all secret or confidential information, knowledge or data relating to the Corporation or any of its affiliated companies, and their respective businesses, which shall have been obtained by the Executive during the Executive's employment by the Corporation or any of its affiliated companies and which shall not be public knowledge (other than by acts by the Executive or his representatives in violation of this Agreement). After termination of the Executive's employment with the Corporation, The Executive shall not, without the prior written consent of the Corporation, communicate or divulge any such information, knowledge or data to anyone other than the Corporation and those designated by it. In no event shall an asserted violation of the provisions of this Section 11 constitute a basis for deferring or withholding any amounts otherwise payable to the Executive under this Agreement.

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**12. Successors.** This Agreement is personal to the Executive and without the prior written consent of the Corporation shall not be assignable by the Executive otherwise than by will or the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable by the Executive's legal representatives. This Agreement shall inure to the benefit of and be binding upon the Corporation and its successors.

In the event of a Change of Control of the Corporation, any parent company or successor shall, in the case of a successor, by an agreement in form and substance satisfactory to the Executive, expressly assume and agree to perform this Agreement and, in the case of a parent company, by an agreement in form and substance satisfactory to the Executive, guarantee and agree to cause the performance of this Agreement, in each case in the same manner and to the same extent as the Corporation would be required to perform if no Change of Control had taken place.

**13. Miscellaneous.**

(a) Governing Law, etc. This Agreement shall be governed by and construed in accordance with the laws of the State of Texas. The Table of Contents and captions of this Agreement are not part of the provisions hereof and shall have no force or effect. This agreement shall supersede any and all existing oral or written agreements between the Company and Executive regarding the subject matter hereof. This Agreement may not be amended or modified otherwise than by a written agreement executed by the parties hereto or their respective successors or legal representatives.

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(b) Notices. All notices and other communications hereunder shall be in writing and shall be given by hand delivery to the other party or by registered or certified mail, return receipt requested, postage prepaid, addressed as follows:

If to the Executive:

At the address indicated  
on the signature page  
hereof.

If to the Corporation:

P.O. Box 36611  
Love Field  
Dallas, Texas 75235-1611

or to such other address as either party shall have furnished to the other in writing in accordance herewith. Notice and communications shall be effective when actually received by the addressee.

(c) Severability. The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision of this Agreement.

(d) Withholding. The Corporation may withhold from any amounts payable under this Agreement such Federal, state or local taxes as shall be required to be withheld pursuant to any applicable law or regulation.

(e) Integration. This Agreement contains the entire understanding of the Corporation and the Executive with respect to the subject matter hereof.

(f) Employment Status. The Executive and the Corporation acknowledge that the employment of the Executive by the Corporation is "at will", and, prior to the Effective Date, may be terminated by either the Executive or the Corporation at any time with or without cause.

[Remainder of page intentionally left blank]

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IN WITNESS WHEREOF, the Executive has hereunto set his hand and, pursuant to the authorization from its Board of Directors, the Corporation has caused these presents to be executed in its name and on its behalf, all as of the day and year first above written.

**EXECUTIVE**

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**SOUTHWEST AIRLINES CO.**

By: \_\_\_\_\_

Name: \_\_\_\_\_

Its: \_\_\_\_\_

EXECUTIVE EMPLOYMENT AGREEMENT

**SOUTHWEST AIRLINES CO.  
PROFITSHARING PLAN**

**SOUTHWEST AIRLINES CO.  
PROFITSHARING PLAN**

Table of Contents

		<u>Page</u>
<b>ARTICLE I</b>	<b>PURPOSE</b>	<b>1</b>
<b>ARTICLE II</b>	<b>DEFINITIONS AND CONSTRUCTION</b>	<b>2</b>
2.1	DEFINITIONS	2
2.2	CONSTRUCTION	8
<b>ARTICLE III</b>	<b>ELIGIBILITY AND PARTICIPATION</b>	<b>8</b>
3.1	ELIGIBILITY REQUIREMENTS	8
3.2	NOTIFICATION OF ELIGIBILITY	8
3.3	REENTRY OF PRIOR MEMBERS	8
<b>ARTICLE IV</b>	<b>CONTRIBUTIONS</b>	<b>9</b>
4.1	COMPANY CONTRIBUTIONS	9
<b>ARTICLE V</b>	<b>ADJUSTMENT OF INDIVIDUAL ACCOUNTS</b>	<b>10</b>
5.1	INDIVIDUAL ACCOUNTS	10
5.2	METHOD OF ADJUSTMENT	10
<b>ARTICLE VI</b>	<b>ALLOCATIONS</b>	<b>10</b>
6.1	COMPANY CONTRIBUTION	10
6.2	ALLOCATION OF FORFEITURES	11
6.3	NOTIFICATION TO MEMBERS	11
6.4	MAXIMUM ANNUAL ADDITION TO ACCOUNT OR BENEFIT	11
<b>ARTICLE VII</b>	<b>RETIREMENT</b>	<b>13</b>
7.1	NORMAL OR LATE RETIREMENT	13
7.2	BENEFIT	14
<b>ARTICLE VIII</b>	<b>DEATH</b>	<b>14</b>
8.1	DEATH OF MEMBER	14
8.2	DESIGNATION OF BENEFICIARY	14
8.3	BENEFIT	14
8.4	NO BENEFICIARY	14
<b>ARTICLE IX</b>	<b>DISABILITY</b>	<b>15</b>
9.1	DISABILITY	15
9.2	BENEFIT	15
<b>ARTICLE X</b>	<b>TERMINATION OF EMPLOYMENT AND FORFEITURES</b>	<b>15</b>
10.1	ELIGIBILITY AND BENEFITS	15
10.2	TIME OF PAYMENT	16
10.3	FORFEITURES	16
10.4	FORFEITURE FOR CAUSE	16
<b>ARTICLE XI</b>	<b>WITHDRAWALS</b>	<b>17</b>
11.1	WITHDRAWALS	17

<b>ARTICLE XII</b>	<b>INVESTMENT OF THE TRUST FUND</b>	<b>17</b>
12.1	MEMBER DIRECTION OF INVESTMENT	17
12.2	CONVERSION OF INVESTMENTS	19
<b>ARTICLE XIII</b>	<b>ADMINISTRATION</b>	<b>20</b>
13.1	APPOINTMENT OF COMMITTEE	20
13.2	COMMITTEE POWERS AND DUTIES	20
13.3	DUTIES AND POWERS OF THE PLAN ADMINISTRATOR	21
13.4	RULES AND DECISIONS	22
13.5	COMMITTEE PROCEDURES	22
13.6	AUTHORIZATION OF BENEFIT PAYMENTS	22
13.7	PAYMENT OF EXPENSES	22
13.8	INDEMNIFICATION OF MEMBERS OF THE COMMITTEE	22
<b>ARTICLE XIV</b>	<b>NOTICES</b>	<b>22</b>
14.1	NOTICE TO TRUSTEE	22
14.2	SUBSEQUENT NOTICES	23
14.3	RELIANCE UPON NOTICE	23
<b>ARTICLE XV</b>	<b>BENEFIT PAYMENTS</b>	<b>23</b>
15.1	METHOD OF PAYMENT	23
15.2	TIME OF PAYMENT	23
15.3	CASH OUT DISTRIBUTION	25
15.4	MINORITY OR DISABILITY PAYMENTS	26
15.5	DISTRIBUTIONS UNDER DOMESTIC RELATIONS ORDERS	26
15.6	DIRECT ROLLOVER OF ELIGIBLE ROLLOVER DISTRIBUTIONS	27
<b>ARTICLE XVI</b>	<b>TRUSTEE</b>	<b>28</b>
16.1	APPOINTMENT OF TRUSTEE	28
16.2	APPOINTMENT OF INVESTMENT MANAGER	29
16.3	RESPONSIBILITY OF TRUSTEE AND INVESTMENT MANAGER	29
16.4	BONDING OF TRUSTEE AND INVESTMENT MANAGER	29
<b>ARTICLE XVII</b>	<b>AMENDMENT AND TERMINATION OF PLAN</b>	<b>29</b>
17.1	AMENDMENT OF PLAN	29
17.2	TERMINATION OF PLAN	30
17.3	COMPLETE DISCONTINUANCE OF CONTRIBUTIONS	30
17.4	LIQUIDATION OF TRUST FUND	30
17.5	CONSOLIDATION OR MERGER	30
<b>ARTICLE XVIII</b>	<b>GENERAL PROVISIONS</b>	<b>31</b>
18.1	NO EMPLOYMENT CONTRACT	31
18.2	MANNER OF PAYMENT	31
18.3	NONALIENATION OF BENEFITS	31
18.4	TITLES FOR CONVENIENCE ONLY	31
18.5	VALIDITY OF PLAN	31
18.6	PLAN BINDING	32
18.7	RETURN OF CONTRIBUTIONS	32
18.8	MISSING MEMBERS OR BENEFICIARIES	32
18.9	VOTING RIGHTS	32
18.10	PRERETIREMENT DIVERSIFICATION RIGHTS	34
18.11	QUALIFIED MILITARY SERVICE	36
<b>ARTICLE XIX</b>	<b>TOP-HEAVY RULES</b>	<b>37</b>
19.1	DEFINITIONS	37
19.2	DETERMINATION OF TOP-HEAVY STATUS	38
19.3	MINIMUM COMPANY CONTRIBUTION	39

---

**ARTICLE XX**

**FIDUCIARY PROVISIONS**

**39**

20.1 GENERAL ALLOCATION OF DUTIES  
20.2 FIDUCIARY DUTY  
20.3 FIDUCIARY LIABILITY  
20.4 CO-FIDUCIARY LIABILITY  
20.5 DELEGATION AND ALLOCATION

39  
40  
40  
40  
41

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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, again amended and restated in its entirety, effective January 1, 1996, and again amended and restated in its entirety, effective January 1, 2008;

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 Heroes Earnings Assistance and Relief Tax Act of 2008; to revise the definition of operating profit to include gains and losses on the sale of aircraft and aircraft delivery positions, 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, 2009, 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.

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**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), 414(u), 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 2 1/2 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.

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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.

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(n) Effective Date. January 1, 2009, 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.

The term "Employee" shall include an individual receiving a differential wage payment under Section 414(u) of the Code.

(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.

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(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)

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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 (59 1/2) 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.

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(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

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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.

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**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; provided further, that effective January 1, 2008, notwithstanding the foregoing, gains and losses from the sale of aircraft and aircraft delivery positions shall be included in operating profit of the Company.

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.

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**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

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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.

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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.

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(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.

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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. Effective January 1, 2007, upon the death of a Member who dies while performing qualified military service (as defined in Section 414(u) of the Code), the survivors of the Member are entitled to any additional benefits provided under the Plan had the participant resumed and then terminated employment on account of death.

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. Effective January 1, 2007, this paragraph shall apply to a Disability incurred while performing qualified military service (as defined in Section 414(u) of the Code).

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:

<u>Completed Years of Vesting Service</u>	<u>Percentage Payable</u>
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.

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**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; provided, however, effective January 1, 2008, that the Southwest Airlines Co. Stock Fund shall be included as an investment option. 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;

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- (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

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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.

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(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

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(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.

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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;

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- (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

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(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</sup>/<sub>2</sub> 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</sup>/<sub>2</sub>. 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</sup>/<sub>2</sub> 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</sup>/<sub>2</sub> 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</sup>/<sub>2</sub> (or by December 31, 1997 in the case of a Member who attains age 70 <sup>1</sup>/<sub>2</sub> 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

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receiving distributions by the April 1 of the calendar year following the year in which the Member attains age 70 1/2 (or by December 31, 1997 in the case of a Member who attains age 70 1/2 in 1996), and any such distributions shall comply with the provisions of the preceding paragraph. Furthermore, any Member who attains age 70 1/2 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 70 1/2. 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

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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

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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

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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.

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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

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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.

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**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.

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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

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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.

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(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

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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).

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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.

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In addition, a Member who dies or incurs a Disability while performing qualified military service (as defined by Section 414(u) of the Code) after January 1, 2007 will receive benefit accruals as if the Member resumed employment in accordance with the Member's reemployment rights under chapter 43 of title 38, United States Code, on the day preceding death or Disability and terminated employment on the actual date of death or Disability. Such benefit accruals shall be determined according to Section 414(u)(9)(C) 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.

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(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

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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

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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.

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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 18<sup>th</sup> day of September, 2008.

**SOUTHWEST AIRLINES CO.**

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

SOUTHWEST AIRLINES CO.  
401(k) PLAN

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

Table of Contents

		<u>Page</u>
<b>ARTICLE I</b>	<b>PURPOSE</b>	<b>1</b>
<b>ARTICLE II</b>	<b>DEFINITIONS AND CONSTRUCTION</b>	<b>2</b>
2.1	DEFINITIONS	2
2.2	CONSTRUCTION	9
<b>ARTICLE III</b>	<b>ELIGIBILITY AND PARTICIPATION</b>	<b>9</b>
3.1	ELIGIBILITY REQUIREMENTS	9
3.2	NOTIFICATION OF ELIGIBILITY	10
3.3	RE-ENTRY OF PRIOR MEMBERS	10
<b>ARTICLE IV</b>	<b>CONTRIBUTIONS</b>	<b>10</b>
4.1	SALARY REDUCTION CONTRIBUTIONS	10
4.2	CATCH-UP CONTRIBUTIONS	11
4.3	COMPANY MATCHING CONTRIBUTIONS	11
4.4	QUALIFIED NONELECTIVE CONTRIBUTIONS	11
4.5	REDUCTION OF EXCESS DEFERRALS	12
4.6	DEFERRAL PERCENTAGE TEST	12
4.7	CONTRIBUTION PERCENTAGE TEST	15
4.8	ROLLOVER CONTRIBUTIONS	16
<b>ARTICLE V</b>	<b>ADJUSTMENT OF INDIVIDUAL ACCOUNTS</b>	<b>18</b>
5.1	INDIVIDUAL ACCOUNTS	18
5.2	METHOD OF ADJUSTMENT	18
5.3	SALARY REDUCTION ELECTIONS	18
<b>ARTICLE VI</b>	<b>ALLOCATIONS</b>	<b>20</b>
6.1	SALARY REDUCTION, COMPANY MATCHING, AND ROLLOVER CONTRIBUTIONS	20
6.2	QUALIFIED NONELECTIVE CONTRIBUTIONS	20
6.3	FORFEITURES	20
6.4	NOTIFICATION TO MEMBERS	20
6.5	MAXIMUM ANNUAL ADDITION TO ACCOUNT OR BENEFIT	21
<b>ARTICLE VII</b>	<b>RETIREMENT</b>	<b>23</b>
7.1	NORMAL OR LATE RETIREMENT	23
7.2	BENEFIT	23
<b>ARTICLE VIII</b>	<b>DEATH</b>	<b>24</b>
8.1	DEATH OF MEMBER	24
8.2	DESIGNATION OF BENEFICIARY	24
8.3	BENEFIT	24
8.4	NO BENEFICIARY	24

<b>ARTICLE IX</b>	<b>DISABILITY</b>	<b>25</b>
9.1	DISABILITY	25
9.2	BENEFIT	25
<b>ARTICLE X</b>	<b>TERMINATION OF EMPLOYMENT AND FORFEITURES</b>	<b>25</b>
10.1	ELIGIBILITY AND BENEFITS	25
10.2	TIME OF PAYMENT	26
10.3	FORFEITURES	26
10.4	FORFEITURES FOR CAUSE	26
<b>ARTICLE XI</b>	<b>WITHDRAWALS AND LOANS</b>	<b>27</b>
11.1	LOANS TO MEMBERS	27
11.2	WITHDRAWALS	29
<b>ARTICLE XII</b>	<b>INVESTMENT OF THE TRUST FUND</b>	<b>34</b>
12.1	MEMBER DIRECTION OF INVESTMENT	34
12.2	CONVERSION OF INVESTMENTS	36
<b>ARTICLE XIII</b>	<b>ADMINISTRATION</b>	<b>37</b>
13.1	APPOINTMENT OF COMMITTEE	37
13.2	COMMITTEE POWERS AND DUTIES	37
13.3	DUTIES AND POWERS OF THE PLAN ADMINISTRATOR	38
13.4	RULES AND DECISIONS	39
13.5	COMMITTEE PROCEDURES	39
13.6	AUTHORIZATION OF BENEFIT PAYMENTS	39
13.7	PAYMENT OF EXPENSES	39
13.8	INDEMNIFICATION OF MEMBERS OF THE COMMITTEE	39
<b>ARTICLE XIV</b>	<b>NOTICES</b>	<b>39</b>
14.1	NOTICE TO TRUSTEE	39
14.2	SUBSEQUENT NOTICES	40
14.3	RELIANCE UPON NOTICE	40
<b>ARTICLE XV</b>	<b>BENEFIT PAYMENTS</b>	<b>40</b>
15.1	METHOD OF PAYMENT	40
15.2	TIME OF PAYMENT	40
15.3	CASH OUT DISTRIBUTION	42
15.4	MINORITY OR DISABILITY PAYMENTS	43
15.5	DISTRIBUTIONS UNDER DOMESTIC RELATIONS ORDERS	43
15.6	DIRECT ROLLOVER OF ELIGIBLE ROLLOVER DISTRIBUTIONS	44
<b>ARTICLE XVI</b>	<b>TRUSTEE</b>	<b>46</b>
16.1	APPOINTMENT OF TRUSTEE	46
16.2	APPOINTMENT OF INVESTMENT MANAGER	46
16.3	RESPONSIBILITY OF TRUSTEE AND INVESTMENT MANAGER	46
16.4	BONDING OF TRUSTEE AND INVESTMENT MANAGER	46
<b>ARTICLE XVII</b>	<b>AMENDMENT AND TERMINATION OF PLAN</b>	<b>46</b>
17.1	AMENDMENT OF PLAN	46
17.2	TERMINATION OF PLAN	47
17.3	SUSPENSION AND DISCONTINUANCE OF CONTRIBUTIONS	47
17.4	LIQUIDATION OF TRUST FUND	48
17.5	CONSOLIDATION, MERGER OR TRANSFER OF PLAN ASSETS	48
<b>ARTICLE XVIII</b>	<b>GENERAL PROVISIONS</b>	<b>48</b>
18.1	NO EMPLOYMENT CONTRACT	48

---

18.2	MANNER OF PAYMENT	48
18.3	NONALIENATION OF BENEFITS	49
18.4	TITLES FOR CONVENIENCE ONLY	49
18.5	VALIDITY OF PLAN	49
18.6	PLAN BINDING	49
18.7	RETURN OF CONTRIBUTIONS	49
18.8	MISSING MEMBERS OR BENEFICIARIES	50
18.9	QUALIFIED MILITARY SERVICE	50
<b>ARTICLE XIX</b>	<b>TOP-HEAVY RULES</b>	<b>51</b>
19.1	DEFINITIONS	51
19.2	DETERMINATION OF TOP-HEAVY STATUS	52
19.3	MINIMUM COMPANY CONTRIBUTION	52
<b>ARTICLE XX</b>	<b>FIDUCIARY PROVISIONS</b>	<b>53</b>
20.1	GENERAL ALLOCATION OF DUTIES	53
20.2	FIDUCIARY DUTY	53
20.3	FIDUCIARY LIABILITY	54
20.4	CO-FIDUCIARY LIABILITY	54
20.5	DELEGATION AND ALLOCATION	54

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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, 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, and which was again amended and restated in its entirety, effective January 1, 2008, to comply with the Pension Protection Act of 2006, to add an automatic enrollment feature, to incorporate amendments that were previously made, and to reflect certain other operational and administrative practices (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 Heroes Earnings Assistance and Relief Tax Act of 2008 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, 2009, 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.

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**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), 414(u), 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 2 1/2 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.

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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.

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(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, 2009, 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

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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.

The term "Employee" shall include an individual receiving a differential wage payment under Section 414(u) of the Code.

(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

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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.

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(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

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(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.

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(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.

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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.

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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.

4.4 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.

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4.5 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.

#### 4.6 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;

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(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 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

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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.

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4.7 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.”

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(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.

#### 4.8 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).

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(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.

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**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.

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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.

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(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.

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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.

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(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.

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(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.

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**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. Effective January 1, 2007, upon the death of a Member who dies while performing qualified military service (as defined in Section 414(u) of the Code), the survivors of the Member are entitled to any additional benefits provided under the Plan had the participant resumed and then terminated employment on account of death.

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. This paragraph shall apply to a Disability incurred while performing qualified military service (as defined in Section 414(u) of the Code).

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:

<u>Completed Years of Service</u>	<u>Percentage Payable</u>
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%

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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.

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**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.

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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

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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;

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(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 (59 1/2) 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

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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 re contribute 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

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(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.

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(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;

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- (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.

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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,

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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.

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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.

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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

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(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 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, and X, Section 18.9, 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

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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 1/2 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 1/2. 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 1/2 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 70 1/2 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 70 1/2 (or by December 31, 1997 in the case of a Member who attains age 70 1/2 in 1996) to defer distributions until April 1 of the calendar year following the

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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 70 1/2 (or by December 31, 1997 in the case of a Member who attains age 70 1/2 in 1996), and any such distributions shall comply with the provisions of the preceding paragraph. Furthermore, any Member who attains age 70 1/2 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 70 1/2. 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)

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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

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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

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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.

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**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

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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.

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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.

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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.

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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.

In addition, a Member who dies or incurs a Disability while performing qualified military service (as defined by Section 414(u) of the Code) after January 1, 2007 will receive benefit accruals as if the Member resumed employment in accordance with the Member's reemployment rights under chapter 43 of title 38, United States Code, on the day preceding death or Disability and terminated employment on the actual date of death or Disability. Such benefit accruals shall be determined according to Section 414(u)(9)(C) of the Code.

Notwithstanding the requirement that the term "Employee" include individuals that receive differential wage payments under Section 414(u) of the Code, a Member shall be treated as having been severed from employment during any period the Member is performing service in the uniformed services described in Section 3401(h)(2)(A) of the Code. If a Member elects to receive a distribution under Article XV pursuant to a deemed severance as described in the preceding sentence, then such Member is prohibited from making Salary Reduction Contributions and Catch-up Contributions during the six-month period beginning on the date of the distribution.

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**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.

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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.

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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;

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- (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 18<sup>th</sup> day of September, 2008.

**SOUTHWEST AIRLINES CO.**

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

**EMPLOYMENT CONTRACT**  
**(as amended and restated November 20, 2008)**

**THIS EMPLOYMENT CONTRACT** (hereinafter referred to as this “Agreement”), effective as of July 15, 2007, and amended and restated effective as of November 20, 2008, by and between **HERBERT D. KELLEHER** (hereinafter referred to as the “Employee”), a resident of Dallas, Texas, and **SOUTHWEST AIRLINES CO.** (hereinafter referred to as “Southwest”, which term shall include its subsidiary companies where the context so admits), a Texas corporation,

**WITNESSETH:**

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

**WHEREAS**, effective as of July 15, 2007, the Employee and Southwest entered into this successor agreement for the continuing services of the Employee (the “2007 Agreement”), which also amended and restated certain provisions of the Old Contracts; and

**WHEREAS**, the Employee and Southwest desire to amend and restate the 2007 Agreement in accordance with the provisions of the final regulations promulgated pursuant to Section 409A of the Internal Revenue Code, as well as other Department of Treasury and Internal Revenue Service guidance;

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

**I. POSITION, DUTIES AND AUTHORITY**

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

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- C. **AUTHORITY.** The Employee shall be vested with all authority reasonably necessary to carry out his duties and responsibilities as set forth in this Article I.
- D. **NECESSARY SUPPORT AND ENVIRONMENT.** Throughout the term of this Agreement, the Employee shall be provided with the office suite and appurtenances thereto that he occupied, and utilized, on July 15, 2007 and with the staff support that he received as of such date.

## II. EMPLOYEE'S OBLIGATIONS

- A. **TIME AND EFFORTS.** During the term of his employment hereunder, the Employee shall devote such time and effort as is required to discharge his duties hereunder.
- B. **NON-COMPETITION.** The Employee recognizes and understands that in performing the duties and responsibilities of his employment as outlined in this Agreement and pursuant to his employment at Southwest prior to the execution of this Agreement, the Employee has occupied and will occupy a position of trust and confidence, pursuant to which the Employee has developed and acquired and will develop and acquire experience and knowledge with respect to various aspects of the business of Southwest and the manner in which such business is conducted. It is the expressed intent and agreement of the Employee and Southwest that such knowledge and experience shall be used in the furtherance of the business interests of Southwest and not in any manner which would be detrimental to such business interests of Southwest. The Employee therefore agrees that, so long as the Employee is employed pursuant to this Agreement, unless he first secures the consent of the Board of Directors of Southwest, the Employee will not invest, engage or participate in any manner whatsoever, either personally or in any status or capacity (other than as a shareholder of less than one percent [1%] of the capital stock of a publicly owned corporation), in any

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business or other entity organized for profit engaged in significant competition with Southwest in the conduct of its air carrier operations anywhere in the States of Texas, Louisiana, Oklahoma, New Mexico, Missouri, Arizona, Nevada, California, Arkansas, Alabama, Tennessee, Kentucky, Michigan, Indiana, Ohio, Maryland, Illinois, Utah, Washington, Oregon, Nebraska, Florida, Idaho, Mississippi, New Hampshire, New York, Rhode Island, Connecticut, North Carolina, Virginia, Pennsylvania, and Colorado. Although the Employee and Southwest regard such restrictions as reasonable for the purpose of preserving Southwest and its proprietary rights, in the event that the provisions of this Paragraph II-B should ever be deemed to exceed the time or geographic limitations permitted by applicable laws, then such provisions shall be reformed to the maximum time or geographic limitations permitted by applicable laws.

### **III. TERM**

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

### **IV. EMPLOYEE'S COMPENSATION**

- A. **BASE SALARY.** The Employee's annual Base Salary for each year during the term of this Agreement shall be \$400,000. The Employee's Base Salary shall be payable to the Employee in equal semi-monthly installments and shall be subject to such payroll and withholding deductions as may be required by law.

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- B. PERFORMANCE BONUS.** The Board of Directors of Southwest (or the Compensation Committee thereof) may grant a Performance Bonus to the Employee, in addition to his Base Salary, at such times and in such amounts as such Board (or Committee) may determine.
- C. DEFERRED COMPENSATION.** In addition to the Base Salary provided for in Paragraph IV-A above, Southwest shall continue to set aside on its books, as provided in Paragraph IV-C of each of the Old Contracts, a special ledger Deferred Compensation Account (the "Account") for the Employee, and shall credit thereto Deferred Compensation determined as hereinafter provided. (Southwest at its election may fund the payment of Deferred Compensation by setting aside and investing such funds as Southwest may from time to time determine. Neither the establishment of the Account, the crediting of Deferred Compensation thereto, nor the setting aside of any funds shall be deemed to create a trust. Legal and equitable title to any funds set aside shall remain in Southwest, and the Employee shall have no security or other interest in such funds. Any funds so set aside or invested shall remain subject to the claims of the creditors of Southwest, present and future.) For each full or partial calendar year as the Employee shall remain in the employment of Southwest under this Agreement, Deferred Compensation shall accumulate in an amount equal to any contributions (including forfeitures but excluding any elective deferrals actually returned to the Employee) which would otherwise have been made by Southwest on behalf of the Employee to the Southwest Airlines Co. Profitsharing Plan and Southwest Airlines Co. 401(k) Plan, but which exceed the amount permitted to be so contributed due to the limitations under Sections 415(c) (the "415(c) Excess Amount") and 401(a)(17) of the Internal Revenue Code. If Employee's employment shall terminate prior to December 31 of any calendar year, Deferred Compensation shall nonetheless accumulate for such year to the

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extent that Employee is otherwise entitled to an allocation of the "Company Contribution" to the Southwest Airlines Co. ProfitSharing Plan for such year in accordance with the terms of the ProfitSharing Plan. In such case, Deferred Compensation shall be calculated for such year as provided above. Employee hereby elects not to invest the 415(c) Excess Amount in Southwest's 2005 Excess Benefit Plan (or any successor plan) during the term of this Agreement.

The Deferred Compensation credited to the Account (including the Interest hereinafter provided) shall be paid to the Employee (or to the executors or administrators of his estate) at the rate of \$200,000 per calendar year (subject to such payroll and withholding deductions as may be required by law), commencing with the calendar year following the year in which (i) the Employee shall attain the age of eighty-two (82) or (ii) the Employee's employment with Southwest shall terminate (whether such termination is under this Agreement or otherwise and whether it is before, on or after the expiration of the initial term set forth in Paragraph III-A above, and irrespective of the cause thereof), whichever shall occur later, and continuing until the entire amount of Deferred Compensation and Interest credited to the Account shall have been paid. Although the total amount of Deferred Compensation ultimately payable to the Employee hereunder shall be computed in accordance with the provisions set forth above, there shall be accrued and credited to the Account, beginning on January 1, 2007 (if not so accrued and credited pursuant to the Old Contracts, and if so accrued and credited, then beginning on January 1, 2008) and continuing annually thereafter until the entire balance of the account has been distributed (whether such distribution takes place during the term of this Agreement or thereafter), amounts equal to simple interest at the rate of ten percent (10%) per annum, compounded annually

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("Interest"), on the accrued and unpaid balance of the Deferred Compensation credited to the Account as of the preceding December 31. The Deferred Compensation and Interest to be paid in any one calendar year shall be paid on the first business day of such calendar year; provided, however, that if the event triggering commencement of payment of Deferred Compensation and Interest is Employee's termination of employment with Southwest, payment of the first of such annual Deferred Compensation and Interest payments shall be deferred to the extent necessary to cause such payment to comply with the six month deferral rule described in Section 409A(a)(2)(B) of the Internal Revenue Code if Employee at his termination of employment with Southwest is a "specified employee" within the meaning of such section. No right, title, interest or benefit under this Paragraph IV-C shall ever be liable for or charged with any of the torts or obligations of the Employee or any person claiming under him, or be subject to seizure by any creditor of the Employee or any person claiming under him. Neither the Employee nor any person claiming under him shall have the power to anticipate or dispose of any right, title, interest or benefit under this Paragraph IV-C in any manner until the same shall have been actually distributed by Southwest.

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

- D. DISABILITY INSURANCE.** During the term of this Agreement, Southwest shall provide long term disability insurance providing for payment, in the event of disability of the Employee, of \$10,000 per month to age eighty-two (82). Except as to amounts payable, the terms and conditions of such policy shall be identical, or substantially similar, to the disability insurance provided by Southwest for its other officers as of the date of this Agreement.

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- E. MEDICAL AND DENTAL EXPENSES.** During the term of this Agreement, the Employee shall remain eligible to participate in any medical benefit plan or program that Southwest makes available to its employees generally. Upon termination of his employment with Southwest, the Employee shall be eligible to participate in any non-contract retiree medical benefit plan or program that Southwest may then make available to its retirees generally. Southwest shall reimburse the Employee for all his out-of-pocket expenses (including specifically all premiums and deductibles) that the Employee may incur for himself and his spouse under any such Southwest plan or program during the term of this Agreement.
- F. STOCK OPTION GRANT.** In connection with its approval of the terms of this Agreement on July 19, 2007, the Compensation Committee of the Board of Directors granted to the Employee ten-year options to purchase 60,000 shares of its common stock. Such options were granted pursuant to the Company's 2007 Equity Incentive Plan and became exercisable with respect to 100% of the shares of Common Stock covered thereby on the date of grant. Such options shall be incentive stock options to the maximum extent permissible under the terms of the 2007 Equity Incentive Plan. The exercise price of such options shall be the fair market value of Southwest's common stock on July 19, 2007 or the date of approval of the form of this Agreement by the Compensation Committee, whichever is higher.
- G. OTHER BENEFITS.** The Employee shall be eligible to continue to participate in all employee pension, profit-sharing, stock purchase, group insurance and other benefit plans or programs in effect for Southwest managerial employees generally to the extent of and in

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accordance with the rules and agreements governing such plans or programs, so long as same shall be in effect, with full service credit where relevant for the Employee's prior employment by Southwest. Southwest shall reimburse the Employee for reasonable expenses incurred by him in the performance of his duties and responsibilities hereunder. The Employee shall be entitled to vacation of three (3) weeks per year or such longer period as may be established from time to time by Southwest for its managerial employees generally.

#### V. TERMINATION PROVISIONS

- A. EXPIRATION OR DEATH.** The Employee's employment hereunder shall terminate on July 15, 2013 (or such later date to which the term of this Agreement may be extended by consent of the parties hereto, in either case without prejudice to the Employee's privilege to remain an employee of Southwest thereafter), or upon the Employee's death, whichever shall first occur, without further obligation or liability of either party hereunder, except for Southwest's obligation to pay Deferred Compensation as provided in Paragraph IV-C of this Agreement.
- B. TERMINATION FOR CAUSE.** Southwest may terminate the Employee's employment hereunder upon the determination by a majority of its whole Board of Directors that the Employee has willfully failed and refused to perform his duties and to discharge his responsibilities hereunder. Such determination shall be final and conclusive. If the Board of Directors of Southwest makes such determination, Southwest may (a) terminate the Employee's employment, effective immediately or at a subsequent date, or (b) condition his continued employment upon the circumstances and place a reasonable limitation upon the time within which the Employee shall comply with such considerations or requirements. If termination is so effected, Southwest shall have no further liability to the Employee hereunder except for the obligation to pay Deferred Compensation as provided in Paragraph IV-C hereof.

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C. **TERMINATION FOR DISABILITY.** Southwest may terminate the Employee's employment hereunder on account of any disabling illness, hereby defined to include any emotional or mental disorders, physical diseases or injuries as a result of which the Employee is, for a continuous period of ninety (90) days, unable to perform his duties hereunder. Southwest shall give to the Employee ninety (90) days' notice of its intention to effect such termination pursuant to this Paragraph V-C. If, within such notice period, the Employee shall have recovered from his disability sufficiently well to resume performance of his duties (although still undergoing treatment or rehabilitation), Southwest shall not have the right to effect such termination. If such disabling illness occurs as a result of a job-related cause, Southwest shall continue to pay the Employee regular installments of his Base Salary in effect at the time of such termination for the remainder of the term of this Agreement in accordance with Southwest's regular payroll practices; provided that, payment shall be deferred to the extent necessary to cause such payment to comply with the six month deferral rule described in Section 409A(a)(2)(B) of the Internal Revenue Code if Employee at his termination of employment with Southwest is a "specified employee" as defined in such section. It is expressly understood and agreed, however, that any obligation of Southwest to continue to pay the Employee his Base Salary pursuant to this Paragraph V-C shall be reduced by the amount of any proceeds of long-term disability insurance provided for the Employee pursuant to Paragraph IV-D above, and shall also be reduced by the amount of the proceeds of any worker's compensation or other benefits which the Employee receives as a result of or growing out of his disabling illness.

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**D. CHANGE OF CONTROL TERMINATION.** In the event of any change of control of Southwest, the Employee may, at his option, terminate his employment hereunder by giving to Southwest notice thereof no later than sixty (60) days after the Employee shall have determined or ascertained that such change has occurred, irrespective whether Southwest shall have purported to terminate this Agreement after such event but prior to receipt of such notice. If termination is so effected, upon termination Southwest shall pay the Employee as "severance pay" a lump sum equal to (i) \$750,000 plus (ii) an amount equal to the unpaid installments of his Base Salary in effect at the time of such termination for the remaining term of this Agreement; provided, however, that if Employee is at his termination of employment with Southwest a "specified employee" within the meaning of Section 409A(a)(2)(B) of the Internal Revenue Code, payment of the "severance pay" shall be deferred to the extent necessary to cause such payment to comply with the six month deferral rule described in such section. If termination is so effected, Southwest shall have no other further liability to the Employee hereunder except for its obligation to pay Deferred Compensation as provided in Paragraph IV-C above. For purposes of this Paragraph V-D, a "change of control of Southwest" shall be deemed to occur if (i) a third person, including a "group" as determined in accordance with Section 13(d)(3) of the Securities Exchange Act of 1934, becomes the beneficial owner of shares of Southwest having twenty percent (20%) or more of the total number of votes that may be cast for the election of directors of Southwest, or (ii) as a result of, or in connection with, any cash tender or exchange offer, merger or other business combination, sale of assets or contested election, or any combination of the foregoing transactions (herein called a "Transaction"), the persons who were directors of Southwest before the Transaction shall cease to constitute a majority of the Board of Directors of Southwest or any successor to Southwest.

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- E. VOLUNTARY TERMINATION.** The Employee's employment hereunder shall terminate forthwith upon his resignation and its acceptance by Southwest, without further obligation or liability of either party hereunder, except for Southwest's obligation to pay Deferred Compensation as provided in Paragraph IV-C above.
- F. TERMINATION OF EMPLOYMENT GENERALLY.** For purposes of any payment under this Agreement: (i) from Employee's Deferred Compensation Account, (ii) of Employee's Base Salary due to a disabling illness occurring as a result of a job-related cause, or (iii) of "severance pay" following a "Change of Control of Southwest," any of which Employee becomes entitled to receive on account of his termination of employment, such termination of employment shall be deemed to refer only to a termination of employment that constitutes a "Separation from Service." For this purpose, "Separation from Service" means a reasonably anticipated permanent reduction in the level of bona fide services performed by the Employee for Southwest and all Affiliates to 20% or less of the average level of bona fide services performed by the Employee for Southwest and all Affiliates (whether as an employee or an independent contractor) in the immediately preceding thirty-six (36) months. For purposes of this paragraph, the term "Affiliate" means each entity that would be considered a single employer with Southwest under Section 414(b) or Section 414(c) of the Internal Revenue Code, except that the phrase "at least 50%" shall be substituted for the phrase "at least 80%" as used therein.

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**VI. MISCELLANEOUS**

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

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**H. GOVERNING LAW.** This Agreement shall be subject to and governed by the laws of the State of Texas.

**IN WITNESS WHEREOF**, the Employee has set his hand hereto and Southwest has caused this Agreement to be signed in its corporate name and behalf by the Chairman of the Compensation Committee of the Board of Directors who is thereunto duly authorized, all as of the 20<sup>th</sup> day of November 2008.

**SOUTHWEST AIRLINES CO.**

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

**THE EMPLOYEE**

/s/ Herbert D. Kelleher  
Herbert D. Kelleher

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

**EMPLOYMENT CONTRACT**  
**(as amended and restated November 20, 2008)**

**THIS EMPLOYMENT CONTRACT** (hereinafter referred to as this "Agreement"), effective as of July 15, 2007, and amended and restated as of November 20, 2008, by and between **GARY C. KELLY** (hereinafter referred to as the "Employee"), a resident of Dallas, Texas, and **SOUTHWEST AIRLINES CO.** (hereinafter referred to as "Southwest", which term shall include its subsidiary companies where the context so admits), a Texas corporation,

**WITNESSETH:**

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

**WHEREAS**, effective as of July 15, 2007, the Employee and Southwest entered into this successor agreement for the continuing full-time services of the Employee (the "2007 Agreement"), which also amended and restated certain provisions of the Old Contract; and

**WHEREAS**, the Employee and Southwest desire to amend and restate the 2007 Agreement in accordance with the provisions of the final regulations promulgated pursuant to Section 409A of the Internal Revenue Code, as well as other Department of Treasury and Internal Revenue Service guidance;

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

**I. POSITION, DUTIES AND AUTHORITY**

- A. POSITIONS, DUTIES AND RESPONSIBILITIES.** The Employee shall serve as Chief Executive Officer of Southwest, and, for so long as he shall be elected to the Board of

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Directors of Southwest and so designated by the Board, he shall serve as Chairman of the Board without additional compensation hereunder. The Employee's duties and responsibilities as Chief Executive Officer shall include general oversight of the operational performance of Southwest; managing costs and generating revenues in order to achieve excellent financial performance; representing Southwest to its multitude of exterior constituencies; implementing Southwest's current and long range business policies and programs; handling, or overseeing, major contract negotiations; and, in general, maintaining employee morale and *esprit de corps*. In addition, he shall perform such other corporate duties and discharge such other corporate responsibilities as are specified in the bylaws of Southwest or are designated from time to time by Board of Directors of Southwest.

- B. AUTHORITY.** The Employee shall be vested with all authority reasonably necessary to carry out his duties and responsibilities as set forth in this Article I.
- C. NECESSARY SUPPORT AND ENVIRONMENT.** The Employee shall be provided with the secretarial and other support personnel (including a full-time administrative assistant) and general working environment (including a private, furnished office) reasonably necessary for him to carry out his duties and responsibilities as set forth in this Article I.

## **II. EMPLOYEE'S OBLIGATIONS**

- A. TIME AND EFFORT.** During the term of his employment hereunder, the Employee shall devote such time and effort as is required to perform his duties and to discharge his responsibilities hereunder. The Employee shall generally conform with all policies of Southwest as they apply to a person of his level of duties and responsibilities.

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

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### III. TERM

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

### IV. EMPLOYEE'S COMPENSATION

- A. **BASE SALARY.** The Employee's annual Base Salary shall be \$424,065. The Board of Directors of Southwest (or the Compensation Committee thereof) may grant a raise to the Employee at such times and in such amounts as such Board (or Committee) may determine. The Employee's Base Salary shall be payable to the Employee in equal semi-monthly installments. The Employee's Base Salary installment payments shall be subject to such payroll and withholding deductions as may be required by law.
- B. **PERFORMANCE BONUS.** The Board of Directors of Southwest (or the Compensation Committee thereof) may grant a Performance Bonus to the Employee, in addition to his Base Salary, at such times and in such amounts as such Board (or Committee) may determine.
- C. **DEFERRED COMPENSATION.** In addition to the Base Salary provided for in Paragraph IV-A above, Southwest shall continue to set aside on its books, as provided in Paragraph IV-C of the Old Contract, a special ledger Deferred Compensation Account (the "Account") for the Employee, and shall credit thereto Deferred Compensation determined as hereinafter provided. (Southwest at its election may fund the payment of Deferred Compensation by setting aside and investing such funds as Southwest may from time to time determine. Neither the establishment of the Account, the crediting of Deferred Compensation thereto, nor the setting aside of any funds shall be deemed to create a trust.

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Legal and equitable title to any funds set aside shall remain in Southwest, and the Employee shall have no security or other interest in such funds. Any funds so set aside or invested shall remain subject to the claims of the creditors of Southwest, present and future.) For each full or partial calendar year as the Employee shall remain in the employment of Southwest under this Agreement, Deferred Compensation shall accumulate in an amount equal to any contributions (including forfeitures but excluding any elective deferrals actually returned to the Employee) which would otherwise have been made by Southwest on behalf of the Employee to the Southwest Airlines Co. Profitsharing Plan and Southwest Airlines Co. 401(k) Plan, but which exceed the amount permitted to be so contributed due to the limitations under Sections 415(c) (the "415(c) Excess Amount") and 401(a)(17) of the Internal Revenue Code. If Employee's employment shall terminate prior to December 31 of any calendar year, Deferred Compensation shall nonetheless accumulate for such year to the extent that Employee is otherwise entitled to an allocation of the "Company Contribution" to the Southwest Airlines Co. ProfitSharing Plan for such year in accordance with the terms of the ProfitSharing Plan. In such case, Deferred Compensation shall be calculated for such year as provided above. Employee hereby elects not to invest the 415(c) Excess Amount in Southwest's 2005 Excess Benefit Plan (or any successor plan) during the term of this Agreement. The Deferred Compensation credited to the Account (including the Interest hereinafter provided) shall be paid to the Employee at the rate of \$200,000 per calendar year (subject to such payroll and withholding deductions as may be required by law), commencing with the calendar year following the year in which (i) the Employee shall become sixty-five (65) or (ii) the Employee's employment with Southwest shall terminate (whether such termination is under this Agreement or otherwise and whether it is before, on

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or after the expiration of the initial term set forth in Paragraph III-A above, and irrespective of the cause thereof), whichever shall occur later, and continuing until the entire amount of Deferred Compensation and Interest credited to the Account shall have been paid. Although the total amount of Deferred Compensation ultimately payable to the Employee hereunder shall be computed in accordance with the provisions set forth above, there shall be accrued and credited to the Account, beginning on January 1, 2007 (if not so accrued and credited pursuant to the Old Contract, and if so accrued and credited, then beginning on January 1, 2008) and continuing annually thereafter until the entire balance of the account has been distributed (whether such distribution takes place during the term of this Agreement or thereafter), amounts equal to simple interest at the rate of ten percent (10%) per annum, compounded annually ("Interest"), on the accrued and unpaid balance of the Deferred Compensation credited to the Account as of the preceding December 31. The Deferred Compensation and Interest to be paid in any one calendar year shall be paid on the first business day of such calendar year; provided, however, that if the event triggering commencement of payment of Deferred Compensation and Interest is Employee's termination of employment with Southwest, payment of the first of such annual Deferred Compensation and Interest payments shall be deferred to the extent necessary to cause such payment to comply with the six month deferral rule described in Section 409A(a)(2)(B) of the Internal Revenue Code if Employee at his termination of employment with Southwest is a "specified employee" within the meaning of such section. Notwithstanding the foregoing, in the event of the Employee's death, then the unpaid balance of the Deferred Compensation (together with any accrued Interest thereon) shall be paid to the executors or administrators of the Employee's estate in cash in one lump sum on the first business day of the calendar

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year next following the calendar year in which the Employee shall have died. No right, title, interest or benefit under this Paragraph IV-C shall ever be liable for or charged with any of the torts or obligations of the Employee or any person claiming under him, or be subject to seizure by any creditor of the Employee or any person claiming under him. Neither the Employee nor any person claiming under him shall have the power to anticipate or dispose of any right, title, interest or benefit under this Paragraph IV-C in any manner until the same shall have been actually distributed by Southwest.

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

- D. DISABILITY INSURANCE.** During the term of this Agreement, Southwest shall provide long term disability insurance providing for payment, in the event of disability of the Employee, of \$10,000 per month to age seventy (70). Except as to amounts payable, the terms and conditions of such policy shall be identical, or substantially similar, to the disability insurance provided by Southwest for its other officers as of the date of this Agreement.
- E. MEDICAL AND DENTAL EXPENSES.** During the term of this Agreement, the Employee shall remain eligible to participate in any medical benefit plan or program that Southwest makes available to its employees generally. Upon termination of his employment with Southwest, the Employee shall be eligible to participate in any non-contract retiree medical benefit plan or program that Southwest may then make available to its retirees generally. Southwest shall reimburse the Employee for all his out-of-pocket expenses (including specifically all premiums and deductibles) that the Employee may incur for himself, his spouse and his children under any such Southwest plan or program during the

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term of this Agreement. In addition, Southwest shall pay Employee the sum of \$10,000 per year to be applied to any supplemental insurance needs he may have, such amount to be payable on August 1 of each year during the term of this Agreement, beginning August 1, 2007.

- F. STOCK OPTION GRANT.** In connection with its approval of the terms of this Agreement on July 19, 2007, the Compensation Committee of the Board of Directors granted to the Employee ten-year options to purchase 150,000 shares of its common stock. Such options were granted pursuant to the Company's 2007 Equity Incentive Plan and one-third of such options were exercisable immediately and one-third will become exercisable on each of July 15, 2008 and July 15, 2009. Such options shall be incentive stock options to the maximum extent permissible under the terms of the 2007 Equity Incentive Plan. The exercise price of such options shall be the fair market value of Southwest's common stock on July 19, 2007 or the date of approval of the form of this Agreement by the Compensation Committee, whichever is higher.
- G. OTHER BENEFITS.** The Employee shall be eligible to continue to participate in all employee pension, profit-sharing, stock purchase, group insurance and other benefit plans or programs in effect for Southwest managerial employees generally to the extent of and in accordance with the rules and agreements governing such plans or programs, so long as same shall be in effect, with full service credit where relevant for the Employee's prior employment by Southwest. Southwest shall reimburse the Employee for reasonable expenses incurred by him in the performance of his duties and responsibilities hereunder. The Employee shall be entitled to vacation of three (3) weeks per year or such longer period as may be established from time to time by Southwest for its managerial employees generally.

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## V. TERMINATION PROVISIONS

- A. EXPIRATION OR DEATH.** The Employee's employment hereunder shall terminate on February 1, 2011 (or such later date to which the term of this Agreement may be extended by consent of the parties hereto, in either case without prejudice to the Employee's privilege to remain an employee of Southwest thereafter), or upon the Employee's death, whichever shall first occur, without further obligation or liability of either party hereunder, except for Southwest's obligation to pay Deferred Compensation as provided in Paragraph IV-C of this Agreement.
- B. TERMINATION FOR CAUSE.** Southwest may terminate the Employee's employment hereunder upon the determination by a majority of its whole Board of Directors that the Employee has willfully failed and refused to perform his duties and to discharge his responsibilities hereunder. Such determination shall be final and conclusive. If the Board of Directors of Southwest makes such determination, Southwest may (a) terminate the Employee's employment, effective immediately or at a subsequent date, or (b) condition his continued employment upon the circumstances and place a reasonable limitation upon the time within which the Employee shall comply with such considerations or requirements. If termination is so effected, Southwest shall have no further liability to the Employee hereunder except for the obligation to pay Deferred Compensation as provided in Paragraph IV-C hereof.

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- C. TERMINATION FOR DISABILITY.** Southwest may terminate the Employee's employment hereunder on account of any disabling illness, hereby defined to include any emotional or mental disorders, physical diseases or injuries as a result of which the Employee is, for a continuous period of ninety (90) days, unable to perform his duties hereunder. Southwest shall give to the Employee ninety (90) days' notice of its intention to effect such termination pursuant to this Paragraph V-C. If, within such notice period, the Employee shall have recovered from his disability sufficiently well to resume performance of his duties (although still undergoing treatment or rehabilitation), Southwest shall not have the right to effect such termination. If such disabling illness occurs as a result of a job-related cause, Southwest shall continue to pay the Employee regular installments of his Base Salary in effect at the time of such termination for the remainder of the term of this Agreement in accordance with Southwest's regular payroll practices; provided that, payment shall be deferred to the extent necessary to cause such payment to comply with the six month deferral rule described in Section 409A(a)(2)(B) of the Internal Revenue Code if Employee at his termination of employment with Southwest is a "specified employee" as defined in such section. It is expressly understood and agreed, however, that any obligation of Southwest to continue to pay the Employee his Base Salary pursuant to this Paragraph V-C shall be reduced by the amount of any proceeds of long-term disability insurance provided for the Employee pursuant to Paragraph IV-D above, and shall also be reduced by the amount of the proceeds of any worker's compensation or other benefits which the Employee receives as a result of or growing out of his disabling illness.
- D. CHANGE OF CONTROL TERMINATION.** In the event of any change of control of Southwest, the Employee may, at his option, terminate his employment hereunder by giving to Southwest notice thereof no later than sixty (60) days after the Employee shall have determined or ascertained that such change has occurred, irrespective whether Southwest

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shall have purported to terminate this Agreement after such event but prior to receipt of such notice. If termination is so effected, upon termination Southwest shall pay the Employee as "severance pay" a lump sum equal to (i) \$750,000 plus (ii) an amount equal to the unpaid installments of his Base Salary in effect at the time of such termination for the remaining term of this Agreement; provided, however, that if Employee is at his termination of employment with Southwest a "specified employee" within the meaning of Section 409A(a)(2)(B) of the Internal Revenue Code, payment of the "severance pay" shall be deferred to the extent necessary to cause such payment to comply with the six month deferral rule described in such section. If termination is so effected, Southwest shall have no other further liability to the Employee hereunder except for its obligation to pay Deferred Compensation as provided in Paragraph IV-C above. For purposes of this Paragraph V-D, a "change of control of Southwest" shall be deemed to occur if (i) a third person, including a "group" as determined in accordance with Section 13(d)(3) of the Securities Exchange Act of 1934, becomes the beneficial owner of shares of Southwest having twenty percent (20%) or more of the total number of votes that may be cast for the election of directors of Southwest, or (ii) as a result of, or in connection with, any cash tender or exchange offer, merger or other business combination, sale of assets or contested election, or any combination of the foregoing transactions (herein called a "Transaction"), the persons who were directors of Southwest before the Transaction shall cease to constitute a majority of the Board of Directors of Southwest or any successor to Southwest.

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- E. VOLUNTARY TERMINATION.** The Employee's employment hereunder shall terminate forthwith upon his resignation and its acceptance by Southwest, without further obligation or liability of either party hereunder, except for Southwest's obligation to pay Deferred Compensation as provided in Paragraph IV-C above.
- F. TERMINATION OF EMPLOYMENT GENERALLY.** For purposes of any payment under this Agreement: (i) from Employee's Deferred Compensation Account, (ii) of Employee's Base Salary due to a disabling illness occurring as a result of a job-related cause, or (iii) of "severance pay" following a "Change of Control of Southwest," any of which Employee becomes entitled to receive on account of his termination of employment, such termination of employment shall be deemed to refer only to a termination of employment that constitutes a "Separation from Service." For this purpose, "Separation from Service" means a reasonably anticipated permanent reduction in the level of bona fide services performed by the Employee for Southwest and all Affiliates to 20% or less of the average level of bona fide services performed by the Employee for Southwest and all Affiliates (whether as an employee or an independent contractor) in the immediately preceding thirty-six (36) months. For purposes of this paragraph, the term "Affiliate" means all companies that would be considered a single employer with Southwest under Section 414(b) or Section 414(c) of the Internal Revenue Code, except that the phrase "at least 50%" shall be substituted for the phrase "at least 80%" as used therein.

#### **VI. MISCELLANEOUS**

- A. ASSIGNABILITY, ETC.** The rights and obligations of Southwest hereunder shall inure to the benefit of and shall be binding upon the successors and assigns of Southwest; provided, however, Southwest's obligations hereunder may not be assigned without the prior approval of the Employee. This Agreement is personal to the Employee and may not be assigned by him.

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- B. NO WAIVERS.** Failure to insist upon strict compliance with any provision hereof shall not be deemed a waiver of such provision or any other provision hereof.
  - C. AMENDMENTS.** This Agreement may not be modified except by an agreement in writing executed by the parties hereto.
  - D. NOTICES.** Any notice required or permitted to be given under this Agreement shall be in writing in the English language and shall be deemed to have been given to the person affected by such notice when personally delivered or when deposited in the United States mail, certified mail, return receipt requested and postage prepaid, and addressed to the party affected by such notice at the address indicated on the signature page hereof.
  - E. SEVERABILITY.** The invalidity or unenforceability of any provision hereof shall not affect the validity or enforceability of any other provision hereof.
  - F. COUNTERPARTS.** This Agreement may be executed in multiple counterparts, each of which shall be deemed an original but all of which taken together shall constitute a single instrument.
  - G. ENTIRE AGREEMENT.** This Agreement contains all of the terms and conditions agreed upon by the parties hereto respecting the subject matter hereof, and all other prior agreements, oral or otherwise, regarding the subject matter of this Agreement shall be deemed to be superseded as of the date of this Agreement and not to bind either of the parties hereto.
  - H. GOVERNING LAW.** This Agreement shall be subject to and governed by the laws of the State of Texas.

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**IN WITNESS WHEREOF**, the Employee has set his hand hereto and Southwest has caused this Agreement to be signed in its corporate name and behalf by the Chairman of the Compensation Committee of the Board of Directors who is thereunto duly authorized, all as of the 20<sup>th</sup> day of November 2008.

**SOUTHWEST AIRLINES CO.**

By: /s/ Jeff Lamb  
Jeff Lamb  
Senior Vice President Administration & Chief People Officer

**THE EMPLOYEE**

/s/ Gary C. Kelly  
Gary C. Kelly

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

**EMPLOYMENT CONTRACT  
(as amended and restated November 20, 2008)**

**THIS EMPLOYMENT CONTRACT** (hereinafter referred to as this "Agreement"), effective as of July 15, 2007, and amended and restated effective as of November 20, 2008, by and between **COLLEEN C. BARRETT** (hereinafter referred to as the "Employee"), a resident of Dallas, Texas, and **SOUTHWEST AIRLINES CO.** (hereinafter referred to as "Southwest", which term shall include its subsidiary companies where the context so admits), a Texas corporation,

**WITNESSETH:**

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

**WHEREAS**, effective as of July 15, 2007, the Employee and Southwest entered into this successor agreement for the continuing services of the Employee (the "2007 Agreement"), which also amended and restated certain provisions of the Old Contracts; and

**WHEREAS**, the Employee and Southwest desire to amend and restate the 2007 Agreement in accordance with the provisions of the final regulations promulgated pursuant to Section 409A of the Internal Revenue Code, as well as other Department of Treasury and Internal Revenue Service guidance;

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

**I. POSITION, DUTIES AND AUTHORITY**

**A. POSITIONS; RETIREMENT FROM OFFICE; AND CONTINUED EMPLOYMENT.** The Employee shall serve as President of Southwest and, for so long as she shall be a

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member of the Board of Directors of Southwest, she shall serve in such capacity and as Corporate Secretary to the Board without additional compensation hereunder. Effective at the Annual Meeting of Shareholders of Southwest to be held in May 2008, the Employee shall retire from the Board of Directors of Southwest, and from her position as Corporate Secretary; effective as of July 15, 2008, the Employee shall resign her position as President of the Company. Notwithstanding such retirements and resignations, Employee shall remain an employee of Southwest through July 14, 2013, and during the period of such employment the Employee shall discharge the obligations set forth in Paragraph I-B of this Agreement. The Employee may elect to terminate her employment at any time prior to July 15, 2013, as provided in Paragraph V-E of this Agreement; provided, however, that in such event Southwest shall be relieved of any obligation to make further payments to the Employee under Paragraph IV-A hereunder

- B. DUTIES.** For so long as Employee remains President hereunder, the Employee's duties shall include managing the Customer and Employee relations functions of Southwest; achieving excellent Customer and Employee service quality; preserving the Southwest servant leader culture; and assisting the Chief Executive Officer in implementing Southwest's current and long range business policies and programs; and in general, maintaining Employee morale and esprit de corps. In addition, she shall perform such other corporate duties and discharge such other corporate responsibilities as are specified in the bylaws of Southwest or as designated from time to time by any of the Chairman of the Board of Directors of Southwest, the Chief Executive Officer or the full Board of Directors. Thereafter, the Employee agrees that she shall make herself generally available at the offices of Southwest in order to consult with the Chief Executive Officer of Southwest, or his designees, as to the business, properties or operations of Southwest. At all times during her employment the Employee shall generally conform to all policies of Southwest as they may apply to an employee of her level of duties and obligations.

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- C. **AUTHORITY.** The Employee shall be vested with all authority reasonably necessary to carry out her duties and responsibilities as set forth in this Article I.
  - D. **NECESSARY SUPPORT AND ENVIRONMENT.** Throughout the term of this Agreement, the Employee shall be provided with the office suite and appurtenances thereto that she occupied, and utilized, on July 15, 2007 and with the staff support that she received as of such date.

## **II. EMPLOYEE'S OBLIGATIONS**

- A. **TIME AND EFFORTS.** During the term of her employment hereunder, the Employee shall devote such time and effort as is required to discharge her duties hereunder.
- B. **NON-COMPETITION.** The Employee recognizes and understands that in performing the duties and responsibilities of her employment as outlined in this Agreement and pursuant to her employment at Southwest prior to the execution of this Agreement, the Employee has occupied and will occupy a position of trust and confidence, pursuant to which the Employee has developed and acquired and will develop and acquire experience and knowledge with respect to various aspects of the business of Southwest and the manner in which such business is conducted. It is the expressed intent and agreement of the Employee and Southwest that such knowledge and experience shall be used in the furtherance of the business interests of Southwest and not in any manner which would be detrimental to such business interests of Southwest. The Employee therefore agrees that, so long as the Employee is employed pursuant to this Agreement, unless she first secures the consent of the

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Board of Directors of Southwest, the Employee will not invest, engage or participate in any manner whatsoever, either personally or in any status or capacity (other than as a shareholder of less than one percent [1%] of the capital stock of a publicly owned corporation), in any business or other entity organized for profit engaged in significant competition with Southwest in the conduct of its air carrier operations anywhere in the States of Texas, Louisiana, Oklahoma, New Mexico, Missouri, Arizona, Nevada, California, Arkansas, Alabama, Tennessee, Kentucky, Michigan, Indiana, Ohio, Maryland, Illinois, Utah, Washington, Oregon, Nebraska, Florida, Idaho, Mississippi, New Hampshire, New York, Rhode Island, Connecticut, North Carolina, Virginia, Pennsylvania, and Colorado. Although the Employee and Southwest regard such restrictions as reasonable for the purpose of preserving Southwest and its proprietary rights, in the event that the provisions of this Paragraph II-B should ever be deemed to exceed the time or geographic limitations permitted by applicable laws, then such provisions shall be reformed to the maximum time or geographic limitations permitted by applicable laws.

### III. TERM

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

### IV. EMPLOYEE'S COMPENSATION

- A. **BASE SALARY.** The Employee's annual Base Salary shall be \$368,752 for the year ended July 15, 2008; thereafter the Employee's annual Base Salary for the balance of the term of this Agreement shall be \$400,000. The Employee's Base Salary shall be payable to the Employee in equal semi-monthly installments and shall be subject to such payroll and withholding deductions as may be required by law.

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- B. PERFORMANCE BONUS.** The Board of Directors of Southwest (or the Compensation Committee thereof) may grant a Performance Bonus to the Employee, in addition to her Base Salary, at such times and in such amounts as such Board (or Committee) may determine.
- C. DEFERRED COMPENSATION.** In addition to the Base Salary provided for in Paragraph IV-A above, Southwest shall continue to set aside on its books, as provided in Paragraph IV-C of each of the Old Contracts, a special ledger Deferred Compensation Account (the "Account") for the Employee, and shall credit thereto Deferred Compensation determined as hereinafter provided. (Southwest at its election may fund the payment of Deferred Compensation by setting aside and investing such funds as Southwest may from time to time determine. Neither the establishment of the Account, the crediting of Deferred Compensation thereto, nor the setting aside of any funds shall be deemed to create a trust. Legal and equitable title to any funds set aside shall remain in Southwest, and the Employee shall have no security or other interest in such funds. Any funds so set aside or invested shall remain subject to the claims of the creditors of Southwest, present and future.) For each full or partial calendar year as the Employee shall remain in the employment of Southwest under this Agreement, Deferred Compensation shall accumulate in an amount equal to any contributions (including forfeitures but excluding any elective deferrals actually returned to the Employee) which would otherwise have been made by Southwest on behalf of the Employee to the Southwest Airlines Co. Profitsharing Plan and Southwest Airlines Co. 401(k) Plan but which exceed the amount permitted to be so contributed due to the limitations under Sections 415(c) (the "415(c) Excess Amount") and 401(a)(17) of the

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Internal Revenue Code. If Employee's employment shall terminate prior to December 31 of any calendar year, Deferred Compensation shall nonetheless accumulate for such year to the extent that Employee is otherwise entitled to an allocation of the "Company Contribution" to the Southwest Airlines Co. ProfitSharing Plan for such year in accordance with the terms of the ProfitSharing Plan. In such case, Deferred Compensation shall be calculated for such year as provided above. Employee hereby elects not to invest the 415(c) Excess Amount in Southwest's 2005 Excess Benefit Plan (or any successor plan) during the term of this Agreement.

The Deferred Compensation credited to the Account (including the Interest hereinafter provided) shall be paid to the Employee (or to the executors or administrators of her estate) at the rate of \$200,000 per calendar year (subject to such payroll and withholding deductions as may be required by law), commencing with the calendar year following the year in which (i) the Employee shall attain the age of sixty-eight (68) or (ii) the Employee's employment with Southwest shall terminate (whether such termination is under this Agreement or otherwise and whether it is before, on or after the expiration of the initial term set forth in Paragraph III-A above, and irrespective of the cause thereof), whichever shall occur later, and continuing until the entire amount of Deferred Compensation and Interest credited to the Account shall have been paid. Although the total amount of Deferred Compensation ultimately payable to the Employee hereunder shall be computed in accordance with the provisions set forth above, there shall be accrued and credited to the Account, beginning on January 1, 2007 (if not so accrued and credited pursuant to the Old Contracts, and if so accrued and credited, then beginning on January 1, 2008) and continuing annually thereafter until the entire balance of the account has been distributed (whether such

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distribution takes place during the term of this Agreement or thereafter), amounts equal to simple interest at the rate of ten percent (10%) per annum, compounded annually ("Interest"), on the accrued and unpaid balance of the Deferred Compensation credited to the Account as of the preceding December 31. The Deferred Compensation and Interest to be paid in any one calendar year shall be paid on the first business day of such calendar year; provided, however, that if the event triggering commencement of payment of Deferred Compensation and Interest is Employee's termination of employment with Southwest, payment of the first of such annual Deferred Compensation and Interest payments shall be deferred to the extent necessary to cause such payment to comply with the six month deferral rule described in Section 409A(a)(2)(B) of the Internal Revenue Code if Employee at her termination of employment with Southwest is a "specified employee" within the meaning of such section. No right, title, interest or benefit under this Paragraph IV-C shall ever be liable for or charged with any of the torts or obligations of the Employee or any person claiming under her, or be subject to seizure by any creditor of the Employee or any person claiming under her. Neither the Employee nor any person claiming under her shall have the power to anticipate or dispose of any right, title, interest or benefit under this Paragraph IV-C in any manner until the same shall have been actually distributed by Southwest.

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

- D. DISABILITY INSURANCE.** During the term of this Agreement, Southwest shall provide long term disability insurance providing for payment, in the event of disability of the Employee, of \$10,000 per month to age seventy (70). Except as to amounts payable, the terms and conditions of such policy shall be identical, or substantially similar, to the disability insurance provided by Southwest for its other officers as of the date of this Agreement.

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- E. MEDICAL AND DENTAL EXPENSES.** During the term of this Agreement, the Employee shall remain eligible to participate in any medical benefit plan or program that Southwest makes available to its employees generally. Upon termination of her employment with Southwest, the Employee shall be eligible to participate in any non-contract retiree medical benefit plan or program that Southwest may then make available to its retirees generally. Southwest shall reimburse the Employee for all her out-of-pocket expenses (including specifically all premiums and deductibles) that the Employee may incur under any such Southwest plan or program during the term of this Agreement.
- F. STOCK OPTION GRANT.** In connection with its approval of the terms of this Agreement on July 19, 2007, the Compensation Committee of the Board of Directors granted to the Employee ten-year options to purchase 75,000 shares of its common stock. Such options were granted pursuant to the Company's 2007 Equity Incentive Plan and became exercisable with respect to 100% of the shares of Common Stock covered thereby on the date of grant. Such options shall be incentive stock options to the maximum extent permissible under the terms of the 2007 Equity Incentive Plan. The exercise price of such options shall be the fair market value of Southwest's common stock on July 19, 2007 or the date of approval of the form of this Agreement by the Compensation Committee, whichever is higher.
- G. OTHER BENEFITS.** The Employee shall be eligible to continue to participate in all employee pension, profit-sharing, stock purchase, group insurance and other benefit plans or programs in effect for Southwest managerial employees generally to the extent of and in

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accordance with the rules and agreements governing such plans or programs, so long as same shall be in effect, with full service credit where relevant for the Employee's prior employment by Southwest. Southwest shall reimburse the Employee for reasonable expenses incurred by her in the performance of her duties and responsibilities hereunder. The Employee shall be entitled to vacation of three (3) weeks per year or such longer period as may be established from time to time by Southwest for its managerial employees generally.

#### V. TERMINATION PROVISIONS

- A. EXPIRATION OR DEATH.** The Employee's employment hereunder shall terminate on July 15, 2013 (or such later date to which the term of this Agreement may be extended by consent of the parties hereto, in either case without prejudice to the Employee's privilege to remain an employee of Southwest thereafter), or upon the Employee's death, whichever shall first occur, without further obligation or liability of either party hereunder, except for Southwest's obligation to pay Deferred Compensation as provided in Paragraph IV-C of this Agreement.
- B. TERMINATION FOR CAUSE.** Southwest may terminate the Employee's employment hereunder upon the determination by a majority of its whole Board of Directors that the Employee has willfully failed and refused to perform her duties and to discharge her responsibilities hereunder. Such determination shall be final and conclusive. If the Board of Directors of Southwest makes such determination, Southwest may (a) terminate the Employee's employment, effective immediately or at a subsequent date, or (b) condition her continued employment upon the circumstances and place a reasonable limitation upon the time within which the Employee shall comply with such considerations or requirements. If termination is so effected, Southwest shall have no further liability to the Employee hereunder except for the obligation to pay Deferred Compensation as provided in Paragraph IV-C hereof.

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C. **TERMINATION FOR DISABILITY.** Southwest may terminate the Employee's employment hereunder on account of any disabling illness, hereby defined to include any emotional or mental disorders, physical diseases or injuries as a result of which the Employee is, for a continuous period of ninety (90) days, unable to perform her duties hereunder. Southwest shall give to the Employee ninety (90) days' notice of its intention to effect such termination pursuant to this Paragraph V-C. If, within such notice period, the Employee shall have recovered from her disability sufficiently well to resume performance of her duties (although still undergoing treatment or rehabilitation), Southwest shall not have the right to effect such termination. If such disabling illness occurs as a result of a job-related cause, Southwest shall continue to pay the Employee regular installments of her Base Salary in effect at the time of such termination for the remainder of the term of this Agreement in accordance with Southwest's regular payroll practices; provided that, payment shall be deferred to the extent necessary to cause such payment to comply with the six month deferral rule described in Section 409A(a)(2)(B) of the Internal Revenue Code if Employee at her termination of employment with Southwest is a "specified employee" as defined in such section. It is expressly understood and agreed, however, that any obligation of Southwest to continue to pay the Employee her Base Salary pursuant to this Paragraph V-C shall be reduced by the amount of any proceeds of long-term disability insurance provided for the Employee pursuant to Paragraph IV-D above, and shall also be reduced by the amount of the proceeds of any worker's compensation or other benefits which the Employee receives as a result of or growing out of her disabling illness.

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**D. CHANGE OF CONTROL TERMINATION.** In the event of any change of control of Southwest, the Employee may, at her option, terminate her employment hereunder by giving to Southwest notice thereof no later than sixty (60) days after the Employee shall have determined or ascertained that such change has occurred, irrespective whether Southwest shall have purported to terminate this Agreement after such event but prior to receipt of such notice. If termination is so effected, upon termination Southwest shall pay the Employee as “severance pay” a lump sum equal to (i) \$750,000 plus (ii) an amount equal to the unpaid installments of her Base Salary in effect at the time of such termination for the remaining term of this Agreement; provided, however, that if Employee is, at her termination of employment with Southwest, a “specified employee” within the meaning of Section 409A(a)(2)(B) of the Internal Revenue Code, payment of the “severance pay” shall be deferred to the extent necessary to cause such payment to comply with the six month deferral rule described in such section. If termination is so effected, Southwest shall have no other further liability to the Employee hereunder except for its obligation to pay Deferred Compensation as provided in Paragraph IV-C above. For purposes of this Paragraph V-D, a “change of control of Southwest” shall be deemed to occur if (i) a third person, including a “group” as determined in accordance with Section 13(d)(3) of the Securities Exchange Act of 1934, becomes the beneficial owner of shares of Southwest having twenty percent (20%) or more of the total number of votes that may be cast for the election of directors of Southwest, or (ii) as a result of, or in connection with, any cash tender or exchange offer, merger or other business combination, sale of assets or contested election, or any combination of the foregoing transactions (herein called a “Transaction”), the persons who were directors of Southwest before the Transaction shall cease to constitute a majority of the Board of Directors of Southwest or any successor to Southwest.

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- E. VOLUNTARY TERMINATION.** The Employee's employment hereunder shall terminate forthwith upon her resignation and its acceptance by Southwest, without further obligation or liability of either party hereunder, except for Southwest's obligation to pay Deferred Compensation as provided in Paragraph IV-C above.
- F. TERMINATION OF EMPLOYMENT GENERALLY.** For purposes of any payment under this Agreement: (i) from Employee's Deferred Compensation Account, (ii) of Employee's Base Salary due to a disabling illness occurring as a result of a job-related cause, or (iii) of "severance pay" following a "Change of Control of Southwest," any of which Employee becomes entitled to receive on account of her termination of employment, such termination of employment shall be deemed to refer only to a termination of employment that constitutes a "Separation from Service." For this purpose, "Separation from Service" means a reasonably anticipated permanent reduction in the level of bona fide services performed by the Employee for Southwest and all Affiliates to 20% or less of the average level of bona fide services performed by the Employee for Southwest and all Affiliates (whether as an employee or an independent contractor) in the immediately preceding thirty-six (36) months. For purposes of this paragraph, the term "Affiliate" means all entities that would be considered a single employer with Southwest under Section 414(b) or Section 414(c) of the Internal Revenue Code, except that the phrase "at least 50%" shall be substituted for the phrase "at least 80%" as used therein.

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**VI. MISCELLANEOUS**

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

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**H. GOVERNING LAW.** This Agreement shall be subject to and governed by the laws of the State of Texas.

**IN WITNESS WHEREOF**, the Employee has set her hand hereto and Southwest has caused this Agreement to be signed in its corporate name and behalf by the Chairman of the Compensation Committee of the Board of Directors who is thereunto duly authorized, all as of the 20<sup>th</sup> day of November 2008.

**SOUTHWEST AIRLINES CO.**

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

**THE EMPLOYEE**

/s/ Colleen C. Barrett  
Colleen C. Barrett

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

**SOUTHWEST AIRLINES CO.**

**EXCESS BENEFIT PLAN**

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SOUTHWEST AIRLINES CO.

EXCESS BENEFIT PLAN

Table of Contents

		<u>Page</u>
ARTICLE I	DEFINITIONS	1
ARTICLE II	ELIGIBILITY	2
ARTICLE III	CREDITS TO ACCOUNT	3
ARTICLE IV	BENEFITS	4
ARTICLE V	PAYMENT OF BENEFITS	4
ARTICLE VI	IN-SERVICE WITHDRAWALS AND LOANS	5
ARTICLE VII	ADMINISTRATION OF THE PLAN	7
ARTICLE VIII	LIMITATION OF RIGHTS	8
ARTICLE IX	LIMITATION OF ASSIGNMENT AND PAYMENTS TO LEGALLY INCOMPETENT DISTRIBUTEES	8
ARTICLE X	AMENDMENT TO OR TERMINATION OF THE PLAN	9
ARTICLE XI	STATUS OF PARTICIPANT AS UNSECURED CREDITOR	9
ARTICLE XII	GENERAL AND MISCELLANEOUS	9

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**SOUTHWEST AIRLINES CO.  
EXCESS BENEFIT PLAN**

**PREAMBLE**

WHEREAS, Southwest Airlines Co., a corporation formed under the laws of the State of Texas, desires to establish an excess benefit plan for the exclusive benefit of its employees to restore retirement benefits decreased due to limitations imposed by Section 415 of the Internal Revenue Code of 1986; and

WHEREAS, Southwest Airlines Co. intends that any Participant or Beneficiary under the Plan shall have the status of an unsecured general creditor with respect to the Plan and any Trust Fund;

NOW, THEREFORE, Southwest Airlines Co. hereby establishes the Southwest Airlines Co. Excess Benefit Plan, effective January 1, 1999.

**ARTICLE I**

**DEFINITIONS**

1.1 "Account" shall mean the record maintained by the Committee showing the monetary value of the individual interest in the Plan of each Participant or Beneficiary. The term "Account" shall refer only to a bookkeeping entry and shall not be construed to require the segregation of assets on behalf of any Participant or Beneficiary.

1.2 "Beneficiary" shall mean, with respect to each Participant, the beneficiary of such Participant under the Southwest Airlines Co. ProfitSharing Plan.

1.3 "Board" shall mean the Board of Directors of Southwest Airlines Co.

1.4 "Code" shall mean the Internal Revenue Code of 1986, as it may be amended from time to time, and the rules and regulations promulgated thereunder.

1.5 "Committee" shall mean the committee designated by the Board to administer the Plan.

1.6 "Company" shall mean Southwest Airlines Co., or its successor or successors.

1.7 "Effective Date" shall mean January 1, 1999.

1.8 "Excess Amount" shall mean, for a particular Plan Year, the amount by which the allocation(s) of a Participant under the Retirement Plans which are attributable to such Plan Year are reduced by reason of the application of the limitations set forth in Section 415 of the Code.

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1.9 "Mandatory Retirement Age" shall, with respect to each Southwest Airlines Co. pilot, mean the mandatory retirement age, if any, imposed by the Federal Aviation Agency.

1.10 "Participant" shall mean an Employee who has met the eligibility requirements for participation in this Plan, as set forth in Article II hereof.

1.11 "Plan" shall mean the Southwest Airlines Co. Excess Benefit Plan, as set forth in this document, and as amended from time to time.

1.12 "Plan Year" shall mean the annual period beginning on January 1 and ending on December 31, both dates inclusive of each year.

1.13 "Retirement Plans" shall mean the Southwest Airlines Co. ProfitSharing Plan (the "ProfitSharing Plan"), the Southwest Airlines Co. 401(k) Plan and the Southwest Airlines Co. Pilots Retirement Savings Plan.

1.14 "Trust Agreement" shall mean the agreement, if any, including any amendments thereto, entered into between the Company and the Trustee to carry out the provisions of the Plan.

1.15 "Trust Fund" shall mean the cash and other properties held and administered by the Trustee pursuant to the Trust Agreement.

1.16 "Trustee" shall mean the designated trustee acting at any time under the Trust Agreement.

1.17 "Valuation Date" shall mean each business day on which the financial markets are open for trading activity.

## **ARTICLE II**

### **ELIGIBILITY**

Each employee of the Company who qualifies for an allocation under each or any one of the Retirement Plans, and whose Excess Amount is at least \$1,000, shall be eligible to participate in this Plan.

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## ARTICLE III

### CREDITS TO ACCOUNT

3.1 For each Plan Year, as soon as practicable following the date on which the company funds its contribution, if any, to the ProfitSharing Plan, the Company shall credit to the Account of each Participant who is actively employed on the date on which such ProfitSharing contribution is funded, an amount equal to the Excess Amount of such Participant for the preceding Plan Year.

3.2 As of each Valuation Date, the Committee shall credit to each Participant's Account the deemed income or losses attributable thereto, as provided in Section 3.3 below, as well as any other credits to or charges against such Account, including such Participant's pro rata portion of Plan administrative expenses. All payments from an Account between Valuation Dates shall be charged against the Account as of the preceding Valuation Date.

3.3 Each Participant, prior to initial participation in the Plan, may, in the manner prescribed by the Committee, designate the manner in which amounts credited to such Participant's Account pursuant to Section 3.1 above shall be deemed to be invested among the various options designated by the Committee for this purpose. Such designation may be changed as of any Valuation Date solely with respect to amounts credited under Section 3.1 after the date of such change, and shall be effected by filing an election with the Committee, in the manner prescribed by the Committee, within the period of time prior to such Valuation Date established by the Committee. The Participant must designate, in such minimum percentages or amounts as may be prescribed by the Committee, that portion of the amount to be credited to the Account of such Participant which is to be allocated to each investment option offered hereunder. In the absence of any such investment designation, amounts credited to a Participant's Account shall be deemed to be invested in such property as the Committee, in its sole and absolute discretion, shall determine. In no event may any Participant designate the investment of amounts credited to an Account in stock or other securities of the Company. The Committee may, but shall not be obligated to, invest amounts credited to a Participant's Account in accordance with the investment designations of such Participant; nevertheless, the Account of such Participant shall be credited with the amount of income, gains and losses attributable thereto, as if the amounts credited to such Account had been so invested. The Committee shall be authorized at any time and from time to time to modify, alter, delete or add to the investment options hereunder. In the event a modification occurs, the Committee shall prior to the effective date of such change, notify those Participants whom the Committee, in its sole and absolute discretion, determines are affected by the change. The Committee shall not be obligated to substitute options with similar investment criteria for existing options, nor shall it be obligated to continue the types of investment options presently available to the Participants.

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**ARTICLE IV**

**BENEFITS**

4.1 Upon the death of a Participant, the Beneficiary of such Participant shall be entitled to the entire value of all amounts credited to such Participant's Account, as of the Valuation Date coincident with or preceding the date of distribution.

4.2 Upon a Participant's termination of employment or attainment of Mandatory Retirement Age, as applicable, such Participant shall be entitled to the entire value of all amounts credited to the Account of such Participant, as of the Valuation Date coincident with or preceding the date of distribution.

**ARTICLE V**

**PAYMENT OF BENEFITS**

5.1 Payment of a Participant's benefit on account of the attainment of Mandatory Retirement Age or termination of employment shall be made either in a lump sum in cash, or in cash payments in annual installments over a period certain not exceeding five (5) years, such method of payment to be irrevocably elected by the Participant upon initial participation in the Plan in the manner prescribed by the Committee; provided, however, that payment will be made in a lump sum in any event if, at the time distribution of the Account is to commence, the amount credited to the Account is \$25,000 or less. Furthermore, notwithstanding the commencement of installment payments under this Section 5.1, all remaining amounts credited to a Participant's Account shall be distributed in a lump sum in cash, at such time as the value of such remaining amounts is \$25,000 or less. Payment shall commence at the time specified by the Participant upon initial participation in the Plan, which may be as soon as practicable following the Participant's termination of employment with the Company or attainment of Mandatory Retirement Age, if applicable, and during the calendar year in which such event occurs or, if so elected by the Participant, as soon as practicable during the calendar year following the year in which such event occurs. If installment payments are made, such payments shall be charged pro rata to the individual investment options in which amounts credited to the Participant's Account are deemed to be invested, pursuant to the Participant's designation under Section 3.3 hereof. Furthermore, the Committee shall continue to credit the unpaid balance of the Participant's Account with the deemed income and losses attributable thereto, in accordance with such Participant's elections pursuant to the provisions of Section 3.3 hereof, as well as with any other credits to or charges against the unpaid balance of such Account, during the period for which installment payments are made.

5.2 Payment of a Participant's benefit on account of death shall be made in a lump sum in cash. Payment of a Participant's death benefit shall be made to the Beneficiary of such Participant as soon as practicable following the Committee's receipt of proper notice of such Participant's death.

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5.3 Notwithstanding any other provision herein to the contrary, unless a Participant elects, prior to the beginning of any Plan Year, in the manner and at the time prescribed by the Committee, to defer the receipt of all or a portion of the amount to be credited to the Account of such Participant hereunder for such Plan Year pursuant to Section 3.1 hereof, such amount shall be paid to such Participant in a cash lump sum as soon as practicable after such amount is credited to such Participant's Account. Any election to defer the receipt of all or a portion of the amount credited in accordance with Section 3.1 shall be permitted only if the portion deferred equals or exceeds \$1,000. Any such election shall be effective for all subsequent Plan Years, unless prior to the beginning of a Plan Year, the Participant affirmatively changes such election in the manner prescribed by the Committee.

5.4 Notwithstanding the provisions of sections 5.1 or 5.2, the benefits payable hereunder may be paid before they would otherwise be payable if, based on a change in the federal or applicable state tax or revenue laws, a published ruling or similar announcement issued by the Internal Revenue Service, a regulation issued by the Secretary of the Treasury, a decision by a court of competent jurisdiction involving a Participant or a Beneficiary, or a closing agreement made under Section 7121 of the Code that is approved by the Internal Revenue Service and involves a Participant, the Committee determines that a Participant has or will recognize income for federal or state income tax purposes with respect to amounts that are or will be payable under the Plan before they otherwise would be paid. The amount of any payments pursuant to this Section 5.4 shall not exceed the lesser of: (a) the amount in the Participant's Account or (b) the amount of taxable income with respect to which the tax liability is assessed or determined.

5.5 The payment of benefits under the Plan shall begin at the date specified in accordance with the provisions of Sections 5.1, 5.2 and 5.3 hereof; provided that, in case of administrative necessity, the starting date of payment of benefits may be delayed up to thirty (30) days as long as such delay does not result in the Participant or Beneficiary receiving the distribution in a different taxable year than if no such delay had occurred.

## ARTICLE VI

### IN-SERVICE WITHDRAWALS AND LOAN

6.1 In the event of an unforeseeable emergency, a Participant may make a request to the Committee for a withdrawal from the Account of such Participant. For purposes of this Section, the term "unforeseeable emergency" shall mean a severe financial hardship to the Participant resulting from a sudden and unexpected illness or accident of the Participant or of a dependent (as defined in Section 152(a) of the Code) of the Participant, loss of the Participant's property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the Participant. Any determination of the existence of an unforeseeable emergency and the amount to be withdrawn on account thereof shall be made by the Committee, in its sole and absolute discretion. However, notwithstanding the foregoing, a withdrawal will not be permitted to the extent that the financial hardship is or may be relieved: (i) through reimbursement or compensation by insurance or otherwise; (ii) by liquidation of the

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Participant's assets, to the extent that liquidation of such assets would not itself cause severe financial hardship; or (iii) by cessation of deferrals under this Plan. In no event shall the need to send a Participant's child to college or the desire to purchase a home be deemed to constitute an unforeseeable emergency. No member of the Committee shall vote or decide upon any matter relating to the determination of the existence of such member's own financial hardship or the amount to be withdrawn on account thereof. A request for a hardship withdrawal must be made in the manner prescribed by the Committee, and must be expressed as a specific dollar amount. The amount of a hardship withdrawal may not exceed the amount required to meet the severe financial hardship. All hardship withdrawals shall be paid in a lump sum in cash.

6.2 A Participant may, prior to the beginning of any Plan Year, in the manner prescribed by the Committee, request an in-service withdrawal of all or a portion of any amounts which have been credited to the Account of such Participant pursuant to Section 3.1 above for at least three (3) calendar years as of the beginning of such Plan Year, together with any income attributable thereto; provided, however, that the amount of any such withdrawal shall never exceed such credited amounts, as adjusted for any deemed income or losses attributable thereto. Such request must set forth the specific dollar amount to be withdrawn and the time at which payment is to be made. The Committee, in its sole and absolute discretion, shall, upon review of the facts pertinent to such request, determine whether the withdrawal request shall be approved. No member of the Committee shall vote upon, decide, or participate in any other way in a decision involving a withdrawal request of such Committee member. Any withdrawal under this Section 6.2 shall be made in a single lump sum, in cash.

6.3 Notwithstanding any other provision herein to the contrary, a Participant may elect at any time, in the manner prescribed by the Committee, to accelerate the date on which payment of such Participant's benefit hereunder would otherwise be made. Upon such election, the amount to which such Participant is entitled shall be ninety percent (90%) of the benefit otherwise payable hereunder, which shall be distributed in one lump sum, in cash, as soon as administratively practicable following such election.

6.4 Withdrawals shall be charged pro rata to the individual investment options in which amounts credited to a Participant's Account are deemed to be invested, pursuant to such Participant's designation under Section 3.3 hereof.

6.5 In no event may a Participant receive a loan of any portion of his benefit hereunder.

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**ARTICLE VII**

**ADMINISTRATION OF THE PLAN**

7.1 The Committee may establish a Trust Fund for the purpose of retaining assets set aside by the Company pursuant to the Trust Agreement for payment of all or a portion of the benefits payable pursuant to the Plan. Any benefits not paid from a Trust shall be paid from the Company's general assets. The Trust Fund, if such shall be established, shall be subject to the claims of general creditors of the Company in the event the Company is Insolvent, as such term is defined in the Trust Agreement.

7.2 The Plan shall be administered by the Committee. The members of the Committee shall not receive compensation with respect to their services for the Committee. The members of the Committee shall 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 a written resignation to the Company and to the other members of the Committee.

7.3 The Committee shall perform any act which the Plan authorizes expressed by a vote at a meeting or in a writing signed by a majority of its members without a meeting. The Committee may, by a writing signed by a majority of its members, appoint any member of the Committee to act on behalf of the Committee. Any person who is a member of the Committee shall not vote or decide upon any matter relating solely to such member or vote in any case in which the individual right or claim of such member to any benefit under the Plan is particularly involved. If, in any matter or case in which a person is so disqualified to act, the remaining persons constituting the Committee cannot resolve such matter or case, the Board will appoint a temporary substitute to exercise all the powers of the disqualified person concerning the matter or case in which such person is disqualified.

7.4 The Committee may designate in writing other persons to carry out its responsibilities under the Plan, and may remove any person designated to carry out its responsibilities under the Plan by notice in writing to that person. The Committee may employ persons to render advice with regard to any of its responsibilities. All usual and reasonable expenses of the Committee shall be paid by the Company. The Company shall indemnify and hold harmless each member of the Committee from and against any and all claims and expenses (including, without limitation, attorney's fees and related costs), in connection with the performance by such member of duties in that capacity, other than any of the foregoing arising in connection with the willful neglect or willful misconduct of the person so acting.

7.5 The Committee shall establish rules and procedures, not contrary to the provisions of the Plan, for the administration of the Plan and the transaction of its business. The Committee shall determine the eligibility of any individual to participate in the Plan, shall interpret the Plan in its sole and absolute discretion, and shall determine all questions arising in the administration, interpretation, and application of the Plan. All determinations of the Committee shall be conclusive and binding on all employees, Participants and Beneficiaries, subject to the provisions of this Plan and applicable law.

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7.6 Any action to be taken hereunder by the Company shall be taken by resolution adopted by the Board or by a committee thereof; provided, however, that by resolution, the Board or a committee thereof may delegate to any officer of the Company the authority to take any such actions hereunder, other than the power to amend or terminate the Plan.

## **ARTICLE VIII**

### **LIMITATION OF RIGHTS**

The establishment of this Plan shall not be construed as giving to any Participant, employee of the Company or any person whomsoever, any legal, equitable or other rights against the Company, or its officers, directors, agents or shareholders, or as giving to any Participant or Beneficiary any equity or other interest in the assets or business of the Company or shares of Company stock or as giving any employee the right to be retained in the employment of the Company. All employees of the Company and Participants shall be subject to discharge to the same extent they would have been if this Plan had never been adopted. The rights of a Participant hereunder shall be solely those of an unsecured general creditor of the Company.

## **ARTICLE IX**

### **LIMITATION OF ASSIGNMENT AND PAYMENTS TO LEGALLY INCOMPETENT DISTRIBUTE**

9.1 No benefits which shall be payable under the Plan to any person shall be subject in any manner to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance or charge, and any attempt to anticipate, alienate, sell, transfer, assign, pledge, encumber, charge or otherwise dispose of the same shall be void. No benefit shall in any manner be subject to the debts, contracts, liabilities; engagements or torts of any person, nor shall it be subject to attachment or legal process for or against any person, except to the extent required by law.

9.2 Whenever any benefit which shall be payable under the Plan is to be paid to or for the benefit of any person who is then a minor or determined by the Committee, on the basis of qualified medical advice, to be incompetent, the Committee need not require the appointment of a guardian or custodian, but shall be authorized to cause the same to be paid over to the person having custody of the minor or incompetent, or to cause the same to be paid to the minor or incompetent without the intervention of a guardian or custodian, or to cause the same to be paid to a legal guardian or custodian of the minor or incompetent, if one has been appointed, or to cause the same to be used for the benefit of the minor or incompetent.

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**ARTICLE X**

**AMENDMENT TO OR TERMINATION OF THE PLAN**

The Company reserves the right at any time to amend or terminate the Plan in whole or in part by resolution of the Board. No amendment shall have the effect of retroactively changing or depriving Participants or Beneficiaries of rights already accrued under the Plan. Upon termination of the Plan, the Board may, in its sole and absolute discretion, and notwithstanding any other provision hereunder to the contrary, direct that all benefits hereunder will be paid as soon as administratively practicable thereafter.

**ARTICLE XI**

**STATUS OF PARTICIPANT AS UNSECURED CREDITOR**

All benefits under the Plan shall be the unsecured obligations of the Company and, except for those assets which may be placed in a Trust Fund established in connection with this Plan, no assets will be placed in trust or otherwise segregated from the general assets of the Company for the payment of obligations hereunder. To the extent that any person acquires a right to receive payments hereunder, such right shall be no greater than the right of any unsecured general creditor of the Company.

**ARTICLE XII**

**GENERAL AND MISCELLANEOUS**

12.1 Severability. In the event that any provision of this Plan shall be declared illegal or invalid for any reason, said illegality or invalidity shall not affect the remaining provisions of this Plan but shall be fully severable and this Plan shall be construed and enforced as if said illegal or invalid provision had never been inserted herein.

12.2 Construction. The Section headings and numbers are included only for convenience of reference and are not to be taken as limiting or extending the meaning of any of the terms and provisions of this Plan. Whenever appropriate, words used in the singular shall include the plural or the plural may be read as the singular.

12.3 Governing Law. The validity and effect of this Plan and the rights and obligations of all persons affected hereby shall be construed and determined in accordance with the laws of the State of Texas unless superseded by federal law.

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12.4 No Requirement to Fund. The Company is not required to set aside any assets for payment of the benefits provided under this Plan; however, it may do so as provided in the Trust Agreement, if any. A Participant shall have no security interest in any such amounts. It is the Company's intention that this Plan be construed as a plan which is unfunded and maintained primarily for the purpose of providing deferred compensation for a select group of highly compensated employees.

12.5 Taxes. All amounts payable hereunder shall be reduced by any and all federal, state and local taxes imposed upon the Participant or a Beneficiary which are required to be paid or withheld by the Company.

IN WITNESS WHEREOF, Southwest Airlines Co., the Company, 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 hereunto duly authorized this 20th day of November, 1998.

COMPANY:  
SOUTHWEST AIRLINES CO.

By: /s/ Herbert D. Kelleher

ATTEST:

/s/ Colleen C. Barrett  
EVP – Customers & Corporate Secretary

[CORPORATE SEAL]

AMENDMENT NO. 1  
TO  
SOUTHWEST AIRLINES CO. EXCESS BENEFIT PLAN

Pursuant to the authority of the Board of Directors of Southwest Airlines Co., and the provisions of Article X thereof, the Southwest Airlines Co. Excess Benefit Plan is hereby amended, effective as of December 31, 2004, in the following respects only:

Article XII is hereby amended to add Section 12.6 to read as follows:

“12.6 Suspension of Certain Credits. Notwithstanding any provision of this Plan to the contrary, the Plan shall be frozen and all amounts which, on or after January 1, 2005, would otherwise be credited pursuant to Section 3.1 hereof shall be suspended to the extent crediting any such amount would result in a deferral of compensation to which Section 409A of the Code applies.”

IN WITNESS WHEREOF, and as conclusive evidence of the adoption of the foregoing instrument comprising Amendment No. 1 to Southwest Airlines Co. Excess Benefit Plan, the Company has caused these presents to be duly executed in its name and behalf by its proper officers thereunto duly authorized effective as of the 31<sup>st</sup> day of December 2004.

SOUTHWEST AIRLINES CO.

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

ATTEST:

/s/ Deborah Ackerman  
Deborah Ackerman, Assistant Secretary

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STATE OF TEXAS           §  
  §  
COUNTY OF DALLAS       §

BEFORE ME, the undersigned, a Notary Public in and for said County and State, on this 15<sup>th</sup> day of December, 2005, personally appeared GARY C. KELLY, to me known to be the identical person who subscribed the name of SOUTHWEST AIRLINES CO., as its CHIEF EXECUTIVE OFFICER to the foregoing instrument and acknowledged to me that he executed the same as his free and voluntary act and deed and as the free and voluntary act and deed of such organization for the uses and purposes therein set forth.

GIVEN UNDER MY HAND AND SEAL OF OFFICE, the day and year last above written.

/s/ Teri Lee Lambert  
Notary Public in and for the State of Texas

My Commission Expires: June 4, 2006

**AMENDMENT NO. 2  
TO  
SOUTHWEST AIRLINES CO. EXCESS BENEFIT PLAN**

Pursuant to the authority of the Board of Directors of Southwest Airlines Co., and the provisions of Article X thereof, the Southwest Airlines Co. Excess Benefit Plan is hereby amended, effective as of November 20, 2008, in the following respects only:

Article VI, Section 6.2, is hereby deleted in its entirety.

IN WITNESS WHEREOF, and as conclusive evidence of the adoption of the foregoing instrument comprising Amendment No. 2 to the Southwest Airlines Co. Excess Benefit Plan, the Company has caused these presents to be duly executed in its name and behalf by its proper officer thereunto duly authorized this 16<sup>th</sup> day of December 2008.

**SOUTHWEST AIRLINES CO.**

By: /s/ Gary C. Kelly  
Name: Gary C. Kelly  
Its: Chief Executive Officer

**AMENDED AND RESTATED  
SOUTHWEST AIRLINES CO.  
2005 EXCESS BENEFIT PLAN**

(as amended and restated effective for plan years beginning on and after January 1, 2009)

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**AMENDED AND RESTATED  
SOUTHWEST AIRLINES CO.  
2005 EXCESS BENEFIT PLAN**  
(as amended and restated effective for plan years beginning January 1, 2009)

Table of Contents

	<u>Page</u>
ARTICLE I	1
ARTICLE II	3
ARTICLE III	3
ARTICLE IV	5
ARTICLE V	5
ARTICLE VI	8
ARTICLE VII	8
ARTICLE VIII	9
ARTICLE IX	11
ARTICLE X	11
ARTICLE XI	11
ARTICLE XII	12
ARTICLE XIII	13

**AMENDED AND RESTATED  
SOUTHWEST AIRLINES CO.  
2005 EXCESS BENEFIT PLAN**

(as amended and restated effective for plan years beginning on and after January 1, 2009)

**PREAMBLE**

WHEREAS, Southwest Airlines Co., a corporation formed under the laws of the State of Texas, previously established the Southwest Airlines Co. 2005 Excess Benefit Plan, as amended and restated effective January 1, 2008, an excess benefit plan for the exclusive benefit of a select group of highly compensated employees, to restore retirement benefits decreased due to limitations imposed by Section 415 of the Internal Revenue Code of 1986; and

WHEREAS, such plan has been designed to comply with Section 409A of the Internal Revenue Code;

WHEREAS, Southwest Airlines Co. now desires to amend and restate such plan in accordance with the provisions of the final regulations promulgated pursuant to Section 409A of the Internal Revenue Code, as well as other Department of Treasury and Internal Revenue Service guidance; and

WHEREAS, Southwest Airlines Co. intends that any Participant or Beneficiary under such plan shall have the status of an unsecured general creditor with respect to the Plan and any Trust Fund; and

NOW, THEREFORE, the 2005 Excess Benefit Plan is hereby amended and restated in its entirety, effective for Plan Years commencing on and after January 1, 2009, as follows:

**ARTICLE I  
DEFINITIONS**

1.1 "Account" shall mean the record maintained by the Committee showing the monetary value of the individual interest in the Plan of each Participant or Beneficiary. The term "Account" shall refer only to a bookkeeping entry and shall not be construed to require the segregation of assets on behalf of any Participant or Beneficiary.

1.2 "Affiliate" means each entity that would be considered a single employer with the Company under Section 414(b) or Section 414(c) of the Code, except that the phrase "at least 50%" shall be substituted for the phrase "at least 80%" as used therein.

1.3 "Aggregated Plan" means all agreements, methods, programs and other arrangements that are aggregated with this Plan under Section 1.409A-1(c) of the Treasury Regulations.

1.4 "Beneficiary" shall mean, with respect to each Participant, the beneficiary of such Participant under the Southwest Airlines Co. ProfitSharing Plan.

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- 1.5 "Board" shall mean the Board of Directors of the Company.
- 1.6 "Code" shall mean the Internal Revenue Code of 1986, as it may be amended from time to time, and the rules and regulations promulgated thereunder.
- 1.7 "Committee" shall mean the committee designated by the Board to administer the Plan.
- 1.8 "Company" shall mean Southwest Airlines Co., or its successor or successors.
- 1.9 "Deferral Amount" shall mean that portion of a Participant's Excess Amount with respect to which such Participant has made a deferral election, as provided in Section 3.1 hereof.
- 1.10 "Excess Amount" shall mean, for a particular Plan Year, the amount by which the allocation(s) of a Participant under the Retirement Plans that are attributable to such Plan Year are reduced by reason of the application of the limitations set forth in Section 415 of the Code.
- 1.11 "Mandatory Retirement Age" shall, with respect to each Southwest Airlines Co. pilot, mean the mandatory retirement age for commercial airline pilots, if any, imposed by the Federal Aviation Administration or applicable law.
- 1.12 "Participant" shall mean an employee of the Company who has met the eligibility requirements for participation in this Plan, as set forth in Article II hereof, and who has made a deferral election under the Plan, as provided in Section 3.1 hereof.
- 1.13 "Plan" shall mean the Amended and Restated Southwest Airlines Co. 2005 Excess Benefit Plan, as set forth in this document.
- 1.14 "Plan Year" shall mean the annual period beginning on January 1 and ending on December 31, both dates inclusive of each year.
- 1.15 "Prior Plan" shall mean the Southwest Airlines Co. 2005 Excess Benefit Plan, as amended and restated effective January 1, 2008, and the Southwest Airlines Co. 2005 Excess Benefit Plan, effective for Plan Years commencing on and after January 1, 2004.
- 1.16 "Retirement Plans" shall mean the Southwest Airlines Co. ProfitSharing Plan (the "ProfitSharing Plan"), the Southwest Airlines Co. 401(k) Plan, and the Southwest Airlines Co. Pilots Retirement Savings Plan, each as amended from time to time.
- 1.17 "Separation from Service" shall mean a reasonably anticipated permanent reduction in the level of bona fide services performed by the Participant for the Company and all Affiliates to 20% or less of the average level of bona fide services performed by the Participant for the Company and all Affiliates (whether as an employee or an independent contractor) over the immediately preceding thirty-six (36) months (or the full period of service to the Company and all Affiliates if less than thirty-six (36) months). The determination of whether a Separation from Service has occurred shall be made by the Committee in accordance with the provisions of Section 409A of the Code.

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1.18 "Specified Employee" shall mean a key employee, as defined in Section 416(i) of the Code, without regard to paragraph (5) thereof, of the Company, as contemplated in Section 409A of the Code.

1.19 "Spouse" means an individual of the opposite sex who is married to the Participant.

1.20 "Trust Agreement" shall mean the agreement, if any, including any amendments thereto, entered into between the Company and the Trustee to carry out the provisions of the Plan.

1.21 "Trust Fund" shall mean the cash and other properties held and administered by the Trustee pursuant to the Trust Agreement.

1.22 "Trustee" shall mean the designated trustee acting at any time under the Trust Agreement.

1.23 "Valuation Date" shall mean each business day on which the financial markets are open for trading activity, or such other dates as shall be established by the Committee.

## **ARTICLE II ELIGIBILITY**

Prior to the end of each Plan Year, the Committee shall, in a timely manner, notify those individuals whom it has determined may have an Excess Amount for the following Plan Year (an "Eligible Plan Year") that equals or exceeds \$1,000, which individuals shall constitute a select group of highly compensated employees of the Company. Such individuals may elect to participate hereunder with respect to an Eligible Plan Year, in the manner prescribed by the Committee. The determination as to the eligibility of any individual to participate in the Plan or to continue to participate shall be in the sole and absolute discretion of the Committee, whose decision in that regard shall be conclusive and binding for all purposes hereunder.

## **ARTICLE III CREDITS TO ACCOUNT**

3.1 Effective January 1, 2005, and continuing for each Plan Year thereafter, each individual who has been notified of his or her eligibility to participate in the Plan with respect to an Eligible Plan Year may, in the manner prescribed by the Committee, irrevocably elect a Deferral Amount, provided that such election must be made no later than the last day of December immediately preceding such Eligible Plan Year and prior to such earlier date as may be established by the Committee and communicated to the eligible individuals. Each deferral election with respect to an Eligible Plan Year shall be contingent on a minimum Excess Amount of \$1,000 and such deferral election shall not be effective if the Participant's Excess Amount for that Eligible Plan Year is less than \$1,000. Subject to the preceding sentence, a Participant's deferral election under this Section 3.1 shall be effective with respect to all subsequent Eligible Plan Years for which such Participant is eligible to make a deferral election, unless prior to the beginning of an Eligible Plan Year, the Participant affirmatively changes such election in the manner prescribed by the Committee.

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3.2 As soon as practicable following the date on which the Company funds its contribution, if any, for an Eligible Plan Year to the ProfitSharing Plan, the Company shall credit a Participant's Deferral Amount, if any, to the Account of such Participant. Notwithstanding the preceding sentence, if such Participant is not actively employed on the date on which such ProfitSharing contribution is funded or in the event that the Participant's Excess Amount for such Eligible Plan Year is less than \$1,000, such Excess Amount will be paid to the Participant in a cash lump sum during the calendar year immediately following the Eligible Plan Year.

3.3 As of each Valuation Date, the Committee shall credit to each Participant's Account the deemed income or losses attributable thereto, as provided in Section 3.4 below, as well as any other credits to or charges against such Account, including such Participant's pro rata portion of Plan administrative expenses. All payments from an Account between Valuation Dates shall be charged against the Account as of the preceding Valuation Date.

3.4 Each Participant, prior to initial participation in the Plan, may, in the manner prescribed by the Committee, designate the manner in which amounts credited to such Participant's Account, as provided above, shall be deemed to be invested among the various options designated by the Committee for this purpose; provided however, that any such designation in effect under the Prior Plan on December 31, 2004 shall automatically carry over and apply to this Plan effective January 1, 2005 until changed by the Participant. A Participant may change the investment designation as of any Valuation Date solely with respect to amounts credited to such Participant's Account after the date of such change, which change shall be effected by filing an election with the Committee, in the manner prescribed by the Committee, within the period of time prior to such Valuation Date established by the Committee. The Participant must designate, in such minimum percentages or amounts as may be prescribed by the Committee, that portion of the amount to be credited to the Account of such Participant that is to be allocated to each investment option offered hereunder. In the absence of any such investment designation, amounts credited to a Participant's Account shall be deemed to be invested in such property as the Committee, in its sole and absolute discretion, shall determine. In no event may any Participant designate the investment of amounts credited to an Account in stock or other securities of the Company. The Committee may, but shall not be obligated to, invest amounts credited to a Participant's Account in accordance with the investment designations of such Participant; nevertheless, the Account of such Participant shall be credited with the amount of income, gains and losses attributable thereto, as if the amounts credited to such Account had been so invested. The Committee shall be authorized at any time and from time to time to modify, alter, delete or add to the investment options hereunder. In the event a modification occurs, the Committee shall, prior to the effective date of such change, notify those Participants whom the Committee, in its sole and absolute discretion, determines are affected by the change. The Committee shall not be obligated to substitute options with similar investment criteria for existing options, nor shall it be obligated to continue the types of investment options presently available to the Participants.

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**ARTICLE IV  
ENTITLEMENT TO BENEFITS**

Except as otherwise provided herein, each Participant (or, in the case of death, the Beneficiary of such Participant) shall be entitled to receive benefits hereunder upon (i) such Participant's Separation from Service, (ii) such Participant's attainment of Mandatory Retirement Age, (iii) such Participant's death, or (iv) the occurrence of an unforeseeable emergency (subject to the Committee's approval of a request pursuant to Article VI below). The time and form of the payment of benefits to a Participant in the event of Separation from Service, attainment of Mandatory Retirement Age, or death will be in accordance with the provisions of Article V below. Any payment of benefits to a Participant upon the occurrence of an unforeseeable emergency will be in accordance with the provisions of Article VI below.

Each Participant or, in the case of the death of a Participant, the Beneficiary of such Participant shall be entitled to the entire value of all amounts credited to such Participant's Account, as of the Valuation Date coincident with the date of distribution hereunder.

**ARTICLE V  
PAYMENT OF BENEFITS**

5.1 Time of Payment. A Participant may elect to receive or commence receiving payment of his or her Account at one of the following times:

- (a) during the calendar year in which the Participant's Separation from Service occurs;
- (b) during the calendar year following the calendar year in which the Participant's Separation from Service occurs;
- (c) during the calendar year in which the Participant attains Mandatory Retirement Age if Mandatory Retirement Age occurs earlier than the Participant's Separation from Service and, if not, during the calendar year in which the Participant's Separation from Service occurs; or
- (d) during the calendar year following the calendar year in which the Participant attains Mandatory Retirement Age if Mandatory Retirement Age occurs earlier than the Participant's Separation from Service and, if not, during the calendar year following the calendar year in which the Participant's Separation from Service occurs.

Notwithstanding a Participant's election, if a Participant has elected to receive payment based on a Separation from Service and such Participant is a Specified Employee at the time of his or her Separation from Service, such Participant's distribution will be delayed until the date that is six months following his or her Separation from Service, to the extent required by Section 409A of the Code. In addition, notwithstanding a Participant's election, in the event of a Participant's death, payment will be made during the calendar year of the Participant's death or, if later, within the ninety (90) day period following the date of the Participant's death.

5.2 Form of Payment. A Participant may elect to receive payment of his or her Account in either a lump sum in cash or in substantially equal annual cash installments over a period certain not exceeding five (5) years. In the event a Participant who has elected to receive cash installments is subject to a six-month delay in accordance with Section 5.1 above, such Participant's first payment will include all installment payments that would otherwise have become due during the period of delay. If a Participant elects to receive installment payments,

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the Committee shall continue to credit the unpaid balance of the Participant's Account with the deemed income and losses attributable thereto, in accordance with the provisions of Section 3.4 above, as well as with any other credits to or charges against the unpaid balance of such Account, during the period for which installment payments are made. Notwithstanding a Participant's election, (i) in the event of the Participant's death, payment will be made in a lump sum in cash; and (ii) a Participant who has elected installment payments will receive a lump sum distribution in cash at such time as the value of the Participant's Account is \$25,000 or less.

5.3 Timing of Elections as to Time and Form of Payment. A Participant must elect the time and form of payment of his or her Account prior to the beginning of the Plan Year with respect to which the Participant first makes his or her initial deferral election under the Plan. Such election must be made in the manner prescribed by the Committee. Such election will be irrevocable and will apply to the Participant's entire Account balance; provided, however, that prior to January 1, 2009, each Participant will be provided the opportunity to make a new, single election as to the time and form of payment of all amounts previously credited to his or her Account, as well as amounts yet to be deferred and credited (the "2009 Election"); and provided further, however, that a 2009 Election may not delay any payments a Participant would otherwise have received during the 2008 calendar year and may not accelerate into 2008 any payments a Participant would not have otherwise received in 2008.

5.4 Default Elections. If a new Participant in the Plan fails to elect a time or form of payment in accordance with the requirements of Sections 5.1 through 5.3 above, the Participant (or, if applicable, the Participant's Beneficiary) will receive his or her payment in a lump sum in cash during the calendar year following the calendar year in which the Participant's Separation from Service occurs or, in the event of the Participant's death, during the calendar year of the Participant's death or, if later, within the ninety (90) day period following the Participant's death. If a Participant who has made an election under the Prior Plan fails to make a 2009 Election, such Participant's prior election will continue to apply with respect to the following: (i) whether payment will be triggered based on his or her Separation from Service or attainment of Mandatory Retirement Age; (ii) whether payment will be made or commence during the calendar year of or following his or her Separation from Service or attainment of Mandatory Retirement Age, as applicable; and (iii) whether payment will be made in a lump sum or in installments; however, all other provisions of this Plan that govern time and form of payment will apply to such prior election, and any reference to "termination of employment" in a Participant's prior election shall be deemed to mean Separation from Service.

5.5 Change in Time of Payments. Notwithstanding any provision of this Article V to the contrary, the benefits payable hereunder may, to the extent expressly provided in this Section 5.5, be paid prior to or later than the date on which they would otherwise be paid to the Participant.

(a) Distribution in the Event of Income Inclusion Under Code Section 409A. If any portion of a Participant's Account is required to be included in income by the Participant prior to receipt due to a failure of this Plan or any Aggregated Plan to comply with the requirements of Code Section 409A, the Committee may determine that such Participant shall receive a distribution from the Plan in an amount equal to the lesser of: (i) the portion of his or her Account required to be included in income as a result of the failure of the Plan or any Aggregated Plan to comply with the requirements of Code Section 409A, or (ii) the balance of the Participant's Account.

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(b) Distribution Necessary to Satisfy Applicable Tax Withholding. If the Company is required to withhold amounts to pay the Participant's portion of the Federal Insurance Contributions Act (FICA) tax imposed under Code Sections 3101, 3121(a) or 3121(v)(2) with respect to amounts that are or will be paid to the Participant under the Plan before they otherwise would be paid, the Committee may determine that such Participant shall receive a distribution from the Plan in an amount equal to the lesser of: (i) the amount in the Participant's Account or (ii) the aggregate of the FICA taxes imposed and the income tax withholding related to such amount.

(c) Delay for Payments in Violation of Federal Securities Laws or Other Applicable Law. In the event the Company reasonably anticipates that the payment of benefits as specified hereunder would violate Federal securities laws or other applicable law, the Committee may delay the payment under this Article V until the earliest date at which the Company reasonably anticipates that the making of such payment would not cause such violation.

(d) Delay for Insolvency or Compelling Business Reasons. In the event the Company determines that the making of any payment of benefits on the date specified hereunder would jeopardize the ability of the Company to continue as a going concern, the Committee may delay the payment of benefits under this Article V until the first calendar year in which the Company notifies the Committee that the payment of benefits would not have such effect.

(e) Administrative Delay in Payment. The payment of benefits hereunder shall begin at the date specified in accordance with the provisions of the foregoing paragraphs of this Article V; provided that, in the case of administrative necessity, the payment of such benefits may be delayed up to the later of the last day of the calendar year in which payment would otherwise be made or the 15<sup>th</sup> day of the third calendar month following the date on which payment would otherwise be made. Further, if, as a result of events beyond the control of the Participant (or following the Participant's death, the Participant's Beneficiary), it is not administratively practicable for the Committee to calculate the amount of benefits due to Participant as of the date on which payment would otherwise be made, the payment may be delayed until the first calendar year in which calculation of the amount is administratively practicable.

(f) No Participant Election. Notwithstanding the foregoing provisions, if the period during which payment of benefits hereunder will be made occurs, or will occur, in two calendar years, the Participant shall not be permitted to elect the calendar year in which the payment shall be made.

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**ARTICLE VI**  
**IN-SERVICE WITHDRAWALS AND LOANS**

6.1 In the event of an unforeseeable emergency, a Participant may make a request to the Committee for a withdrawal from his or her Account. For purposes of this Section, the term "unforeseeable emergency" shall mean a severe financial hardship to the Participant resulting from an illness or accident of the Participant, the Participant's Spouse, or a dependent (as defined in Section 152(a) of the Code, without regard to Sections 152(b)(1), (b)(2), and (d)(1)(B) of the Code) of the Participant, loss of the Participant's property due to casualty (including the need to rebuild a home following damage to a home not otherwise covered by insurance, as in the case of a natural disaster), or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the Participant. Any determination of the existence of an unforeseeable emergency and the amount to be withdrawn on account thereof shall be made by the Committee, in its sole and absolute discretion. However, the amount to be withdrawn on account of an unforeseeable emergency may not exceed the amounts necessary to satisfy such emergency plus amounts necessary to pay taxes reasonably anticipated as a result of the distribution, after taking into account the extent to which such hardship is or may be relieved: (i) through reimbursement or compensation by insurance or otherwise; (ii) by liquidation of the Participant's assets, to the extent that liquidation of such assets would not itself cause severe financial hardship; or (iii) by cessation of deferrals under this Plan. In no event shall the need to send a Participant's child to college or the desire to purchase a home be deemed to constitute an unforeseeable emergency. No member of the Committee shall vote or decide upon any matter relating to the determination of the existence of such member's own financial hardship. A request for a withdrawal on account of an unforeseeable emergency must be made in the manner prescribed by the Committee, and must be expressed as a specific dollar amount. All hardship withdrawals shall be paid in a lump sum in cash.

6.2 Withdrawals shall be charged pro rata to the individual investment options in which amounts credited to a Participant's Account are deemed to be invested, pursuant to such Participant's designation under Section 3.4 hereof.

6.3 In no event may a Participant receive a loan of any portion of his benefit hereunder.

**ARTICLE VII**  
**ADMINISTRATION OF THE PLAN**

7.1 The Committee may establish a Trust Fund for the purposes of retaining assets set aside by the Company pursuant to the Trust Agreement for payment of all or a portion of the benefits payable pursuant to the Plan. Any benefits not paid from a Trust shall be paid from the Company's general assets. The Trust Fund, if such shall be established, shall be subject to the claims of general creditors of the Company in the event the Company is Insolvent, as such term is defined in the Trust Agreement.

7.2 The Plan shall be administered by the Committee. The members of the Committee shall not receive compensation with respect to their services for the Committee. The members of the Committee shall serve without bond or security for the performance of their

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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 a written resignation to the Company and to the other members of the Committee.

7.3 The Committee shall perform any act that the Plan authorizes expressed by a vote at a meeting or in a writing signed by a majority of its members without a meeting. The Committee may, by a writing signed by a majority of its members, appoint any member of the Committee to act on behalf of the Committee. Any person who is a member of the Committee shall not vote or decide upon any matter relating solely to such member or vote in any case in which the individual right or claim of such member to any benefit under the Plan is particularly involved. If, in any matter or case in which a person is so disqualified to act, the remaining persons constituting the Committee cannot resolve such matter or case, the Board will appoint a temporary substitute to exercise all the powers of the disqualified person concerning the matter or case in which such person is disqualified.

7.4 The Committee may designate in writing other persons to carry out its responsibilities under the Plan, and may remove any person designated to carry out its responsibilities under the Plan by notice in writing to that person. The Committee may employ persons to render advice with regard to any of its responsibilities. All usual and reasonable expenses of the Committee shall be paid by the Company. The Company shall indemnify and hold harmless each member of the Committee from and against any and all claims and expenses (including, without limitation, attorneys' fees and related costs), in connection with the performance by such member of duties in that capacity, other than any of the foregoing arising in connection with the willful neglect or willful misconduct of the person so acting.

7.5 The Committee shall establish rules and procedures, not contrary to the provisions of the Plan, for the administration of the Plan and the transaction of its business. The Committee shall determine the eligibility of any individual to participate in the Plan, shall interpret the Plan in its sole and absolute discretion, and shall determine all questions arising in the administration, interpretation and application of the Plan. All determinations of the Committee shall be conclusive and binding on all employees, Participants and Beneficiaries, subject to the provisions of this Plan and applicable law.

7.6 Any action to be taken hereunder by the Company shall be taken by resolution adopted by the Board or by a committee thereof; provided, however, that by resolution, the Board or a committee thereof may delegate to any officer of the Company the authority to take any such actions hereunder, other than the power to amend or terminate the Plan.

#### **ARTICLE VIII CLAIMS REVIEW PROCEDURE**

8.1 In the event that a Participant or Beneficiary (the "Claimant") is denied a claim for benefits under this Plan, the Committee will, within a reasonable period of time, but not later than ninety (90) days after its receipt of the claim, provide the Claimant a written statement, which shall be delivered or mailed to the Claimant by certified or registered mail to his or her last known address, and which will contain the following:

- (a) the specific reason or reasons for the denial of benefits;

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(b) a specific reference to the pertinent provisions of the Plan upon which the denial is based;

(c) a description of any additional material or information that is necessary for the Claimant to perfect the claim and an explanation of why such material or information is necessary; and

(d) an explanation of the review procedures and the time limits applicable to such procedures, as provided below, including a statement of the Claimant's right to bring a civil action under Section 502(a) of ERISA following an adverse benefit determination on review.

In the event that the Committee determines that an extension is necessary due to matters beyond the control of the Plan, the Committee will provide the Claimant with the written statement described above not later than one hundred eighty (180) days after receipt of the Claimant's claim, but, in that event, the Committee will furnish the Claimant, within ninety (90) days after its receipt of the claim, written notification of the extension explaining the special circumstances requiring the extension and the date by which the Committee expects to render a decision.

8.2 Within sixty (60) days after receipt of a notice of a denial of benefits as provided above, if the Claimant disagrees with the denial of benefits, the Claimant or his or her authorized representative may request, in writing, that the Committee review the Claimant's claim and may request to appear before the Committee for the review. The Claimant will be given the opportunity to submit written comments, documents, records, and other information relating to the claim for benefits. The Claimant will be provided, upon request and free of charge, reasonable access to, and copies of, all documents, records, and other information relevant to the Claimant's claim for benefits, as provided in Department of Labor regulations. In conducting its review, the Committee will consider all comments, documents, records, and other information relating to the claim submitted by the Claimant or his or her authorized representative, whether or not such information was submitted or considered in the initial benefit determination.

8.3 Within a reasonable period of time, but not later than sixty (60) days after receipt by the Committee of a written application for review of the Claimant's claim, the Committee will notify the Claimant of its decision on review by delivery or by certified or registered mail to the Claimant's last known address; provided, however, in the event that special circumstances require an extension of time for processing such application, the Committee will so notify the Claimant of its decision not later than one hundred twenty (120) days after receipt of such application, but, in that event, the Committee will furnish the Claimant, within sixty (60) days after its receipt of such application, written notification of the extension explaining the special circumstances requiring the extension and the date that it is anticipated that its decision will be furnished. The decision of the Committee will be in writing and will include the specific reasons for the decision presented in a manner calculated to be understood by the Claimant and will contain reference to all relevant Plan provisions on which the decision was based, as well as a statement that the Claimant is entitled to receive, upon request and free of charge, reasonable

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access to, and copies of, all documents, records, and other information relevant to the Claimant's claim for benefits, and a statement of the Claimant's right to bring an action under Section 502(a) of the Employee Retirement Income Security Act of 1974. The decision of the Committee will be final and conclusive.

**ARTICLE IX  
LIMITATION OF RIGHTS**

The establishment of this Plan shall not be construed as giving to any Participant, employee of the Company or any person whomsoever, any legal, equitable or other rights against the Company, or its officers, directors, agents or shareholders, or as giving to any Participant or Beneficiary any equity or other interest in the assets or business of the Company or shares of Company stock or as giving any employee the right to be retained in the employment of the Company. All employees of the Company and Participants shall be subject to discharge to the same extent they would have been if this Plan had never been adopted. The rights of a Participant hereunder shall be solely those of an unsecured general creditor of the Company.

**ARTICLE X  
LIMITATION OF ASSIGNMENT AND PAYMENTS TO  
LEGALLY INCOMPETENT DISTRIBUTE**

10.1 No benefits which shall be payable under the Plan to any person shall be subject in any manner to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance or charge, and any attempt to anticipate, alienate, sell, transfer, assign, pledge, encumber, charge or otherwise dispose of the same shall be void. No benefit shall in any manner be subject to the debts, contracts, liabilities, engagements or torts of any person, nor shall it be subject to attachment or legal process for or against any person, except to the extent required by law.

10.2 Whenever any benefit which shall be payable under the Plan is to be paid to or for the benefit of any person who is then a minor or determined by the Committee, on the basis of qualified medical advice, to be incompetent, the Committee need not require the appointment of a guardian or custodian, but shall be authorized to cause the same to be paid over to the person having custody of the minor or incompetent, or to cause the same to be paid to the minor or incompetent without the intervention of a guardian or custodian, or to cause the same to be paid to a legal guardian or custodian of the minor or incompetent, if one has been appointed, or to cause the same to be used for the benefit of the minor or incompetent.

**ARTICLE XI  
AMENDMENT TO OR TERMINATION OF THE PLAN**

11.1 Amendment and Termination. The Company reserves the right at any time to amend or terminate the Plan in whole or in part by resolution of the Board. No amendment shall have the effect of retroactively changing or depriving Participants or Beneficiaries of rights already accrued under the Plan.

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11.2 Effect of Termination. If the Plan is terminated, all deferrals shall thereupon cease, but deemed income or losses shall continue to be credited to the Deferral Accounts in accordance with Section 3.3 hereof. Notwithstanding the foregoing, to the extent provided by the Company, the Plan may be liquidated following a termination under any of the following circumstances:

(a) the termination and liquidation of the Plan within twelve (12) months of a complete dissolution of the Company taxed under Section 331 of the Code or with the approval of a bankruptcy court pursuant to 11 U.S.C. § 503(b)(1)(A); provided that the amounts deferred under this Plan are included in the Participants' gross incomes in the latest of the following years (or, if earlier, the taxable year in which the amount is actually or constructively received): (i) the calendar year in which the Plan is terminated; (ii) the first calendar year in which the amount is no longer subject to a substantial risk of forfeiture; or (iii) the first calendar year in which the payment is administratively practicable.

(b) the termination and liquidation of the Plan pursuant to irrevocable action taken by the Company within the thirty (30) days preceding or the twelve (12) months following a change of control within the meaning of Section 409A of the Code; provided that all Aggregated Plans are terminated and liquidated with respect to each Participant that experienced such change of control, so that under the terms of the termination and liquidation, all such Participants are required to receive all amounts of deferred compensation under this Plan and any other Aggregated Plans within twelve (12) months of the date the Company irrevocably takes all necessary action to terminate and liquidate this Plan and such other Aggregated Plans;

(c) the termination and liquidation of the Plan, provided that: (1) the termination and liquidation does not occur proximate to a downturn in the Company's financial health; (2) the Company terminates and liquidates all Aggregated Plans; (3) no payments in liquidation of this Plan are made within twelve (12) months of the date the Company irrevocably takes all necessary action to terminate and liquidate this Plan, other than payments that would be payable under the terms of this Plan if the action to terminate and liquidate this Plan had not occurred; (4) all payments are made within twenty four (24) months of the date on which the Company irrevocably takes all action necessary to terminate and liquidate this Plan; and (5) the Company does not adopt a new Aggregated Plan at any time within three (3) years following the date on which the Company irrevocably takes all action necessary to terminate and liquidate the Plan.

## **ARTICLE XII STATUS OF PARTICIPANT AS UNSECURED CREDITOR**

All benefits under the Plan shall be the unsecured obligations of the Company and, except for those assets that may be placed in a Trust Fund established in connection with this Plan, no assets will be placed in trust or otherwise segregated from the general assets of the Company for the payment of obligations hereunder. To the extent that any person acquires a right to receive payments hereunder, such right shall be no greater than the right of any unsecured general creditor of the Company.

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**ARTICLE XIII  
GENERAL AND MISCELLANEOUS**

13.1 Severability. In the event that any provision of this Plan shall be declared illegal or invalid for any reason, said illegality or invalidity shall not affect the remaining provisions of this Plan but shall be fully severable, and this Plan shall be construed and enforced as if said illegal or invalid provision had never been inserted herein.

13.2 Construction. The Section headings and numbers are included only for convenience of reference and are not to be taken as limiting or extending the meaning of any of the terms and provisions of this Plan. Whenever appropriate, words used in the singular shall include the plural or the plural may be read as the singular.

13.3 Governing Law. The validity and effect of this Plan and the rights and obligations of all persons affected hereby shall be construed and determined in accordance with the laws of the State of Texas unless superseded by federal law.

13.4 No Requirement to Fund. The Company is not required to set aside any assets for payment of the benefits provided under this Plan; however, it may do so as provided in the Trust Agreement, if any. A Participant shall have no security interest in any such amounts. It is the Company's intention that this Plan be construed as a plan that is unfunded and maintained primarily for the purpose of providing deferred compensation for a select group of highly compensated employees.

13.5 Indemnification. To the extent permitted by applicable law, the Company shall indemnify and hold harmless the members of the Committee from and against any and all liabilities, costs and expenses incurred by such persons as a result of any act, or omission to act, in connection with the performance of such person's duties, responsibilities and obligations under the Plan, other than such liabilities, costs and expenses as may result from the gross negligence, willful misconduct, and/or criminal acts of such persons.

13.6 Taxes. All amounts credited and payable hereunder shall be reduced by any and all federal, state and local taxes imposed upon the Participant or a Beneficiary that are required to be paid or withheld by the Company.

13.7 USERRA. Notwithstanding any provision of this Plan to the contrary, contributions, benefits and service credit with respect to qualified military service will be provided to the extent necessary to comply with the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA).

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IN WITNESS WHEREOF, Southwest Airlines Co., the Company, has caused these presents to be duly executed in its name and behalf by its proper officers thereunto duly authorized this 16<sup>th</sup> day of December, 2008.

**SOUTHWEST AIRLINES CO.**

By: /s/ Gary C. Kelly  
Name: Gary C. Kelly  
Its: Chief Executive Officer

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 Form S-3 Nos. 333-126738 and 333-100861) of Southwest Airlines Co. and in the related Prospectus of our reports dated January 29, 2009, 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, 2008.

/s/ Ernst & Young LLP

Dallas, Texas  
January 29, 2009

## CERTIFICATION

I, Gary C. Kelly, Chairman of the Board, President, & Chief Executive Officer of Southwest Airlines Co., certify that:

1. I have reviewed this annual report on Form 10-K for the year ended December 31, 2008 of Southwest Airlines Co.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: January 29, 2009

By: /s/ Gary C. Kelly

Gary C. Kelly  
Chairman of the Board, President, & Chief Executive Officer

## 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, 2008 of Southwest Airlines Co.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: January 29, 2009

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, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Gary C. Kelly, Chairman of the Board, President, & Chief Executive Officer 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: January 29, 2009

By: /s/ Gary C. Kelly  
Gary C. Kelly  
Chairman of the Board, President, & Chief Executive Officer

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