

Item 8. Financial Statements and Supplementary Data

Southwest Airlines Co.
Consolidated Balance Sheet
(in millions, except share data)

	December 31, 2015	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,583	\$ 1,282
Short-term investments	1,468	1,706
Accounts and other receivables	474	365
Inventories of parts and supplies, at cost	311	342
Prepaid expenses and other current assets	188	232
Total current assets	4,024	3,927
Property and equipment, at cost:		
Flight equipment	19,462	18,473
Ground property and equipment	3,219	2,853
Deposits on flight equipment purchase contracts	1,089	566
Assets constructed for others	915	621
	24,685	22,513
Less allowance for depreciation and amortization	9,084	8,221
	15,601	14,292
Goodwill	970	970
Other assets	717	534
	\$ 21,312	\$ 19,723
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,188	\$ 1,203
Accrued liabilities	2,591	1,565
Air traffic liability	2,990	2,897
Current maturities of long-term debt	637	258
Total current liabilities	7,406	5,923
Long-term debt less current maturities	2,541	2,434
Deferred income taxes	2,490	2,782
Construction obligation	757	554
Other noncurrent liabilities	760	1,255
Stockholders' equity:		
Common stock, \$1.00 par value: 2,000,000,000 shares authorized; 807,611,634 shares issued in 2015 and 2014	808	808
Capital in excess of par value	1,374	1,315
Retained earnings	9,409	7,416
Accumulated other comprehensive loss	(1,051)	(738)
Treasury stock, at cost: 160,010,017 and 132,017,550 shares in 2015 and 2014 respectively	(3,182)	(2,026)
Total stockholders' equity	7,358	6,775
	\$ 21,312	\$ 19,723

See accompanying notes.

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

	Year ended December 31,		
	2015	2014	2013
OPERATING REVENUES:			
Passenger	\$ 18,299	\$ 17,658	\$ 16,721
Freight	179	175	164
Special revenue adjustment	172	—	—
Other	1,170	772	814
Total operating revenues	19,820	18,605	17,699
OPERATING EXPENSES:			
Salaries, wages, and benefits	6,383	5,434	5,035
Fuel and oil	3,616	5,293	5,763
Maintenance materials and repairs	1,005	978	1,080
Aircraft rentals	238	295	361
Landing fees and other rentals	1,166	1,111	1,103
Depreciation and amortization	1,015	938	867
Acquisition and integration	39	126	86
Other operating expenses	2,242	2,205	2,126
Total operating expenses	15,704	16,380	16,421
OPERATING INCOME	4,116	2,225	1,278
OTHER EXPENSES (INCOME):			
Interest expense	121	130	131
Capitalized interest	(31)	(23)	(24)
Interest income	(9)	(7)	(6)
Other (gains) losses, net	556	309	(32)
Total other expenses (income)	637	409	69
INCOME BEFORE INCOME TAXES	3,479	1,816	1,209
PROVISION FOR INCOME TAXES	1,298	680	455
NET INCOME	\$ 2,181	\$ 1,136	\$ 754
NET INCOME PER SHARE, BASIC	\$ 3.30	\$ 1.65	\$ 1.06
NET INCOME PER SHARE, DILUTED	\$ 3.27	\$ 1.64	\$ 1.05
Cash dividends declared per common share	\$.2850	\$.2200	\$.1300

See accompanying notes.

Southwest Airlines Co.
Consolidated Statement of Comprehensive Income
(in millions)

	Year ended December 31,		
	2015	2014	2013
NET INCOME	\$ 2,181	\$ 1,136	\$ 754
Unrealized gain (loss) on fuel derivative instruments, net of deferred taxes of (\$181), (\$430), and \$31	(308)	(727)	52
Unrealized gain on interest rate derivative instruments, net of deferred taxes of \$6, \$5, and \$19	9	8	31
Unrealized gain (loss) on defined benefit plan items, net of deferred taxes of (\$7), (\$8), and \$15	(12)	(16)	24
Other, net of deferred taxes of \$-, \$-, and \$7	(2)	—	9
OTHER COMPREHENSIVE INCOME (LOSS)	\$ (313)	\$ (735)	\$ 116
COMPREHENSIVE INCOME	\$ 1,868	\$ 401	\$ 870

See accompanying notes.

Southwest Airlines Co.
Consolidated Statement of Stockholders' Equity
(in millions, except per share amounts)

	Year ended December 31, 2015, 2014, and 2013					
	Common Stock	Capital in excess of par value	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	Total
Balance at December 31, 2012	\$ 808	\$ 1,210	\$ 5,768	\$ (119)	\$ (675)	\$ 6,992
Repurchase of common stock	—	—	—	—	(540)	(540)
Issuance of common and treasury stock pursuant to Employee stock plans	—	12	—	—	84	96
Net tax benefit (expense) of options exercised	—	(9)	—	—	—	(9)
Share-based compensation	—	18	—	—	—	18
Cash dividends, \$.1300 per share	—	—	(91)	—	—	(91)
Comprehensive income	—	—	754	116	—	870
Balance at December 31, 2013	\$ 808	\$ 1,231	\$ 6,431	\$ (3)	\$ (1,131)	\$ 7,336
Repurchase of common stock	—	—	—	—	(955)	(955)
Issuance of common and treasury stock pursuant to Employee stock plans	—	40	—	—	60	100
Net tax benefit (expense) of options exercised	—	23	—	—	—	23
Share-based compensation	—	21	—	—	—	21
Cash dividends, \$.2200 per share	—	—	(151)	—	—	(151)
Comprehensive income	—	—	1,136	(735)	—	401
Balance at December 31, 2014	\$ 808	\$ 1,315	\$ 7,416	\$ (738)	\$ (2,026)	\$ 6,775
Repurchase of common stock	—	—	—	—	(1,180)	(1,180)
Issuance of common and treasury stock pursuant to Employee stock plans	—	6	—	—	24	30
Net tax benefit (expense) of options exercised	—	24	—	—	—	24
Share-based compensation	—	29	—	—	—	29
Cash dividends, \$.2850 per share	—	—	(188)	—	—	(188)
Comprehensive income	—	—	2,181	(313)	—	1,868
Balance at December 31, 2015	\$ 808	\$ 1,374	\$ 9,409	\$ (1,051)	\$ (3,182)	\$ 7,358

See accompanying notes.

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

	Year ended December 31,		
	2015	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 2,181	\$ 1,136	\$ 754
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation and amortization	1,015	938	867
Unrealized (gain) loss on fuel derivative instruments	113	279	(5)
Deferred income taxes	(109)	501	50
Changes in certain assets and liabilities:			
Accounts and other receivables	(88)	54	(17)
Other assets	103	142	(46)
Accounts payable and accrued liabilities	961	36	343
Air traffic liability	94	326	400
Cash collateral received from (provided to) derivative counterparties	(570)	(233)	57
Other, net	(462)	(277)	74
Net cash provided by operating activities	3,238	2,902	2,477
CASH FLOWS FROM INVESTING ACTIVITIES:			
Capital expenditures	(2,041)	(1,748)	(1,433)
Assets constructed for others	(102)	(80)	(14)
Purchases of short-term investments	(1,986)	(3,080)	(3,135)
Proceeds from sales of short-term and other investments	2,223	3,185	3,198
Other, net	(7)	(4)	—
Net cash used in investing activities	(1,913)	(1,727)	(1,384)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of long-term debt	500	300	—
Proceeds from Employee stock plans	46	110	96
Reimbursement for assets constructed for others	24	27	—
Proceeds from termination of interest rate derivative instrument	12	—	—
Payments of long-term debt and capital lease obligations	(213)	(561)	(313)
Payments of cash dividends	(180)	(139)	(71)
Repayment of construction obligation	(10)	(11)	(5)
Repurchase of common stock	(1,180)	(955)	(540)
Other, net	(23)	(19)	(18)
Net cash used in financing activities	(1,024)	(1,248)	(851)
NET CHANGE IN CASH AND CASH EQUIVALENTS	301	(73)	242
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	1,282	1,355	1,113
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 1,583	\$ 1,282	\$ 1,355
CASH PAYMENTS FOR:			
Interest	\$ 105	\$ 128	\$ 133
Income taxes	\$ 1,440	\$ 155	\$ 346
SUPPLEMENTAL DISCLOSURE OF NONCASH TRANSACTIONS:			
Flight equipment under capital leases	\$ 193	\$ 153	\$ 26
Assets constructed for others	\$ 192	\$ 88	\$ 105

See accompanying notes.

Southwest Airlines Co.
Notes to Consolidated Financial Statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

Southwest Airlines Co. (the "Company") operates Southwest Airlines, a major domestic airline. The Consolidated Financial Statements include the accounts of the Company and its wholly owned subsidiaries, which include AirTran Holdings, LLC. On May 2, 2011 (the "acquisition date"), the Company acquired all of the outstanding equity of AirTran Holdings, Inc. ("AirTran Holdings"), the former parent company of AirTran Airways, Inc. ("AirTran Airways"). Throughout these Notes, the Company makes reference to AirTran, which is meant to be inclusive of AirTran Holdings, LLC, the successor to AirTran Holdings, and its subsidiaries, including among others, AirTran Airways. AirTran's final passenger service was on December 28, 2014. Although the vast majority of integration costs were incurred in periods prior to 2015, the Company incurred some additional costs in 2015 associated with the integration of AirTran, and those costs are included in Acquisition and integration costs in the accompanying Consolidated Statement of Comprehensive Income. See Note 7 for further information. The accompanying Consolidated Financial Statements include the results of operations and cash flows for all periods presented and all significant inter-entity 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.

On November 20, 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-17, Balance Sheet Classification of Deferred Taxes. The standard amends the current requirement for organizations to present deferred tax liabilities and assets as current and noncurrent in a classified balance sheet. Instead, organizations will now be required to classify all deferred tax assets and liabilities as noncurrent. The ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016, with early adoption permitted. The Company early adopted this standard during fourth quarter 2015, utilizing retrospective application as permitted. As such, certain prior period amounts have been reclassified to conform to the current presentation. In the Consolidated Balance Sheet as of December 31, 2014, the Company reclassified \$477 million from current Deferred income tax assets to reduce Deferred income taxes within non-current liabilities.

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 original maturities of three months or less when purchased are classified as cash and cash equivalents, which primarily consists 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 fair value.

As of December 31, 2015, \$835 million in cash collateral deposits were provided by the Company to its fuel hedge counterparties and no cash collateral deposits were held by or provided by the Company to its interest rate hedge counterparties. As of December 31, 2014, \$266 million in cash collateral deposits were provided by the Company to its fuel hedge counterparties and no cash collateral deposits were held by or provided by the Company to its interest rate hedge counterparties. Cash collateral amounts provided or held associated with fuel and interest rate derivative instruments are not restricted in any way and earn interest income at an agreed upon rate that approximates the rates earned on short-term securities issued by the U.S. Government. Depending on the fair value of the Company's fuel and interest rate derivative instruments, the amounts of collateral deposits held or provided at any point in time can fluctuate significantly. See Note 10 for further information on these collateral deposits and fuel derivative instruments.

Short-term and Noncurrent Investments

Short-term investments consist of investments with original maturities of greater than three months but less than twelve months when purchased. These are primarily short-term securities issued by the U.S. Government and certificates of deposit issued by domestic banks. All of these investments are classified as available-for-sale securities and are stated at fair value, which approximates cost. For all short-term investments, at each reset period or upon reinvestment, the Company accounts for the transaction as Proceeds from sales of short-term investments for the security relinquished, and Purchases of short-investments for the security purchased, in the accompanying Consolidated Statement of Cash Flows. Unrealized gains and losses, net of tax, if any, are recognized in Accumulated other comprehensive income (loss) ("AOCI") in the accompanying Consolidated Balance Sheet. Realized net gains and losses on specific investments, if any, are reflected in Interest income in the accompanying Consolidated Statement of Income. Both unrealized and realized gains and/or losses associated with investments were immaterial for all years presented.

Noncurrent investments consist of investments with maturities of greater than twelve months. Noncurrent investments are included as a component of Other assets in the Consolidated Balance Sheet.

Accounts and Other Receivables

Accounts and other receivables are carried at cost. They primarily consist of amounts due from credit card companies associated with sales of tickets for future travel, and amounts due from business partners in the Company's frequent flyer program. The allowance for doubtful accounts was immaterial at December 31, 2015 and 2014 . In addition, the provision for doubtful accounts and write-offs for 2015 , 2014 , and 2013 were each immaterial.

Inventories

Inventories primarily consist of aircraft fuel, flight equipment expendable parts, materials, 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 \$47 million and \$46 million at December 31, 2015 , and 2014 , respectively. In addition, the Company's provision for obsolescence and write-offs for 2015 , 2014 , and 2013 were each immaterial.

Property and Equipment

Property and equipment is stated at cost. Capital expenditures includes payments made for aircraft, other flight equipment, purchase deposits related to future aircraft deliveries, and ground and other property and equipment. Depreciation is provided by the straight-line method to estimated residual values over periods generally ranging from 23 to 25 years for flight equipment, 5 to 30 years for ground property and equipment once the asset is placed in service, and 25 to 30 years for Assets constructed for others. Residual values estimated for aircraft generally range from 2 to 20 percent , for ground property and equipment generally range from 0 to 10 percent , and for Assets constructed for others range from 17 to 25 percent . Property under capital leases and related obligations are initially 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 and amortization expense. Leasehold improvements generally are amortized on a straight-line basis over the shorter of the estimated useful life of the improvement or the remaining term of the lease. Assets constructed for others primarily consists of airport improvement projects, once placed into service, in which the Company is considered the accounting owner of the facilities, and such assets are amortized to estimated residual value over the term of the Company's lease or the expected life of the asset. See Note 4 for further information.

Based on a revision of the Company's future firm aircraft order book with Boeing at the end of December 2015, the Company changed the estimated retirement dates of many of its owned 737-300 and 737-500 aircraft. Previously, this fleet was estimated to retire by mid-2021; however, pursuant to this change, the fleet and related parts are expected to be retired by mid-2018. See Note 4 for further information on the Company's future firm aircraft deliveries. This change in retirement dates is considered a change in estimate. It has been accounted for on a prospective basis, and thus the

Company will record accelerated depreciation expense over the remainder of the useful lives for each aircraft and its related parts. The impact of this change on the year ended December 31, 2015 was immaterial. The impact of this change in estimate in 2016 is an approximate \$89 million increase to Depreciation and amortization expense.

The Company evaluates its long-lived assets used in operations for impairment when events and circumstances indicate that the undiscounted cash flows to be generated by that asset are less than the carrying amounts of the asset and may not be recoverable. 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. If an asset is deemed to be impaired, an impairment loss is recorded for the excess of the asset book value in relation to its estimated fair value.

Aircraft and Engine Maintenance

The cost of scheduled inspections and repairs and routine maintenance costs for all aircraft and engines are charged to Maintenance materials and repairs expense as incurred. The Company also has "power-by-the-hour" agreements related to certain of its aircraft engines with external service providers. Under these agreements, which the Company has determined effectively transfer the risk and create an obligation associated with the maintenance on such engines to the counterparty, expense is recorded commensurate with each hour flown on an engine. In situations where the payments to the counterparty do not sufficiently match the level of services received during the period, expense is recorded on a straight-line basis over the term of the agreement based on the Company's best estimate of expected future aircraft utilization. For its engine maintenance contracts that do not transfer risk to the service provider, the Company records expense on a time and materials basis when an engine repair event takes place. 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.

Goodwill and Intangible Assets

The Company applies a fair value based impairment test to the carrying value of goodwill and indefinite-lived intangible assets annually on October 1st, or more frequently if certain events or circumstances indicate that an impairment loss may have been incurred. The Company assesses the value of goodwill and indefinite-lived assets under either a qualitative or quantitative approach. Under a qualitative approach, the Company considers various market factors, including applicable key assumptions listed below. These factors are analyzed to determine if events and circumstances could reasonably have affected the fair value of goodwill and indefinite-lived intangible assets. If the Company determines that it is more likely than not that an indefinite-lived intangible asset is impaired, the quantitative approach is used to assess the asset's implied fair value and the amount of the impairment. Under a quantitative approach, the implied fair value of the Company's identifiable assets and liabilities is calculated based on key assumptions. If the Company assets' carrying value exceeds the fair value calculated using the quantitative approach, an impairment charge is recorded for the difference in fair value and carrying value.

The following table is a summary of the Company's intangible assets, which are included as a component of Other assets in the Company's Consolidated Balance Sheet, as of December 31, 2015 and 2014 :

(in millions)	Weighted-average useful life (in years)	Year ended December 31, 2015		Year ended December 31, 2014	
		Gross carrying amount	Accumulated amortization	Gross carrying amount	Accumulated Amortization
Customer relationships/marketing agreements	9	\$ 38	\$ 30	\$ 38	\$ 26
Trademarks/trade names	6	36	34	36	30
Owned domestic slots	Indefinite	303	n/a	303	n/a
Leased domestic slots (b)	47	17	3	19	5
Gate leasehold rights (a)	15	180	43	60	32
Total	15	\$ 574	\$ 110	\$ 456	\$ 93

(a) Intangible assets primarily consist of acquired leasehold rights to certain airport owned gates at Chicago's Midway International Airport, takeoff and landing slots (a "slot" is the right of an air carrier, pursuant to regulations of the Federal Aviation Administration ("FAA"), to operate a takeoff or landing at a specific time at certain airports) at certain domestic slot-controlled airports, and certain intangible assets recognized from the AirTran acquisition. The increase in Intangible assets during 2015 was primarily due to the acquisition of two additional airport gate rights at Dallas Love Field, which were subleased from United Airlines. The purchase price paid for these airport gate rights was included as a component of Capital expenditures in the accompanying Consolidated Statement of Cash Flows.

(b) Useful life of leased slots is based on the stated lease term.

The aggregate amortization expense for 2015 , 2014 , and 2013 was \$19 million , \$13 million , and \$19 million , respectively. Estimated aggregate amortization expense for the five succeeding years and thereafter is as follows: 2016 – \$17 million , 2017 – \$14 million , 2018 – \$13 million , 2019 – \$13 million , 2020 – \$12 million , and thereafter – \$89 million .

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 funds that are past flight date and remain unused. The majority of the Company's tickets sold are nonrefundable. Refundable tickets 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 refunded. A small percentage of tickets (or partial tickets) expire unused. The Company estimates the amount of tickets that expire unused and recognizes such amounts in Passenger revenue using the redemption method based on scheduled flight date. Prior to September 13, 2013, funds associated with tickets in which a passenger did not show up for a flight without canceling were able to be reused on another flight for up to twelve months. On September 13, 2013, Southwest implemented a No Show policy that applies to nonrefundable fares that are not canceled or changed by a Customer at least ten minutes prior to a flight's scheduled departure. Based on the Company's revenue recognition policy, revenue is recorded at the flight date for a Customer who does not change his/her itinerary and loses his/her funds. Amounts collected from passengers for ancillary service fees are generally recognized as Other revenue when the service is provided, which is typically the flight date.

The Company's policy is to record revenue for the estimated spoilage of tickets (including partial tickets) once the flight date has passed, under the redemption method. Initial spoilage estimates are routinely adjusted and ultimately finalized once the tickets expire, which is typically twelve months after the original purchase date. Spoilage estimates are based on the Customers' historical travel behavior as well as assumptions about the Customers' future travel behavior. Assumptions used to generate spoilage estimates can be impacted by several factors including, but not limited to: fare increases, fare sales, changes to the Company's ticketing policies, changes to the Company's refund, exchange and unused funds policies, or economic factors.

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 foreign and

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 frequent flyer program for all amounts earned from flight activity that are expected to be redeemed for future travel. The estimated incremental cost includes direct passenger costs such as fuel, food, and other operational costs, but does not include any contribution to fixed overhead costs or profit.

Southwest also sells frequent flyer points and related services to companies participating in its frequent flyer program. Historically, funds received from the sale of points associated with these agreements were accounted for under the residual method. Under this method, the Company estimated the portion of the amounts received from the sale of frequent flyer points that related to free travel and these amounts were deferred and recognized as Passenger revenue when the ultimate free travel awards are flown. On July 1, 2015, the Company executed an amended co-branded credit card agreement ("Agreement") with Chase Bank USA, N.A. ("Chase"), through which the Company sells loyalty points and other items to Chase. This material modification triggered an accounting change under ASU 2009-13, which is recorded on a prospective basis. The impact of the accounting change is that the Company estimated the selling prices and volumes over the term of the Agreement in order to determine the allocation of proceeds to each of the deliverables (travel points to be awarded; use of the Southwest Airlines' brand and access to Rapid Reward Member lists; advertising elements; and the Company's resource team). The Company records passenger revenue related to air transportation and certificates for discounted companion travel when the transportation is delivered. The other elements are recognized as Other - net revenue when earned.

The Company followed the transition approach of ASU 2009-13, which required that the Company adjust the existing deferred revenue balance to reflect the value, on a relative selling price basis, of any undelivered element remaining at the date of contract modification. The relative selling price of the undelivered element (air transportation) was lower than the rate at which it had been deferred under the previous contract, and the Company recorded a one-time, non-cash adjustment to decrease frequent flyer deferred revenue and increase revenue through the recording of a Special revenue adjustment of \$172 million. In addition, 2015 Operating revenues increased by a net \$255 million as a result of the Agreement and the resulting July 1, 2015 change in accounting methodology, all of which would have been deferred under the Company's previous accounting. The estimated impacts on revenue and earnings from this change in accounting principle are as follows:

(in millions, except per share amounts)		Year ended December 31, 2015	
Passenger revenue	\$		(89)
Special revenue adjustment			172
Other revenue			344
Operating revenues	\$		427
Net income	\$		227
Net income per basic share	\$		0.34
Net income per diluted share	\$		0.34

For all points sold to business partners that are expected to expire unused, the Company recognizes spoilage in accordance with the redemption method. The Company's consolidated liability associated with the sale of frequent flyer points, was approximately \$1.3 billion as of December 31, 2015, and 2014, which is classified within Air traffic liability. During fourth quarter 2014, the Company obtained sufficient historical behavioral data to develop a predictive statistical model to analyze the amount of spoilage expected for points sold to business partners, which indicated an

increase in the expected spoilage rate. This change in estimate was recorded on a prospective basis, as of October 1, 2014, the impacts on revenue and earnings are as follows:

(in millions, except per share amounts)	Year ended December 31, 2015		Year ended December 31, 2014	
Passenger revenue	\$	115	\$	55
Net income	\$	61	\$	29
Net income per basic share	\$	0.09	\$	0.04
Net income per diluted share	\$	0.09	\$	0.04

Advertising

Advertising costs are charged to expense as incurred. Advertising and promotions expense for the years ended December 31, 2015, 2014, and 2013 was \$218 million, \$207 million, and \$208 million, respectively, and is included as a component of Other operating expense in the accompanying Consolidated Statement of Income.

Share-based Employee Compensation

The Company has share-based compensation plans covering certain Employees, including a plan that also covers the Company's Board of Directors. The Company accounts for share-based compensation based on its grant date fair value. See Note 9 for further information.

Financial Derivative Instruments

The Company accounts for financial derivative instruments at fair value and applies hedge accounting rules where appropriate. The Company utilizes various derivative instruments, including jet fuel, 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 consist primarily of purchased call options, collar structures, call spreads, put spreads, and fixed price swap agreements, and upon proper qualification are accounted for as cash-flow hedges. The Company also has interest rate swap agreements to convert a portion of its fixed-rate debt to floating rates and has swap agreements that convert certain floating-rate debt to a fixed-rate. These interest rate hedges are appropriately designated as either fair value hedges or as cash flow hedges.

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 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. Forward jet fuel prices are estimated through utilization of a statistical-based regression equation with data from market forward prices of like commodities. This equation is then adjusted for certain items, such as transportation costs, that are stated in the Company's fuel purchasing contracts with its vendors.

For the effective portion of settled fuel hedges, 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 in connection 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 hedge accounting and financial derivative instruments.

The Company classifies its cash collateral provided to or held from counterparties in a “net” presentation on the Consolidated Balance Sheet against the fair value of the derivative positions with those counterparties. See Note 10 for further information.

Software Capitalization

The Company capitalizes certain internal and external costs related to the acquisition and development of internal use software during the application development stages of projects. The Company amortizes these costs using the straight-line method over the estimated useful life of the software, which typically ranges from five to fifteen years. Costs incurred during the preliminary project or the post-implementation/operation stages of the project are expensed as incurred. Capitalized computer software, included as a component of Ground property and equipment in the accompanying Consolidated Balance Sheet, net of accumulated depreciation, was \$378 million and \$403 million at December 31, 2015 , and 2014 , respectively. Computer software depreciation expense was \$106 million , \$122 million , and \$90 million for the years ended December 31, 2015 , 2014 , and 2013 , respectively, and is included as a component of Depreciation and amortization expense in the accompanying Consolidated Statement of Income.

Income Taxes

The Company accounts for deferred income taxes utilizing an asset and liability method, whereby deferred tax assets and liabilities are recognized based on the tax effect of temporary differences between the financial statements and the tax basis of assets and liabilities, as measured by current enacted tax rates. The Company also evaluates the need for a valuation allowance to reduce deferred tax assets to estimated recoverable amounts. See "Basis of Presentation" for further information on current presentation of deferred income taxes.

The Company's policy for recording interest and penalties associated with uncertain tax positions is to record such items as a component of income before income 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 Consolidated Statement of Income. Amounts recorded for penalties and interest related to uncertain tax positions were immaterial for all years presented.

Concentration Risk

Approximately 83 percent of the Company's full-time equivalent Employees are unionized and are covered by collective-bargaining agreements. The majority of the Company's unionized Employees, including its Pilots, Mechanics, Ramp, Operations, Provisioning and Freight Agents, Flight Attendants, Material Specialists, Flight Crew Training Instructors, Facilities Maintenance Technicians, and Source of Support Representatives are in discussions on labor agreements or have labor agreements which will become amendable within one year. These Employee groups represent approximately 69 percent of the Company's full-time equivalent Employees as of December 31, 2015 .

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 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. Collateral deposits

provided to or held from counterparties serve to decrease, but not totally eliminate, the credit risk associated with the Company's hedging program. See Note 10 for further information.

As of December 31, 2015, the Company operated an all-Boeing fleet, all of which are variations of the Boeing 737. Following the 2011 acquisition of AirTran, the Company also operated a fleet of Boeing 717's, but these aircraft were removed from the Company's operations prior to the end of 2014. See Note 7 for further information. If the Company were unable to acquire additional aircraft or associated aircraft parts from Boeing, or Boeing were unable or unwilling to make timely deliveries of aircraft or to provide adequate support for its products, the Company's operations would be materially adversely impacted. In addition, the Company would be materially adversely impacted in the event of a mechanical or regulatory issue associated with the Boeing 737 aircraft type, whether as a result of downtime for part or all of the Company's fleet, increased maintenance costs, or because of a negative perception by the flying public. The Company is also dependent on sole suppliers for aircraft engines and certain other aircraft parts and would, therefore, also be materially adversely impacted in the event of the unavailability of, or a mechanical or regulatory issue associated with, engines and other parts.

The Company has historically entered into agreements with some of its co-brand, payment, and loyalty partners that contain exclusivity aspects which place certain confidential restrictions on the Company from entering into certain arrangements with other payment and loyalty partners. These arrangements generally extend for the terms of the partnerships, none of which currently extend beyond May 2022. The Company believes the financial benefits generated by the exclusivity aspects of these arrangements outweigh the risks involved with such agreements.

2 . NEW ACCOUNTING PRONOUNCEMENTS AND ACCOUNTING CHANGES

On May 28, 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers. Following the FASB's finalization of a one year deferral of this standard, the ASU is now effective for fiscal years, and interim periods within those years, beginning on or after December 15, 2017, with early adoption permitted for fiscal years, and interim periods within those years, beginning on or after December 15, 2016. The Company currently believes the most significant impact of this ASU on its accounting will be the elimination of the incremental cost method for frequent flyer accounting, which will require the Company to re-value its liability earned by Customers associated with flight points with a relative fair value approach, resulting in a significant increase in the liability. The Company is continuing to evaluate the new guidance and plans to provide additional information about its expected financial impact, including the expected method and period of adoption, at a future date.

On February 18, 2015, the FASB and the International Accounting Standards Board issued a final standard that amends the current consolidation guidance. The standard amends both the variable interest entity and voting interest entity consolidation models. The standard is effective for public reporting entities in fiscal periods beginning after December 15, 2015, and early adoption is permitted. Once adopted, the Company will need to assess the potential for entity consolidation under a new consolidation model; however, the Company does not believe this will result in changes to its previous consolidation conclusions. The Company will adopt this new standard during first quarter 2016.

3 . NET INCOME PER SHARE

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

	Year ended December 31,		
	2015	2014	2013
NUMERATOR:			
Net income	\$ 2,181	\$ 1,136	\$ 754
Incremental income effect of interest on 5.25% convertible notes	4	4	3
Net income after assumed conversion	\$ 2,185	\$ 1,140	\$ 757
DENOMINATOR:			
Weighted-average shares outstanding, basic	661	687	710
Dilutive effect of Employee stock options and restricted stock units	2	3	2
Dilutive effect of 5.25% convertible notes	6	6	6
Adjusted weighted-average shares outstanding, diluted	669	696	718
NET INCOME PER SHARE:			
Basic	\$ 3.30	\$ 1.65	\$ 1.06
Diluted	\$ 3.27	\$ 1.64	\$ 1.05
Potentially dilutive amounts excluded from calculations:			
Stock options and restricted stock units	—	—	9

4 . COMMITMENTS AND CONTINGENCIES

Commitments

The Company has contractual obligations and commitments primarily with regard to future purchases of aircraft, repayment of debt, and lease arrangements. During the year ended December 31, 2015 , the Company purchased 19 new 737-800 aircraft from Boeing and eight used 737-700 aircraft from third parties. In addition, the Company also leased 16 737-700 aircraft from third parties, and retired from service four of its older aircraft (two 737-300 and two 737-500).

In December 2015, the Company and Boeing agreed to modify the existing schedule of future aircraft commitments to reflect 33 additional -800s, and the conversion of its remaining 25 -700 firm orders to -800s. In addition, two pre-owned -700s were added to its delivery schedule. A total of six additional options were added to the schedule as well. As of December 31, 2015 , the Company had firm deliveries and options for Boeing 737-700, 737-800, 737 MAX 7, and 737 MAX 8 aircraft as follows:

	The Boeing Company 737 NG				The Boeing Company 737 MAX			
	-800 Firm Orders	Options	Additional -700 A/C		-7 Firm Orders	-8 Firm Orders	Options	
2016	36	—	17		—	—	—	53
2017	35	—	14		—	14	—	63
2018	18	18	4		—	13	—	53
2019	—	—	—		15	10	—	25
2020	—	—	—		14	22	—	36
2021	—	—	—		1	33	18	52
2022	—	—	—		—	30	19	49
2023	—	—	—		—	24	23	47
2024	—	—	—		—	24	23	47
2025	—	—	—		—	—	36	36
2026	—	—	—		—	—	36	36
2027	—	—	—		—	—	36	36
Total	89	18	35	(b)	30	170	(a)	533

(a) The Company has flexibility to substitute MAX 7 in lieu of MAX 8 firm orders beginning in 2019 .

(b) To be acquired in leases from various third parties.

The Company's financial commitments associated with the Boeing firm orders and additional scheduled deliveries in the above aircraft table are as follows: \$1.1 billion in 2016 , \$1.3 billion in 2017 , \$1.1 billion in 2018 , \$1.2 billion in 2019 , \$1.5 billion in 2020 , and \$4.4 billion thereafter.

Fort Lauderdale-Hollywood International Airport

In December 2013 , the Company entered into an agreement with Broward County, Florida, which owns and operates Fort Lauderdale-Hollywood International Airport, to oversee and manage the design and construction of the airport's Terminal 1 Modernization Project at a cost not to exceed \$295 million . In addition to significant improvements to the existing Terminal 1, the project includes the design and construction of a new five-gate Concourse A with an international processing facility. Funding for the project will come directly from Broward County sources, but will flow through the Company in its capacity as manager of the project. Major construction on the project began during third quarter 2015 and is estimated to be completed during 2017. The Company believes that, due to its agreed upon role in overseeing and managing the project, it is considered the owner of the project for accounting purposes. As such, during construction, the Company records expenditures as Assets constructed for others in the Consolidated Balance Sheet, along with a corresponding outflow within Assets constructed for others in the Consolidated Statement of Cash Flows, and an increase to Construction obligation (with a corresponding cash inflow from Financing activities in the Consolidated Statement of Cash Flows) as reimbursements are received from Broward County. As of December 31, 2015 , the Company had recorded construction costs related to the project of \$25 million .

Houston William P. Hobby Airport

The Company entered into a Memorandum of Agreement (“MOA”) with the City of Houston (“City”), effective June 2012 , to expand the existing Houston Hobby airport facility. As provided in the MOA, the Company and the City entered into an Airport Use and Lease Agreement (“Lease”) to control the execution of this expansion and the financial terms thereof. Per the MOA and Lease, this project provided a new five-gate international terminal with international passenger processing facilities, expansion of the security checkpoint, and upgrades to the Southwest Airlines ticket counter area. The project cost approximately \$156 million , and the Company provided the funding for, as well as management over, the project. In return, the capital cost portion of the rent the Company pays for the international facility is waived from the initial occupancy until the expiration of the Lease. However, at any point following

completion of the project, the City has the option to reimburse the Company's investment at the then-unamortized cost of the facility. This purchase would trigger payment of the previously waived capital cost component of rents owed the City. Additionally, a small portion of the project qualified for rental credits that will be utilized against the Company's 2016 lease payments at the airport. Construction was effectively completed in October 2015, at which time the Company began operating from the new facility.

As a result of its significant involvement in the Houston Hobby project, the Company determined that it is the owner of the facility for accounting purposes. As such, during construction, the Company recorded expenditures as Assets constructed for others in the Consolidated Balance Sheet, along with a corresponding outflow within Assets constructed for others, in the Consolidated Statement of Cash Flows. As of December 31, 2015, the Company had recorded construction costs related to Houston Hobby of \$146 million.

Los Angeles International Airport

In March 2013, the Company executed a lease agreement with Los Angeles World Airports ("LAWA"), which owns and operates Los Angeles International Airport ("LAX"). Under the lease agreement, which was amended in June 2014, the Company is overseeing and managing the design, development, financing, construction and commissioning of the airport's Terminal 1 Modernization Project (the "Project") at a cost not to exceed \$526 million. The Project is being funded primarily using the Regional Airports Improvement Corporation ("RAIC"), which is a quasi-governmental special purpose entity that acts as a conduit borrower under a syndicated credit facility provided by a group of lenders. Loans made under the credit facility are being used to fund the development of the Project, and the outstanding loans will be repaid with the proceeds of LAWA's payments to purchase completed Project phases. The Company has guaranteed the obligations of the RAIC under the credit facility. Construction on the Project began during 2014 and is estimated to be completed during 2018. The Company believes that, due to its agreed upon role in overseeing and managing the Project, it is considered the owner of the Project for accounting purposes. LAWA will reimburse the Company for the non-proprietary renovations, while the Company will not be reimbursed for proprietary renovations. As a result, the \$196 million of costs incurred as of December 31, 2015, are included within Assets constructed for others, and all amounts that have been or will be reimbursed will be included within Construction obligation on the accompanying Consolidated Balance Sheet.

Dallas Love Field

During 2008, the City of Dallas approved the Love Field Modernization Program ("LFMP"), a project to reconstruct Dallas Love Field with modern, convenient air travel facilities. Pursuant to a Program Development Agreement with the City of Dallas and the Love Field Airport Modernization Corporation (or "LFAMC," a Texas non-profit "local government corporation" established by the City of Dallas to act on the City of Dallas' behalf to facilitate the development of the LFMP), the Company managed this project. Major construction was effectively completed by December 31, 2014. This project consisted of the complete replacement of gate facilities with a new 20-gate facility, including infrastructure, systems and equipment, aircraft parking apron, fueling system, roadways and terminal curbside, baggage handling systems, passenger loading bridges and support systems, and other supporting infrastructure.

Although the City of Dallas received commitments from various sources that are helping to fund portions of this LFMP project, including the Federal Aviation Administration ("FAA"), the Transportation Security Administration, and the City of Dallas' Aviation Fund, the majority of the funds used were from the issuance of bonds. During fourth quarter 2010, \$310 million of such bonds were issued by the LFAMC, and the Company has guaranteed principal and interest payments on the bonds. An additional tranche of such bonds totaling \$146 million was issued during second quarter 2012, and the Company has guaranteed the principal and interest payments on these bonds as well.

In conjunction with the Company's significant presence at Dallas Love Field, the Company agreed to manage the majority of the LFMP project. Based on the pertinent factors in place at the time the agreement was made, the Company utilized the accounting guidance provided for lessees involved in asset construction. As of December 31, 2015, the Company had recorded LFMP construction costs of \$548 million within Assets constructed for others and had recorded

a liability of \$536 million within Construction obligation in its Consolidated Balance Sheet. Upon completion of different phases of the LFMP project, the Company has placed the associated assets in service and has begun depreciating the assets over their estimated useful lives. The amount of depreciation recorded for the year ended December 31, 2015, associated with the LFMP assets in service was \$36 million. The corresponding LFMP liabilities are being reduced primarily through the Company's airport rental payments to the City of Dallas as the construction costs of the project are passed through to the Company via recurring airport rates and charges. A portion of these payments are reflected as Repayment of construction obligation in the Consolidated Statement of Cash Flows. The imputed interest rate associated with construction obligation was nominal for 2015 and 2014. During 2015, the City of Dallas issued additional bonds for the construction of a new parking garage. The Company has not guaranteed the principal or interest payments on these bonds, but remains the accounting owner of this project.

Contingencies

The Company is from time to time subject to various legal proceedings and claims arising in the ordinary course of business, including, but not limited to, examinations by the IRS. The Company's management does not expect that the outcome in any of its currently ongoing legal proceedings or the outcome of any adjustments presented by the IRS, individually or collectively, will have a material adverse effect on the Company's financial condition, results of operations, or cash flow.

5. SUPPLEMENTAL FINANCIAL INFORMATION

(in millions)	December 31, 2015	December 31, 2014
Intangible assets	\$ 464	\$ 363
Non-current investments	40	35
Other	213	136
Other assets	<u>\$ 717</u>	<u>\$ 534</u>

(in millions)	December 31, 2015	December 31, 2014
Accounts payable trade	\$ 178	\$ 123
Salaries payable	173	160
Taxes payable	179	163
Aircraft maintenance payable	168	314
Fuel payable	48	85
Other payable	442	358
Accounts payable	<u>\$ 1,188</u>	<u>\$ 1,203</u>

(in millions)	December 31, 2015	December 31, 2014
Profitsharing and savings plans	\$ 655	\$ 374
Aircraft and other lease related obligations	74	159
Vacation pay	309	292
Accrued union bonuses	329 (a)	9
Health	86	84
Derivative contracts	643	174
Workers compensation	187	165
Property and other taxes	62	81
Other	246	227
Accrued liabilities	<u>\$ 2,591</u>	<u>\$ 1,565</u>

(a) As part of the ongoing negotiations with various union contract groups during 2015, the Company has recorded a liability for estimated bonuses that would be paid out to union members upon ratification of labor agreements. The liability excludes certain immaterial benefit costs that are included as a component of Accounts payable. The amount accrued is subject to change based on subsequent negotiations, and any changes would be recorded on a prospective basis.

(in millions)	December 31, 2015	December 31, 2014
Postretirement obligation	\$ 201	\$ 169
Non-current lease-related obligations	165	193
Other deferred compensation	179	174
Deferred gains from sale and leaseback of aircraft	43	53
Derivative contracts	74	622
Other	98	44
Other non-current liabilities	<u>\$ 760</u>	<u>\$ 1,255</u>

Other Operating Expenses

Other operating expenses consist of distribution costs, advertising expenses, personnel expenses, professional fees, and other operating costs, none of which individually exceed 10 percent of Operating expenses.

6 . LONG-TERM DEBT

(in millions)	December 31, 2015	December 31, 2014
5.75% Notes due 2016	\$ 307	\$ 313
5.25% Convertible Senior Notes due 2016	111	113
5.125% Notes due 2017	309	316
French Credit Agreements due 2018—1.53%	25	36
Fixed-rate 737 Aircraft Notes payable through 2018—7.02%	17	24
2.75% Notes due 2019	303	300
Term Loan Agreement due 2019—6.315%	143	178
Term Loan Agreement due 2019—4.84%	36	73
2.65% Notes due 2020	494	—
Term Loan Agreement due 2020—5.223%	329	372
Floating-rate 737 Aircraft Notes payable through 2020	257	300
Pass Through Certificates due 2022—6.24%	340	355
7.375% Debentures due 2027	132	134
Capital leases	395	199
	<u>\$ 3,198</u>	<u>\$ 2,713</u>
Less current maturities	637	258
Less debt discount and issuance costs	20	21
	<u>\$ 2,541</u>	<u>\$ 2,434</u>

AirTran Long-Term Debt

AirTran Holdings previously entered into aircraft purchase financing facilities, and as of December 31, 2015 , 19 Boeing 737 aircraft remained that were financed under floating-rate facilities. Each note is secured by a first mortgage on the aircraft to which it relates. The notes bear interest at a floating rate per annum equal to a margin plus the three or six-month LIBOR in effect at the commencement of each semi-annual or three-month period, as applicable. As of December 31, 2015 , the weighted average interest rate was 1.86 percent . Principal and interest under the notes are payable semi-annually or every three months as applicable. As of December 31, 2015 , the remaining debt outstanding may be prepaid without penalty under all aircraft loans provided under such facilities. The notes mature in years 2016

to 2020 . As discussed further in Note 10 , a portion of the above floating-rate debt has been effectively converted to a fixed rate via interest rate swap agreements which expire between 2016 and 2020 .

As of December 31, 2015 , three Boeing 737 aircraft were financed under a fixed-rate facility. Each note is secured by a first mortgage on the aircraft to which it relates. As of December 31, 2015 , the weighted average interest rate was 7.02 percent . Payments of principal and interest under the notes are due semi-annually. The notes mature in years 2016 to 2018 .

In October 2009 , AirTran Holdings completed a public offering of \$115 million of convertible senior notes due November 1, 2016. Such notes bear interest at 5.25 percent payable semi-annually, in arrears, on May 1 and November 1 . As a result of the acquisition and subsequent dividends declared by the Company, the convertible senior notes are convertible into AirTran conversion units of 168.6576 per \$1,000 in principal amount of such notes. Based on the terms of the merger agreement, the holders of these notes would receive shares of the Company's common stock at a conversion rate of 54.1391 shares and \$615.16 in cash per \$1,000 in principal amount of such notes. This conversion rate is subject to adjustment under certain circumstances such as: granting of stock and cash dividends, a make-whole fundamental change of ownership provision, the issuance of rights or warrants, and/or a distribution of capital stock. Subsequent to the acquisition, holders of \$5 million in principal amount elected to convert their notes. Remaining holders may convert their convertible senior notes into cash and shares of common stock at their option at any time. The convertible senior notes are not redeemable at the Company's option prior to maturity. The holders of the convertible senior notes may require the Company to repurchase such notes, in whole or in part, for cash upon the occurrence of a fundamental change, as defined in the governing supplemental indenture, at a repurchase price of 100 percent of the principal amount plus any accrued and unpaid interest.

As a result of triggering the fundamental change of ownership provision in the convertible senior notes and as a result of the acquisition, an embedded conversion option is deemed to exist. In accordance with applicable accounting guidance, the embedded conversion option was effectively separated and accounted for as a free-standing derivative. A fair value calculation, utilizing similar market yields and the Company's common stock price, was performed for the debt with and without the equity to measure the equity component. The value allocated to the conversion option of \$35 million is classified as permanent equity. The estimated premium associated with the notes excluding the equity feature was \$10 million , and is being amortized to interest expense over the remaining life of the notes. The dilutive effect of the shares that would be issued if the convertible notes were converted is considered in the Company's net income per share calculations, unless such conversion would be considered antidilutive. See Note 3 .

Other Company Long-Term Debt

During November 2015, the Company issued \$500 million senior unsecured notes due 2020 . The notes bear interest at 2.65 percent , and are payable semi-annually in arrears on May 5 and November 5. Concurrently, the Company entered into a fixed-to-floating interest rate swap to convert the interest on these unsecured notes to a floating rate until their maturity. See Note 10 for further information on the interest-rate swap agreement.

During November 2014 , the Company issued \$300 million senior unsecured notes due 2019 . The notes bear interest at 2.75 percent , payable semi-annually in arrears on May 6 and November 6 . Concurrently, the Company entered into a fixed-to-floating interest rate swap to convert the interest on these unsecured notes to a floating rate until their maturity. See Note 10 for further information on the interest-rate swap agreement.

On July 1, 2009 , the Company entered into a term loan agreement providing for loans to the Company aggregating up to \$124 million , to be secured by mortgages on five of the Company's 737-700 aircraft. The Company has borrowed the full \$124 million and secured this loan with the requisite five aircraft mortgages. The loan matures on July 1, 2019 , and is repayable semi-annually in installments of principal that began January 1, 2010 . The loan bears interest at a fixed rate of 4.84 percent , and interest is payable semi-annually, which payments began on January 1, 2010 . In September 2015 , the Company prepaid \$24 million on the loan agreement, which in turn released one of the encumbered aircraft. As such, the remaining four aircraft related to this transaction are still encumbered as of December 31, 2015 .

On April 29, 2009 , the Company entered into a term loan agreement providing for loans to the Company aggregating up to \$332 million , to be secured by mortgages on 14 of the Company's 737-700 aircraft. The Company borrowed the full \$332 million and secured the loan with the requisite 14 aircraft mortgages. The loan matures on May 6, 2019 , and is being repaid via quarterly installments of principal that began August 6, 2009 . The loan bears interest at the LIBO Rate (as defined in the term loan agreement) plus 3.30 percent , and interest is payable quarterly, which payments began on August 6, 2009 . Pursuant to the terms of the term loan agreement, the Company entered into an interest rate swap agreement to convert the variable rate on the term loan to a fixed 6.315 percent until maturity.

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 0.95 percent , and interest is payable quarterly. Pursuant to the terms of the term loan agreement, the Company entered into an interest rate swap agreement to convert the variable rate on the term loan to a fixed 5.223 percent until maturity.

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 . 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 December 15, 2016 . The notes bear interest at 5.75 percent , payable semi-annually in arrears, with the first payment made on June 15, 2007 . During fourth quarter 2009 , the Company entered into a fixed-to-floating interest rate swap to convert the interest on these unsecured notes to a floating rate; however, the interest rate swap was terminated in 2015. See Note 10 for further information on the interest-rate swap agreement and termination.

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 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 estimated at inception that, considering the full effect of the "net present value benefits" included in the transactions, the effective economic yield over the 13 -year term of the loans will be approximately LIBOR minus 45 basis points. Principal and interest are payable semi-annually on June 30 and December 31 for each of the loans, and the Company may terminate the arrangements in any year on either of those dates, under certain conditions. The Company pledged four aircraft as collateral for the transactions.

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; however, the interest rate swap was terminated in December 2012.

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 the obligations to which they relate are reflected as liabilities in the Consolidated Balance Sheet. Outstanding letters of credit totaled \$184 million at December 31, 2015 .

The net book value of the assets pledged as collateral for the Company's secured borrowings, primarily aircraft and engines, was \$1.9 billion at December 31, 2015 . In addition, the Company has pledged a total of up to 88 of its Boeing 737-700 and 12 of its Boeing 737-800 aircraft at a net book value of \$2.5 billion , in the case that it has obligations related to its fuel derivative instruments with counterparties that exceed certain thresholds. See Note 10 for further information on these collateral arrangements.

As of December 31, 2015 , aggregate annual principal maturities of debt and capital leases (not including amounts associated with interest rate swap agreements, interest on capital leases, amortization of capital lease incentives, and amortization of purchase accounting adjustments) for the five-year period ending December 31, 2020, and thereafter, were \$617 million in 2016, \$528 million in 2017, \$272 million in 2018, \$522 million in 2019, \$751 million in 2020, and \$424 million thereafter.

7 . LEASES

The Company's fleet included 28 aircraft on capital lease as of December 31, 2015 , compared with 16 aircraft on capital lease, including two B717s, as of December 31, 2014 . Amounts applicable to these aircraft that are included in property and equipment were:

(in millions)	2015	2014
Flight equipment	\$ 435	\$ 214
Less: accumulated amortization	29	22
	<u>\$ 406</u>	<u>\$ 192</u>

Total rental expense for operating leases, both aircraft and other, charged to operations in 2015 , 2014 , and 2013 was \$909 million , \$931 million , and \$997 million , respectively. The majority of the Company's terminal operations space, as well as 95 aircraft, were under operating leases at December 31, 2015 . For aircraft operating leases and for terminal operations leases, expense is included in Aircraft rentals and in Landing fees and other rentals, respectively, in the Consolidated Statement of Income. Future minimum lease payments under capital leases and noncancelable operating leases and rentals to be received under subleases with initial or remaining terms in excess of one year at December 31, 2015 , were:

(in millions)	Capital leases	Operating leases	Subleases	LFMP facility lease*	Operating leases, net
2016	\$ 46	\$ 636	\$ (103)	\$ 24	\$ 557
2017	46	624	(103)	24	545
2018	45	551	(102)	25	474
2019	45	479	(97)	25	407
2020	44	359	(78)	26	307
Thereafter	209	961	(66)	634	1,529
Total minimum lease payments	\$ 435	\$ 3,610	\$ (549)	\$ 758	\$ 3,819
Less amount representing interest	79				
Present value of minimum lease payments	356				
Less current portion	32				
Long-term portion	\$ 324				

* See Note 4 for further details

The aircraft leases generally can be renewed for one to five years at rates based on fair market value at the end of the lease term. 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.

On July 9, 2012, the Company signed an agreement with Delta Air Lines, Inc. and Boeing Capital Corp. to lease or sublease all 88 of AirTran's B717s to Delta at agreed-upon lease rates. The first converted B717 was delivered to Delta in September 2013, and as of December 31, 2015, the Company had delivered a total of 87 B717s to Delta. As the Company previously announced, all B717s remaining at Southwest were grounded on December 28, 2014. The Company expects the one remaining B717 to be converted and delivered to Delta by early 2016. A total of 76 of the B717s are on operating lease, ten are owned, and two are on capital lease.

The Company paid the majority of the costs to convert the aircraft to the Delta livery and perform certain maintenance checks prior to the delivery of each aircraft. The agreement to pay these conversion and maintenance costs is a "lease incentive" under applicable accounting guidance. The sublease terms for the 76 B717s on operating lease and the two B717s on capital lease coincide with the Company's remaining lease terms for these aircraft from the original lessor, which range from approximately three to eight years. The leasing of the ten B717s that are owned by the Company is subject to certain conditions, and the lease terms are for up to seven years, after which Delta will have the option to purchase the aircraft at the then-prevailing market value. The ten owned B717s are accounted for as sales type leases, the two B717s classified by the Company as capital leases are accounted for as direct financing leases, and the remaining 76 subleases are accounted for as operating leases with Delta. With respect to the 87 B717s delivered to Delta as of December 31, 2015, the Company had 76 operating leases, nine sales type leases, and two direct financing leases. There are no contingent payments and no significant residual value conditions associated with the transaction.

The accounting for this transaction is based on the guidance provided for lease transactions. The Company recorded an initial charge of approximately \$137 million during third quarter 2012, representing the remaining estimated cost, at the scheduled date of delivery of each B717 to Delta (including the conversion, maintenance, and other contractual costs to be incurred), of the Company's lease of the 76 B717s that are accounted for as operating leases, net of the future sublease income from Delta and the remaining unfavorable aircraft lease liability established as of the acquisition date. During 2014, the Company recorded an additional \$22 million in expense for its revised estimate of conversion costs for these B717s, and an additional \$9 million associated with the extension of time between when the Company removed the aircraft from revenue service, on December 28, 2014, and when they entered the conversion process. The charges recorded by the Company for this transaction were included as a component of Acquisition and integration costs in the Company's Consolidated Statement of Income and were included as a component of Other, net in Cash flows from operating activities in the Company's Consolidated Statement of Cash Flows, and the corresponding liability for this transaction is included as a component of Current liabilities and Other noncurrent liabilities in the Company's

Consolidated Balance Sheet. A rollforward of the Company's B717 lease/sublease liability for 2015 and 2014 is shown below:

(in millions)	B717 lease/sublease liability
Balance at December 31, 2013	\$ 122
Lease/sublease accretion	5
Lease/sublease expense adjustment	22
Lease/sublease payments, net (a)	(86)
Balance at December 31, 2014	\$ 63
Lease/sublease accretion	1
Lease/sublease expense adjustment	2
Lease/sublease payments, net (a)	(48)
Balance at December 31, 2015	\$ 18

(a) Includes lease conversion cost payments

8. 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, 2015, the Company had 60 million shares of common stock reserved for issuance pursuant to Employee equity plans (of which 33 million shares had not been granted) through various share-based compensation arrangements. See Note 9 to the Consolidated Financial Statements for information regarding the Company's equity plans.

9. STOCK PLANS

Share-based Compensation

The Company accounts for share-based compensation utilizing fair value, which is determined on the date of grant for all instruments. The Consolidated Statement of Income for the years ended December 31, 2015, 2014, and 2013, reflects share-based compensation expense of \$29 million, \$21 million, and \$18 million, respectively. The total tax benefit recognized in earnings from share-based compensation arrangements for the years ended December 31, 2015, 2014, and 2013, was not material. As of December 31, 2015, there was \$34 million of total unrecognized compensation cost related to share-based compensation arrangements, which is expected to be recognized over a weighted-average period of 1.9 years. The Company expects substantially all unvested awards to vest.

Restricted Stock Units and Stock Grants

Under the Company's Amended and Restated 2007 Equity Incentive Plan ("2007 Equity Plan"), it granted restricted stock units ("RSUs") to certain Employees during 2013, 2014, and 2015 and performance-based restricted stock units ("PBRsUs") to certain Employees during 2014 and 2015. Outstanding RSUs vest over three years, subject generally to the individual's continued employment or service. The Company recognizes all expense on a straight-line basis over the vesting period, with any changes in expense due to the number of PBRsUs expected to vest being modified on a prospective basis. The PBRsUs granted in May 2014 and February 2015 are subject to the Company's performance with respect to a three-year simple average of Return on Invested Capital, before taxes and excluding special items ("ROIC"), for the defined performance period and the individual's continued employment or service. The number of PBRsUs vesting on the vesting date will be interpolated based on the Company's ROIC performance and ranges from zero PBRsUs to 200 percent of granted PBRsUs.

Aggregated information regarding the Company's RSUs and PBRsUs is summarized below:

	All Restricted Stock Units	
	Units (000)	Wtd. Average Fair Value (per share)
Outstanding December 31, 2012, Unvested	2,876	\$ 9.57
Granted	1,139	14.34
Vested	(1,263)	10.24
Surrendered	(168)	9.11
Outstanding December 31, 2013	2,584	11.38
Granted	834 (a)	24.93
Vested	(1,239)	11.05
Surrendered	(102)	13.18
Outstanding December 31, 2014	2,077	16.92
Granted	561 (b)	45.80
Vested	(1,095)	13.33
Surrendered	(58)	25.49
Outstanding December 31, 2015, Unvested	1,485	\$ 30.17

(a) Includes 198 thousand shares of PBRsUs

(b) Includes 183 thousand shares of PBRsUs

In addition, the Company granted approximately 28 thousand shares of unrestricted stock at a weighted average grant price of \$41.27 in 2015 , approximately 36 thousand shares at a weighted average grant price of \$24.91 in 2014 , and approximately 63 thousand shares at a weighted average grant price of \$14.34 in 2013 , to members of its Board of Directors.

A remaining balance of up to 23 million shares of the Company's common stock may be issued pursuant to grants under the 2007 Equity Plan.

Stock Options

The Company has stock options outstanding, which were granted prior to 2013, with an exercise price equal to the fair value of the Company's common stock on the date of grant. The Company determined fair value of stock options using the Black-Scholes option valuation model. As of December 31, 2015, there were 822 thousand outstanding stock option awards, all of which are vested and exercisable, with a weighted average exercise price of \$13.44 .

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 10 million shares of the Company's 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, 2015 , 2014 , and 2013 , participants under the plan purchased 597 thousand shares, 792 thousand shares, and 1.5 million shares at average prices of \$36.40 , \$23.17 , and \$12.03 , respectively. The weighted-average fair value of each purchase right under the ESPP granted for the years ended December 31, 2015 , 2014 , and 2013 , 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 \$4.04 , \$2.68 , and \$1.34 , respectively.

Taxes

A portion of the Company's granted options qualify as incentive stock options 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 incentive stock option 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.

10 . FINANCIAL DERIVATIVE INSTRUMENTS

Fuel Contracts

Airline operators are inherently dependent upon energy to operate and, therefore, are impacted by changes in jet fuel prices. Furthermore, jet fuel and oil typically represent one of the largest operating expenses for airlines. The Company endeavors to acquire jet fuel at the lowest possible cost and to reduce volatility in operating expenses through its fuel hedging program. Although the Company may periodically enter into jet fuel derivatives for short-term timeframes, because jet fuel is not widely traded on an organized futures exchange, there are limited opportunities to hedge directly in jet fuel for time horizons longer than approximately 24 months into the future. However, the Company has found that financial derivative instruments in other commodities, such as West Texas Intermediate ("WTI") crude oil, Brent crude oil, and refined products, such as heating oil and unleaded gasoline, can be useful in decreasing its exposure to jet fuel price volatility. The Company does not purchase or hold any financial derivative instruments for trading or speculative purposes.

The Company has used financial derivative instruments for both short-term and long-term time frames, and primarily uses a mixture of purchased call options, collar structures (which include both a purchased call option and a sold put option), call spreads (which include a purchased call option and a sold call option), put spreads (which include a purchased put option and a sold put option), and fixed price swap agreements in its portfolio. Although the use of collar structures and swap agreements can reduce the overall cost of hedging, these instruments carry more risk than purchased call options in that the Company could end up in a liability position when the collar structure or swap agreement settles. With the use of purchased call options and call spreads, the Company cannot be in a liability position at settlement, but does not have coverage once market prices fall below the strike price of the purchased call option.

The Company evaluates its hedge volumes strictly from an "economic" standpoint and thus does not consider whether the hedges have qualified or will qualify for hedge accounting. The Company defines its "economic" hedge as the net volume of fuel derivative contracts held, including the impact of positions that have been offset through sold positions, regardless of whether those contracts qualify for hedge accounting. The level at which the Company is economically hedged for a particular period is also dependent on current market prices for that period, as well as the types of derivative instruments held and the strike prices of those instruments. For example, the Company may enter into "out-of-the-money" option contracts (including catastrophic protection), which may not generate intrinsic gains at settlement if market prices do not rise above the option strike price. Therefore, even though the Company may have an "economic" hedge in place for a particular period, that hedge may not produce any hedging gains at settlement and may even produce hedging losses depending on market prices, the types of instruments held, and the strike prices of those instruments.

For 2015 , the Company had fuel derivative instruments in place for up to 15 percent of its fuel consumption. The Company also had fuel derivative instruments in place to provide coverage for up to 63 percent of its 2016 estimated fuel consumption, depending on where market prices settle. The following table provides information about the Company's volume of fuel hedging for the years 2016 through 2018 on an "economic" basis considering current market prices:

<u>Period (by year)</u>	Fuel hedged as of	Derivative underlying commodity type as of
	December 31, 2015	December 31, 2015
	(gallons in millions) (a)	
2016	1,226	Brent crude oil, Heating oil, and Gulf Coast jet fuel
2017	1,503	WTI crude and Brent crude oil
2018	731	Brent crude oil

(a) Due to the types of derivatives utilized by the Company and different price levels of those contracts, these volumes represent the maximum economic hedge in place and may vary significantly as market prices fluctuate.

Upon proper qualification, the Company accounts for its fuel derivative instruments as cash flow hedges. Generally, utilizing hedge accounting, all periodic changes in fair value of the derivatives designated as hedges that are considered to be effective are recorded in Accumulated other comprehensive income (loss) ("AOCI") until the underlying jet fuel is consumed. See Note 12. The Company's results are subject to the possibility that periodic changes will not be effective, as defined, or that the derivatives will no longer qualify for hedge accounting. Ineffectiveness 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 ineffective, the ineffective portion is recorded to Other (gains) losses, net, in the Consolidated Statement of Income. Likewise, if a hedge ceases to qualify for hedge accounting, any change in the fair value of derivative instruments since the last reporting period is recorded to Other (gains) losses, net, in the Consolidated Statement of Income in the period of the change; however, any amounts previously recorded to AOCI would remain there until such time as the original forecasted transaction occurs, at which time these amounts would be reclassified to Fuel and oil expense. When the Company has sold derivative positions in order to effectively "close" or offset a derivative already held as part of its fuel derivative instrument portfolio, any subsequent changes in fair value of those positions are marked to market through earnings. Likewise, any changes in fair value of those positions that were offset by entering into the sold positions and were de-designated as hedges are concurrently marked to market through earnings. However, any changes in value related to hedges that were deferred as part of AOCI while designated as a hedge would remain until the originally forecasted transaction occurs. In a situation where it becomes probable that a fuel hedged forecasted transaction will not occur, any gains and/or losses that have been recorded to AOCI would be required to be immediately reclassified into earnings. The Company did not have any such situations occur during 2013, 2014, or 2015.

In some situations, an entire commodity type used in hedging may cease to qualify for special hedge accounting treatment. As an example, from July 2013 to July 2015, the Company's routine statistical analysis performed to determine which commodities qualified for special hedge accounting treatment on a prospective basis dictated that WTI crude oil based derivatives no longer qualified for hedge accounting. This was primarily due to the fact that the correlation between WTI crude oil prices and jet fuel prices fell below established thresholds, and therefore the Company could no longer demonstrate that derivatives based on WTI crude oil prices would result in effective hedges on a prospective basis. As such, the changes in fair value of all of the Company's derivatives based in WTI were recorded directly to Other (gains) losses. The Company's routine statistical analysis performed during second half 2015, dictated that WTI crude oil based derivatives again qualified for hedge accounting.

Ineffectiveness is inherent in hedging jet fuel with derivative positions based in other crude oil related commodities. 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. Factors that have and may continue to lead to ineffectiveness and unrealized gains and losses on derivative contracts include: significant fluctuation in energy prices, the number of derivative positions the Company holds, significant weather events affecting refinery capacity and the production of refined products, and the volatility of the different types of products the Company uses in hedging. However, even though derivatives may not qualify for hedge accounting, the Company continues to hold the instruments as management believes derivative instruments continue to afford the Company the opportunity to stabilize jet fuel costs.

Accounting pronouncements pertaining to derivative instruments and hedging are complex 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. The Company also examines the effectiveness of each individual hedge and 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.

All cash flows associated with purchasing and selling fuel derivatives are classified as Other operating cash flows in the Consolidated Statement of Cash Flows. The following table presents the location of all assets and liabilities associated with the Company's hedging instruments within the Consolidated Balance Sheet:

(in millions)	Balance Sheet location	Asset derivatives		Liability derivatives	
		Fair value at 12/31/2015	Fair value at 12/31/2014	Fair value at 12/31/2015	Fair value at 12/31/2014
Derivatives designated as hedges*					
Fuel derivative contracts (gross)	Prepaid expenses and other current assets	\$ 2	\$ —	\$ —	\$ —
Fuel derivative contracts (gross)	Other assets	2	—	—	—
Fuel derivative contracts (gross)	Accrued liabilities	107	—	526	—
Fuel derivative contracts (gross)	Other noncurrent liabilities	55	—	658	643
Interest rate derivative contracts	Other assets	2	13	—	—
Interest rate derivative contracts	Other noncurrent liabilities	—	—	49	61
Total derivatives designated as hedges		\$ 168	\$ 13	\$ 1,233	\$ 704
Derivatives not designated as hedges*					
Fuel derivative contracts (gross)	Prepaid expenses and other current assets	\$ 39	\$ —	\$ 26	\$ —
Fuel derivative contracts (gross)	Other assets	5	—	—	—
Fuel derivative contracts (gross)	Accrued liabilities	1,395	1,190	1,854	1,432
Fuel derivative contracts (gross)	Other noncurrent liabilities	330	157	352	273
Total derivatives not designated as hedges		\$ 1,769	\$ 1,347	\$ 2,232	\$ 1,705
Total derivatives		\$ 1,937	\$ 1,360	\$ 3,465	\$ 2,409

* Represents the position of each trade before consideration of offsetting positions with each counterparty and does not include the impact of cash collateral deposits provided to or received from counterparties. See discussion of credit risk and collateral following in this Note.

In addition, the Company also had the following amounts associated with fuel derivative instruments and hedging activities in its Consolidated Balance Sheet:

(in millions)	Balance Sheet location	December 31, 2015	December 31, 2014
Cash collateral deposits provided to counterparties for fuel contracts - current	Offset against Accrued liabilities	\$ 235	\$ 68
Cash collateral deposits provided to counterparties for fuel contracts- noncurrent	Offset against Other noncurrent liabilities	600	198
Due to third parties for fuel contracts	Accrued liabilities	46	16

All of the Company's fuel derivative instruments and interest rate swaps are subject to agreements that follow the netting guidance in the applicable accounting for derivatives and hedging. The types of derivative instruments the Company has determined are subject to netting requirements in the accompanying Consolidated Balance Sheet are those in which the Company pays or receives cash for transactions with the same counterparty and in the same currency

via one net payment or receipt. For cash collateral held by the Company or provided to counterparties, the Company nets such amounts against the fair value of the Company's derivative portfolio by each counterparty. The Company has elected to utilize netting for both its fuel derivative instruments and interest rate swap agreements and also classifies such amounts as either current or noncurrent, based on the net fair value position with each of the Company's counterparties in the Consolidated Balance Sheet.

The Company's application of its netting policy associated with cash collateral differs depending on whether its derivative instruments are in a net asset position or a net liability position. If its fuel derivative instruments are in a net asset position with a counterparty, cash collateral amounts held are first netted against current outstanding derivative amounts associated with that counterparty until that balance is zero, and then any remainder is applied against the fair value of noncurrent outstanding derivative instruments. If the Company's fuel derivative instruments are in a net liability position with the counterparty, cash collateral amounts provided are first netted against noncurrent outstanding derivative amounts associated with that counterparty until that balance is zero, and then any remainder is applied against the fair value of current outstanding derivative instruments.

The Company has the following recognized financial assets and financial liabilities resulting from those transactions that meet the scope of the disclosure requirements as necessitated by applicable accounting guidance for balance sheet offsetting:

Offsetting of derivative assets

(in millions)

Description	Balance Sheet location	(i)	(ii)	(iii) = (i) + (ii)	(i)	(ii)	(iii) = (i) + (ii)
		December 31, 2015			December 31, 2014		
		Gross amounts of recognized assets	Gross amounts offset in the Balance Sheet	Net amounts of assets presented in the Balance Sheet (a)	Gross amounts of recognized assets	Gross amounts offset in the Balance Sheet	Net amounts of assets presented in the Balance Sheet (a)
Fuel derivative contracts	Prepaid expenses and other current assets	\$ 41	\$ (26)	\$ 15	\$ —	\$ —	\$ —
Fuel derivative contracts	Other assets	\$ 7	\$ —	\$ 7	\$ —	\$ —	\$ —
Fuel derivative contracts	Accrued liabilities	\$ 1,737	\$ (1,737)	\$ —	\$ 1,258	\$ (1,258)	\$ —
Fuel derivative contracts	Other noncurrent liabilities	\$ 985	\$ (985)	\$ —	\$ 355	\$ (355)	\$ —
Interest rate derivative contracts	Other assets	\$ 2	\$ —	\$ 2	\$ 13	\$ —	\$ 13

(a) The net amounts of derivative assets and liabilities are reconciled to the individual line item amounts presented in the Consolidated Balance Sheet in Note 5 .

		(i)	(ii)	(iii) = (i) + (ii)		(i)	(ii)	(iii) = (i) + (ii)	
		December 31, 2015			December 31, 2014				
Description	Balance Sheet location	Gross amounts of recognized liabilities	Gross amounts offset in the Balance Sheet	Net amounts of liabilities presented in the Balance Sheet (a)	Gross amounts of recognized liabilities	Gross amounts offset in the Balance Sheet	Net amounts of liabilities presented in the Balance Sheet (a)		
Fuel derivative contracts	Prepaid expenses and other current assets	\$ 26	\$ (26)	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Fuel derivative contracts	Accrued liabilities	\$ 2,380	\$ (1,737)	\$ 643	\$ 1,432	\$ (1,258)	\$ 174		
Fuel derivative contracts	Other noncurrent liabilities	\$ 1,010	\$ (985)	\$ 25	\$ 916	\$ (355)	\$ 561		
Interest rate derivative contracts	Other noncurrent liabilities	\$ 49	\$ —	\$ 49	\$ 61	\$ —	\$ 61		

(a) The net amounts of derivative assets and liabilities are reconciled to the individual line item amounts presented in the Consolidated Balance Sheet in Note 5 .

The following tables present the impact of derivative instruments and their location within the Consolidated Statement of Income for the year ended December 31, 2015 and 2014 :

Derivatives in cash flow hedging relationships

(in millions)	(Gain) loss recognized in AOCI on derivatives (effective portion)		(Gain) loss reclassified from AOCI into income (effective portion)(a)		(Gain) loss recognized in income on derivatives (ineffective portion) (b)	
	Year ended December 31,		Year ended December 31,		Year ended December 31,	
	2015	2014	2015	2014	2015	2014
Fuel derivative contracts	\$ 546 *	\$ 749 *	\$ 238 *	\$ 22 *	\$ (9)	\$ 7
Interest rate derivatives	4 *	6 *	13 *	14 *	(4)	(4)
Total	\$ 550	\$ 755	\$ 251	\$ 36	\$ (13)	\$ 3

*Net of tax

(a) Amounts related to fuel derivative contracts and interest rate derivatives are included in Fuel and oil and Interest expense, respectively.

(b) Amounts are included in Other (gains) losses, net.

Derivatives not in cash flow hedging relationships

	(Gain) loss recognized in income on derivatives		
	Year ended December 31,		Location of (gain) loss recognized in income on derivatives
(in millions)	2015	2014	
Fuel derivative contracts	\$ 444	\$ 244	Other (gains) losses, net

The Company also recorded expense associated with premiums paid for fuel derivative contracts that settled/expired during 2015 , 2014 , and 2013 of \$ 124 million , \$ 62 million , and \$ 60 million , respectively. These amounts are excluded from the Company's measurement of effectiveness for related hedges and are included as a component of Other (gains) losses, net, in the Consolidated Statement of Income.

The fair values of the derivative instruments, depending on the type of instrument, were determined by the use of present value methods or option value models with assumptions about commodity prices based on those observed in underlying markets or provided by third parties. Included in the Company's cumulative net unrealized losses from fuel hedges as of December 31, 2015 , recorded in AOCI, were approximately \$620 million in unrealized losses , net of taxes, which are expected to be realized in earnings during the twelve months subsequent to December 31, 2015 .

Interest Rate Swaps

The Company is party to certain interest rate swap agreements that are accounted for as either fair value hedges or cash flow hedges, as defined in the applicable accounting guidance for derivative instruments and hedging. Several of the Company's interest rate swap agreements qualify for the "shortcut" method of accounting for hedges, which dictates that the hedges are assumed to be perfectly effective, and, thus, there is no ineffectiveness to be recorded in earnings. For the Company's interest rate swap agreements that do not qualify for the "shortcut" method of accounting, ineffectiveness is required to be measured at each reporting period. The ineffectiveness associated with all of the Company's, including AirTran Holdings', interest rate swap agreements for all periods presented was not material.

The Company has floating-to-fixed interest rate swap agreements associated with its \$600 million floating-rate term loan agreement due 2020 and its \$332 million term loan agreement due 2019 that are accounted for as cash flow hedges. These interest rate hedges have fixed the interest rate on the \$600 million floating-rate term loan agreement at 5.223 percent until maturity, and for the \$332 million term loan agreement at 6.315 percent until maturity.

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 \$2 million are fair value hedges and are classified as a component of Other assets. The corresponding adjustment related to the net asset associated with the Company's fair value hedges is to the carrying value of the long-term debt. Agreements totaling a net liability of \$49 million are fair value hedges and cash flow hedges and are classified as a component of Other noncurrent liabilities. The corresponding adjustment related to the net liability associated with the Company's cash flow hedges is to AOCI and fair value hedges is to the carrying value of the long-term debt. See Note 12 .

There are also a number of interest rate swap agreements, which convert a portion of AirTran Holdings' floating-rate debt to a fixed-rate basis for the remaining life of the debt, thus reducing the impact of interest rate changes on future interest expense and cash flows. Under these agreements, which expire between 2016 and 2020 , it pays fixed rates between 4.35 percent and 6.435 percent and receives either three-month or six-month LIBOR on the notional values. The notional amount of outstanding debt related to interest rate swaps as of December 31, 2015 , was \$208 million . These interest rate swap arrangements were designated as cash flow hedges as of the acquisition date. The ineffectiveness associated with all of the Company's interest rate cash flow hedges for all periods presented was not material.

During 2015, the Company terminated the fixed-to-floating interest rate swap agreements related to its \$300 million 5.75% unsecured notes due 2016. The effect of this termination is such that the interest associated with the debt prospectively reverts back to its original fixed rate. As a result of the approximate \$12 million gain realized on this transaction, which will be amortized over the remaining term of the corresponding unsecured notes, and based on projected interest rates at the date of termination, the Company does not believe its future interest expense associated with these unsecured notes will significantly differ from the expense it would have recorded had the unsecured notes remained at floating rates.

During fourth quarter 2015, the Company entered into an interest rate swap agreement related to its \$500 million 2.65% Notes due 2020 . The primary objective for the Company's use of this interest rate hedge was to reduce the volatility

of net interest expense by better matching the repricing of its assets and liabilities. Under this interest rate swap agreement, the Company pays 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. This interest rate swap agreement qualifies as a fair value hedge. As a result of the fixed-to-floating interest rate swap agreement in place, the average floating rate recognized during 2015 was approximately 1.94 percent , based on actual and forward rates as of December 31, 2015 .

The Company also has fixed-to-floating interest rate swap agreements in place associated with its \$300 million 2.75% Notes due 2019 that are accounted for as fair value hedges. As a result of the fixed-to-floating interest rate swap agreements in place, the average floating rate recognized during 2015 was approximately 1.27 percent , based on actual and forward rates as of December 31, 2015 .

Credit Risk and Collateral

Credit exposure related to fuel derivative instruments is represented by the fair value of contracts that are an asset 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, the Company has not experienced any significant credit loss as a result of counterparty nonperformance in the past. To manage credit risk, the Company selects and periodically reviews counterparties based on credit ratings, limits its exposure with respect to each counterparty, and monitors the market position of the fuel hedging program and its relative market position with each counterparty. At December 31, 2015 , the Company had agreements with all of its active counterparties containing early termination rights and/or bilateral collateral provisions whereby security is required if market risk exposure exceeds a specified threshold amount based on the counterparty credit rating. The Company also had agreements with counterparties in which cash deposits, letters of credit, and/or pledged aircraft are required to be posted whenever the net fair value of derivatives associated with those counterparties exceeds specific thresholds. The following table provides the fair values of fuel derivatives, amounts posted as collateral, and applicable collateral posting threshold amounts as of December 31, 2015 , at which such postings are triggered:

(in millions)	Counterparty (CP)							Total
	A	B	C	D	E	F	Other (a)	
Fair value of fuel derivatives	\$ (562)	\$ (201)	\$ (176)	\$ (411)	\$ (159)	\$ 20	\$ 8	\$ (1,481)
Cash collateral held (by) CP	(284)	(159)	(56)	(299)	(37)	—	—	(835)
Aircraft collateral pledged to CP	(250)	—	—	—	—	—	—	(250)
Letters of credit (LC)	—	—	—	—	—	—	—	—
Option to substitute LC for aircraft	(200) to (600)(h)	(100) to (500) (d)	N/A	(150) to (550) (d)	(150) to (550) (d)	N/A		
Option to substitute LC for cash	N/A	>(500)(e)	(225) to (275)(e)	(75) to (150) or >(550)(e)	(125) to (150) or >(550)(e)	(g)		

If credit rating is investment grade, fair value of fuel derivative level at which:

Cash is provided to CP	(50) to (200) or > (600)	(50) to (100) or > >(500)	>(125)	(75) to (150) or >(550)	(125) to (150) or >(550)	>(100)
Cash is received from CP	>50	>150	>175(c)	>250	>75	>0
Aircraft or cash can be pledged to CP as collateral	(200) to (600)(f)	(100) to (500) (d)	N/A	(150) to (550) (d)	(150) to (550) (d)	N/A

If credit rating is non-investment grade, fair value of fuel derivative level at which:

Cash is provided to CP	(0) to (200) or > (600)	(0) to (100) or > (500)	(b)	(0) to (150) or > (550)	(0) to (150) or > (550)	(b)
Cash is received from CP	(b)	(b)	(b)	(b)	(b)	(b)
Aircraft or cash can be pledged to CP as collateral	(200) to (600)	(100) to (500)	N/A	(150) to (550)	(150) to (550)	N/A

(a) Individual counterparties with fair value of fuel derivatives < \$10 million .

(b) Cash collateral is provided at 100 percent of fair value of fuel derivative contracts.

(c) Thresholds may vary based on changes in credit ratings within investment grade.

(d) The Company has the option of providing cash, letters of credit, or pledging aircraft as collateral.

(e) The Company has the option of providing cash or letters of credit as collateral.

(f) The Company has the option of providing cash or pledging aircraft as collateral.

(g) The Company has the option to substitute letters of credit for 100 percent of cash collateral requirement.

(h) The Company has the option of providing letters of credit in addition to aircraft collateral if the appraised value of the aircraft does not meet the collateral requirement.

11 . FAIR VALUE MEASUREMENTS

Accounting standards pertaining to fair value measurements establish 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, 2015 , 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 (primarily treasury bills and certificates of deposit), interest rate derivative contracts, fuel derivative contracts, and available-for-sale securities. The majority of the Company's short-term investments consist of instruments classified as Level 1. However, the Company has certificates of deposit, commercial paper, and Eurodollar time deposits that are classified as Level 2, due to the fact that the fair value for these instruments is determined utilizing observable inputs in non-active markets. Other available-for-sale securities primarily consist of investments associated with the Company's excess benefit plan.

The Company's fuel and interest rate derivative instruments consist of over-the-counter contracts, which are not traded on a public exchange. Fuel derivative instruments include swaps, as well as different types of option contracts, whereas interest rate derivatives consist solely of swap agreements. 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's Treasury Department, which reports to the Chief Financial Officer, determines the value of option contracts utilizing an 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 provided by financial institutions that trade these contracts. The option pricing model used by the Company is an industry standard model for valuing options and is the same model used by the broker/dealer community (i.e., the Company's counterparties). The inputs to this option pricing model are the option strike price, underlying price, risk free rate of interest, time to expiration, and volatility. Because certain inputs used to determine the fair value of option contracts are unobservable (principally implied volatility), the Company has categorized these option contracts as Level 3. Volatility information is obtained from external sources, but is analyzed by the Company for reasonableness and compared to similar information received from other external sources. The fair value of option contracts considers both the intrinsic value and any remaining time value associated with those derivatives that have not yet settled. The Company also considers counterparty credit risk and its own credit risk in its determination of all estimated fair values. To validate the reasonableness of the Company's option pricing model, on a monthly basis, the Company compares its option valuations to third party valuations. If any significant differences were to be noted, they would be researched in order to determine the reason. However, historically, no significant differences have been noted. 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.

Included in Other available-for-sale securities are the Company's investments associated with its excess benefit plan which consist of mutual funds that are publicly traded and for which market prices are readily available. This plan is a non-qualified deferred compensation plan designed to hold Employee contributions in excess of limits established by Section 415 of the Internal Revenue Code of 1986, as amended. Payments under this plan are made based on the participant's distribution election and plan balance. Assets related to the funded portion of the deferred compensation plan are held in a rabbi trust, and the Company remains liable to these participants for the unfunded portion of the plan. The Company records changes in the fair value of the asset in the Company's earnings.

The following tables present the Company's assets and liabilities that are measured at fair value on a recurring basis at December 31, 2015 , and December 31, 2014 :

Description	December 31, 2015	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)
Assets		(in millions)		
Cash equivalents				
Cash equivalents (a)	\$ 1,337	\$ 1,337	\$ —	\$ —
Commercial paper	200	—	200	—
Certificates of deposit	13	—	13	—
Eurodollar Time Deposits	33	—	33	—
Short-term investments:				
Treasury bills	1,248	1,248	—	—
Certificates of deposit	220	—	220	—
Interest rate derivatives (see Note 10)	2	—	2	—
Fuel derivatives:				
Swap contracts (b)	38	—	38	—
Swap contracts (c)	931	—	931	—
Option contracts (b)	10	—	—	10
Option contracts (c)	956	—	—	956
Other available-for-sale securities	93	66	—	27
Total assets	\$ 5,081	\$ 2,651	\$ 1,437	\$ 993
Liabilities				
Fuel derivatives:				
Swap contracts (c)	\$ (774)	\$ —	\$ (774)	\$ —
Option contracts (b)	(26)	—	—	(26)
Option contracts (c)	(2,616)	—	—	(2,616)
Interest rate derivatives (see Note 10)	(49)	—	(49)	—
Total liabilities	\$ (3,465)	\$ —	\$ (823)	\$ (2,642)

(a) Cash equivalents are primarily composed of money market investments.

(b) In the Consolidated Balance Sheet amounts are presented as a net asset. See Note 10 .

(c) In the Consolidated Balance Sheet amounts are presented as a net liability. See Note 10 .

Description	December 31, 2014	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)	
Assets		(in millions)			
Cash equivalents					
Cash equivalents (a)	\$ 1,110	\$ 1,110	\$ —	\$ —	
Commercial paper	70	—	70	—	
Certificates of deposit	4	—	4	—	
Eurodollar Time Deposits	98	—	98	—	
Short-term investments:					
Treasury bills	1,450	1,450	—	—	
Certificates of deposit	256	—	256	—	
Interest rate derivatives (see Note 10)	13	—	13	—	
Fuel derivatives:					
Swap contracts (b)	455	—	455	—	
Option contracts (b)	892	—	—	892	
Other available-for-sale securities	95	63	—	32	
Total assets	\$ 4,443	\$ 2,623	\$ 896	\$ 924	
Liabilities					
Fuel derivatives:					
Swap contracts (b)	\$ (365)	\$ —	\$ (365)	\$ —	
Option contracts (b)	(1,983)	—	—	(1,983)	
Interest rate derivatives (see Note 10)	(61)	—	(61)	—	
Total liabilities	\$ (2,409)	\$ —	\$ (426)	\$ (1,983)	

(a) Cash equivalents are primarily composed of money market investments.

(b) In the Consolidated Balance Sheet amounts are presented as a net liability. See Note 10 .

The Company had no transfers of assets or liabilities between any of the above levels during the years ended December 31, 2015 or 2014 . The Company did not have any assets or liabilities measured at fair value on a nonrecurring basis as of December 31, 2015 or 2014 . The following tables present the Company's activity for items measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for 2015 and 2014 :

(in millions)	Fair value measurements using significant unobservable inputs (Level 3)		
	Fuel derivatives	Other securities	Total
Balance at December 31, 2014	\$ (1,091)	\$ 32	\$ (1,059)
Total losses (realized or unrealized)			
Included in earnings	(646)	(1)	(647)
Included in other comprehensive income	(858)	—	(858)
Purchases	750 (a)	—	750
Sales	(196) (a)	(4)	(200)
Settlements	365	—	365
Balance at December 31, 2015	\$ (1,676)	\$ 27	\$ (1,649)
The amount of total losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at December 31, 2015	\$ (428)	\$ —	\$ (428)

(a) The purchase and sale of fuel derivatives are recorded gross based on the structure of the derivative instrument and whether a contract with multiple derivatives is purchased as a single instrument or separate instruments.

(in millions)	Fair value measurements using significant unobservable inputs (Level 3)		
	Fuel derivatives	Other securities	Total
Balance at December 31, 2013	\$ 172	\$ 44	\$ 216
Total gains or (losses) (realized or unrealized)			
Included in earnings	(439)	—	(439)
Included in other comprehensive income	(1,091)	3	(1,088)
Purchases	403 (a)	—	403
Sales	(155) (a)	(15)	(170)
Settlements	19	—	19
Balance at December 31, 2014	\$ (1,091)	\$ 32	\$ (1,059)
The amount of total losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at December 31, 2014	\$ (450)	\$ —	\$ (450)

(a) The purchase and sale of fuel derivatives are recorded gross based on the structure of the derivative instrument and whether a contract with multiple derivatives is purchased as a single instrument or separate instruments.

The significant unobservable input used in the fair value measurement of the Company's derivative option contracts is implied volatility. Holding other inputs constant, a significant increase (decrease) in implied volatility would result in a significantly higher (lower) fair value measurement, respectively, for the Company's derivative option contracts.

The following table presents a range of the unobservable inputs utilized in the fair value measurements of the Company's fuel derivatives classified as Level 3 at December 31, 2015 :

Quantitative information about Level 3 fair value measurements

	Valuation technique	Unobservable input	Period (by year)	Range
Fuel derivatives	Option model	Implied volatility	2016	26-47%
			2017	25-37%
			2018	16-31%

The carrying amounts and estimated fair values of the Company's long-term debt (including current maturities), as well as the applicable fair value hierarchy tier, at December 31, 2015, are presented in the table below. The fair values of the Company's publicly held long-term debt 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 agreements as Level 2. Six of the Company's debt agreements are not publicly held. The Company has determined the estimated fair value of this debt to be Level 3, as certain inputs used to determine the fair value of these agreements are unobservable. The Company utilizes indicative pricing from counterparties and a discounted cash flow method to estimate the fair value of the Level 3 items.

(in millions)	Carrying value	Estimated fair value	Fair value level hierarchy
5.75% Notes due 2016	\$ 307	\$ 319	Level 2
5.25% Convertible Senior Notes due 2016	111	324	Level 2
5.125% Notes due 2017	309	321	Level 2
French Credit Agreements due 2018 - 1.53%	25	25	Level 3
Fixed-rate 737 Aircraft Notes payable through 2018 - 7.02%	17	17	Level 3
2.75% Notes due 2019	303	307	Level 2
Term Loan Agreement due 2019 - 6.315%	143	147	Level 3
Term Loan Agreement due 2019 - 4.84%	36	37	Level 3
2.65% Notes due 2020	494	493	Level 2
Term Loan Agreement due 2020 - 5.223%	329	323	Level 3
Floating-rate 737 Aircraft Notes payable through 2020	257	253	Level 3
Pass Through Certificates due 2022 - 6.24%	340	382	Level 2
7.375% Debentures due 2027	132	154	Level 2

12 . ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Comprehensive income includes changes in the fair value of certain financial derivative instruments that qualify for hedge accounting, unrealized gains and losses on certain investments, and actuarial gains/losses arising from the Company's postretirement benefit obligation. A rollforward of the amounts included in AOCI, net of taxes, is shown below for 2015 and 2014 :

(in millions)	Fuel derivatives	Interest rate derivatives	Defined benefit plan items	Other	Deferred tax impact	Accumulated other comprehensive income (loss)
Balance at December 31, 2013	\$ (20)	\$ (58)	\$ 65	\$ 8	\$ 2	\$ (3)
Changes in fair value	(1,191)	(10)	(24)	—	454	(771)
Reclassification to earnings	34	23	—	—	(21)	36
Balance at December 31, 2014	\$ (1,177)	\$ (45)	\$ 41	\$ 8	\$ 435	\$ (738)
Changes in fair value	(867)	(5)	(19)	(2)	329	(564)
Reclassification to earnings	378	20	—	—	(147)	251
Balance at December 31, 2015	\$ (1,666)	\$ (30)	\$ 22	\$ 6	\$ 617	\$ (1,051)

The following table illustrates the significant amounts reclassified out of each component of AOCI for the year ended December 31, 2015 :

Year ended December 31, 2015		
(in millions)		
AOCI components	Amounts reclassified from AOCI	Affected line item in the Consolidated Statement of Comprehensive Income
Unrealized loss on fuel derivative instruments	\$ 378	Fuel and oil expense
	140	Less: Tax expense
	\$ 238	Net of tax
Unrealized loss on interest rate derivative instruments	\$ 20	Interest expense
	7	Less: Tax expense
	\$ 13	Net of tax
Total reclassifications for the period	\$ 251	Net of tax

13 . EMPLOYEE RETIREMENT PLANS

Defined Contribution Plans

Southwest has defined contribution plans covering substantially all of its Employees. Contributions under all defined contribution plans are primarily based on Employee compensation and performance of the Company. The Company sponsors Employee savings plans under section 401(k) of the Internal Revenue Code of 1986, as amended, which include Company matching contributions. In addition, the Southwest Airlines Co. ProfitSharing Plan (ProfitSharing Plan) is a defined contribution plan to which the Company may contribute a percentage of its eligible pre-tax profits, as defined, on an annual basis. No Employee contributions to the ProfitSharing Plan are allowed.

Company contributions to all defined contribution plans expensed in 2015 , 2014 , and 2013 , reflected as a component of Salaries, wages, and benefits, were \$945 million , \$644 million , and \$497 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 accumulated postretirement benefit obligation (APBO) for the years ended December 31, 2015 and 2014 :

(in millions)	2015		2014	
APBO at beginning of period	\$	169	\$	138
Service cost		11		10
Interest cost		7		7
Benefits paid		(6)		(4)
Actuarial loss		20		21
Settlements	\$	—	\$	(3)
APBO at end of period	\$	201	\$	169

All plans are unfunded, and benefits are paid as they become due. Estimated future benefit payments expected to be paid are \$5 million in 2016 , \$6 million in 2017 , \$7 million in 2018 , \$8 million in 2019 , \$9 million in 2020 , and \$71 million for the next five years thereafter.

The funded status (the difference between the fair value of plan assets and the projected benefit obligations) of the Company's consolidated benefit plans are recognized in the Consolidated Balance Sheet, with a corresponding adjustment to AOCI. The following table reconciles the funded status of the plans to the accrued postretirement benefit cost recognized in Other non-current liabilities on the Company's Consolidated Balance Sheet at December 31, 2015 and 2014 .

(in millions)	2015		2014	
Funded status	\$	(201)	\$	(169)
Unrecognized net actuarial gain		(31)		(53)
Unrecognized prior service cost		9		12
Accumulated other comprehensive income		22		41
Cost recognized on Consolidated Balance Sheet	\$	(201)	\$	(169)

The consolidated periodic postretirement benefit cost for the years ended December 31, 2015 , 2014 , and 2013 , included the following:

(in millions)	2015		2014		2013	
Service cost	\$	11	\$	10	\$	30
Interest cost		7		7		4
Amortization of prior service cost		3		3		3
Recognized actuarial gain		(3)		(4)		(4)
Settlements	\$	—	\$	(1)	\$	—
Net periodic postretirement benefit cost	\$	18	\$	15	\$	33

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 plans. Actuarial gains are amortized utilizing the minimum amortization method. The following actuarial assumptions were used to account for the Company's postretirement benefit plans at December 31, 2015 , 2014 , and 2013 :

	2015	2014	2013
Weighted-average discount rate	4.50%	4.10%	5.05%
Assumed healthcare cost trend rate (1)	7.08%	6.88%	7.50%

(1) The assumed healthcare cost trend rate is assumed to remain at 7.08% for 2016 , then decline gradually to 5.19% by 2026 and remain level thereafter.

The assumed healthcare cost trend rates have a significant effect on the amounts reported for the consolidated postretirement plans. A one percent change in all healthcare cost trend rates used in measuring the APBO at December 31, 2015 , would have the following effects:

(in millions)	1% increase	1% decrease
Increase (decrease) in total service and interest costs	\$ 3	\$ (2)
Increase (decrease) in the APBO	\$ 29	\$ (24)

The selection of a discount rate is made annually and is selected by the Company based upon comparison of the expected future cash flows associated with the Company's future payments under its consolidated postretirement obligations to a yield curve created using high quality bonds that closely match those expected future cash flows. This rate increased during 2015 due to market conditions. 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.

14 . 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, 2015 and 2014 , are as follows:

(in millions)	2015	2014
DEFERRED TAX LIABILITIES:		
Accelerated depreciation	\$ 4,429	\$ 4,277
Other	62	51
Total deferred tax liabilities	4,491	4,328
DEFERRED TAX ASSETS:		
Fuel derivative instruments	750	521
Capital and operating leases	81	125
Construction obligation	289	209
Accrued engine maintenance	74	83
Accrued employee benefits	541	334
State taxes	62	65
Business partner income	107	90
Other	97	119
Total deferred tax assets	2,001	1,546
Net deferred tax liability	\$ 2,490	\$ 2,782

The provision for income taxes is composed of the following:

(in millions)	2015	2014	2013
CURRENT:			
Federal	\$ 1,292	\$ 203	\$ 355
State	114	29	44
Total current	1,406	232	399
DEFERRED:			
Federal	(97)	421	62
State	(11)	27	(6)
Total deferred	(108)	448	56
	<u>\$ 1,298</u>	<u>\$ 680</u>	<u>\$ 455</u>

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

(in millions)	2015	2014	2013
Tax at statutory U.S. tax rates	\$ 1,218	\$ 636	\$ 423
Nondeductible items	15	9	10
State income taxes, net of federal benefit	66	37	25
Other, net	(1)	(2)	(3)
Total income tax provision	<u>\$ 1,298</u>	<u>\$ 680</u>	<u>\$ 455</u>

The only periods subject to examination for the Company's federal tax return are the 2014 and 2015 tax years.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders Southwest Airlines Co.

We have audited the accompanying consolidated balance sheet of Southwest Airlines Co. as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2015. 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, 2015 and 2014, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2015, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, the Company has changed its method of accounting for its co-brand credit card agreement to apply the amendments to the FASB Accounting Standards Codification resulting from Accounting Standards Update No. 2009-13, Multiple Deliverable Revenue Arrangements, effective July 1, 2015.

As discussed in Note 1 to the consolidated financial statements, the Company has adopted ASU 2015-17 Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes.

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, 2015, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 Framework) and our report dated February 2, 2016 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Dallas, Texas
February 2, 2016

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders Southwest Airlines Co.

We have audited Southwest Airlines Co.'s internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 Framework) (the COSO criteria). Southwest Airlines Co.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying "Management's Annual Report on Internal Control Over Financial Reporting." Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, Southwest Airlines Co. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, 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, 2015 and 2014, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2015 and our report dated February 2, 2016 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Dallas, Texas
February 2, 2016

QUARTERLY FINANCIAL DATA
(unaudited)

(in millions except per share amounts)	Three months ended			
	March 31	June 30	Sept. 30	Dec. 31
2015				
Operating revenues (a)(b)	\$ 4,414	\$ 5,111	\$ 5,318	\$ 4,977
Operating income	780	1,085	1,225	1,026
Income before income taxes	723	977	933	847
Net income	453	608	584	536
Net income per share, basic (a)(b)	0.67	0.91	0.89	0.83
Net income per share, diluted (a)(b)	0.66	0.90	0.88	0.82
	March 31	June 30	Sept. 30	Dec. 31
2014				
Operating revenues (a)	\$ 4,166	\$ 5,011	\$ 4,800	\$ 4,628
Operating income	215	775	614	621
Income before income taxes	244	746	525	302
Net income	152	465	329	190
Net income per share, basic (a)	0.22	0.67	0.48	0.28
Net income per share, diluted (a)	0.22	0.67	0.48	0.28

(a) Includes a change in estimate, recorded on a prospective basis, effective October 1, 2014, which increased Passenger revenues by approximately \$43 million , \$41 million , and \$30 million , and increased both Basic and Diluted net income per share by approximately \$.03 , \$.03 , and \$.02 for first, second, and third quarters of 2015, respectively. Also, as a result, fourth quarter 2014 Passenger revenues increased by approximately \$55 million and both Basic and Diluted net income per share for the period increased by \$.04 . See Note 1 for further detail.

(b) Includes the impact of the July 2015 amended Agreement with Chase and the resulting change in accounting methodology. The impact of this change during third quarter and fourth quarter 2015 resulted in increases to Operating revenue of approximately \$303 million and \$124 million , and increased both Basic and Diluted net income per share by approximately \$.24 and \$.10 , respectively. See Note 1 for further detail.