

Item 8. Financial Statements and Supplementary Data

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

	December 31, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,495	\$ 1,680
Short-term investments	1,778	1,625
Accounts and other receivables	662	546
Inventories of parts and supplies, at cost	420	337
Prepaid expenses and other current assets	460	310
Total current assets	4,815	4,498
Property and equipment, at cost:		
Flight equipment	21,368	20,275
Ground property and equipment	4,399	3,779
Deposits on flight equipment purchase contracts	919	1,190
Assets constructed for others	1,543	1,220
	28,229	26,464
Less allowance for depreciation and amortization	9,690	9,420
	18,539	17,044
Goodwill	970	970
Other assets	786	774
	\$ 25,110	\$ 23,286
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,320	\$ 1,178
Accrued liabilities	1,777	1,985
Air traffic liability	3,460	3,115
Current maturities of long-term debt	348	566
Total current liabilities	6,905	6,844
Long-term debt less current maturities	3,320	2,821
Deferred income taxes	2,358	3,374
Construction obligation	1,390	1,078
Other noncurrent liabilities	707	728
Stockholders' equity:		
Common stock, \$1.00 par value: 2,000,000,000 shares authorized; 807,611,634 shares issued in 2017 and 2016	808	808
Capital in excess of par value	1,451	1,410
Retained earnings	14,621	11,418
Accumulated other comprehensive income (loss)	12	(323)
Treasury stock, at cost: 219,060,856 and 192,450,855 shares in 2017 and 2016 respectively	(6,462)	(4,872)
Total stockholders' equity	10,430	8,441
	\$ 25,110	\$ 23,286

See accompanying notes.

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

	Year ended December 31,		
	2017	2016	2015
OPERATING REVENUES:			
Passenger	\$ 19,141	\$ 18,594	\$ 18,299
Freight	173	171	179
Special revenue adjustment	—	—	172
Other	1,857	1,660	1,170
Total operating revenues	21,171	20,425	19,820
OPERATING EXPENSES:			
Salaries, wages, and benefits	7,319	6,798	6,383
Fuel and oil	3,940	3,647	3,616
Maintenance materials and repairs	1,001	1,045	1,005
Aircraft rentals	198	229	238
Landing fees and other rentals	1,292	1,211	1,166
Depreciation and amortization	1,218	1,221	1,015
Acquisition and integration	—	—	39
Other operating expenses	2,688	2,514	2,242
Total operating expenses	17,656	16,665	15,704
OPERATING INCOME	3,515	3,760	4,116
OTHER EXPENSES (INCOME):			
Interest expense	114	122	121
Capitalized interest	(49)	(47)	(31)
Interest income	(35)	(24)	(9)
Other (gains) losses, net	234	162	556
Total other expenses (income)	264	213	637
INCOME BEFORE INCOME TAXES	3,251	3,547	3,479
PROVISION FOR INCOME TAXES	(237)	1,303	1,298
NET INCOME	\$ 3,488	\$ 2,244	\$ 2,181
NET INCOME PER SHARE, BASIC	\$ 5.80	\$ 3.58	\$ 3.30
NET INCOME PER SHARE, DILUTED	\$ 5.79	\$ 3.55	\$ 3.27
Cash dividends declared per common share	\$.4750	\$.3750	\$.2850

See accompanying notes.

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

	Year ended December 31,		
	2017	2016	2015
NET INCOME	\$ 3,488	\$ 2,244	\$ 2,181
Unrealized gain (loss) on fuel derivative instruments, net of deferred taxes of \$185, \$432, and (\$181)	317	735	(308)
Unrealized gain on interest rate derivative instruments, net of deferred taxes of \$4, \$5, and \$6	7	7	9
Unrealized gain (loss) on defined benefit plan items, net of deferred taxes of \$2, (\$13), and (\$7)	3	(23)	(12)
Other, net of deferred taxes of \$5, \$5, and \$-	8	9	(2)
OTHER COMPREHENSIVE INCOME (LOSS)	\$ 335	\$ 728	\$ (313)
COMPREHENSIVE INCOME	\$ 3,823	\$ 2,972	\$ 1,868

See accompanying notes.

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

	Year ended December 31, 2017, 2016, and 2015					
	Common Stock	Capital in excess of par value	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	Total
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
Repurchase of common stock	—	—	—	—	(1,750)	(1,750)
Issuance of common and treasury stock pursuant to Employee stock plans	—	8	—	—	12	20
Conversion of 5.25% senior notes to common stock	—	(5)	—	—	48	43
Share-based compensation	—	33	—	—	—	33
Cash dividends, \$.3750 per share	—	—	(235)	—	—	(235)
Comprehensive income	—	—	2,244	728	—	2,972
Balance at December 31, 2016	\$ 808	\$ 1,410	\$ 11,418	\$ (323)	\$ (4,872)	\$ 8,441
Repurchase of common stock	—	—	—	—	(1,600)	(1,600)
Issuance of common and treasury stock pursuant to Employee stock plans	—	4	—	—	10	14
Share-based compensation	—	37	—	—	—	37
Cash dividends, \$.4750 per share	—	—	(285)	—	—	(285)
Comprehensive income	—	—	3,488	335	—	3,823
Balance at December 31, 2017	\$ 808	\$ 1,451	\$ 14,621	\$ 12	\$ (6,462)	\$ 10,430

See accompanying notes.

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

	Year ended December 31,		
	2017	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 3,488	\$ 2,244	\$ 2,181
Adjustments to reconcile net income to cash provided by (used in) operating activities:			
Depreciation and amortization	1,218	1,221	1,015
Loss on asset impairment	—	21	—
Aircraft grounding charge	63	—	—
Unrealized/realized (gain) loss on fuel derivative instruments	(50)	(200)	113
Deferred income taxes	(1,212)	455	(109)
Changes in certain assets and liabilities:			
Accounts and other receivables	(102)	(50)	(88)
Other assets	(262)	(119)	103
Accounts payable and accrued liabilities	246	226	961
Air traffic liability	345	125	94
Cash collateral received from (provided to) derivative counterparties	316	535	(570)
Other, net	(121)	(165)	(462)
Net cash provided by operating activities	3,929	4,293	3,238
CASH FLOWS FROM INVESTING ACTIVITIES:			
Capital expenditures	(2,123)	(2,038)	(2,041)
Assets constructed for others	(126)	(109)	(102)
Purchases of short-term investments	(2,380)	(2,388)	(1,986)
Proceeds from sales of short-term and other investments	2,221	2,263	2,223
Other, net	—	—	(7)
Net cash used in investing activities	(2,408)	(2,272)	(1,913)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of long-term debt	600	515	500
Proceeds from Employee stock plans	29	29	46
Reimbursement for assets constructed for others	126	107	24
Proceeds from termination of interest rate derivative instrument	—	—	12
Payments of long-term debt and capital lease obligations	(592)	(523)	(213)
Payments of convertible debt	—	(68)	—
Payments of cash dividends	(274)	(222)	(180)
Repayment of construction obligation	(10)	(9)	(10)
Repurchase of common stock	(1,600)	(1,750)	(1,180)
Other, net	15	(3)	(23)
Net cash used in financing activities	(1,706)	(1,924)	(1,024)
NET CHANGE IN CASH AND CASH EQUIVALENTS	(185)	97	301
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	1,680	1,583	1,282
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 1,495	\$ 1,680	\$ 1,583
CASH PAYMENTS FOR:			
Interest, net of amount capitalized	\$ 81	\$ 100	\$ 105
Income taxes	\$ 992	\$ 902	\$ 1,440
SUPPLEMENTAL DISCLOSURE OF NONCASH TRANSACTIONS:			
Flight equipment acquired through the assumption of debt	\$ —	\$ 20	\$ —

Flight equipment under capital leases	\$	233	\$	307	\$	193
Assets constructed for others	\$	197	\$	196	\$	192

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, the successor to AirTran Holdings, Inc. ("AirTran Holdings"), the former parent company of AirTran Airways, Inc. ("AirTran Airways"). 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.

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 consist of certificates of deposit, money market funds, and investment grade commercial paper issued by major corporations and financial institutions. Cash and cash equivalents are stated at cost, which approximates fair value.

As of December 31, 2017, \$15 million in cash collateral deposits were held by the Company from 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, 2016, \$301 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, 2017 and 2016 . In addition, the provision for doubtful accounts and write-offs for 2017 , 2016 , and 2015 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 \$45 million and \$57 million at December 31, 2017 , and 2016 , respectively. In addition, the Company's provision for obsolescence and write-offs for 2017 , 2016 , and 2015 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, airport and other facility construction projects, and ground and other property and equipment. Depreciation is provided by the straight-line method to estimated residual values over periods of approximately 25 years for flight equipment, 5 to 30 years for ground property and equipment, and 10 to 30 years, or the expected term of the Company's lease if shorter, for Assets constructed for others, once the asset is placed in service. Residual values estimated for aircraft are approximately 15 percent , for ground property and equipment generally range from 0 to 10 percent , and for Assets constructed for others range from 17 to 75 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 in which the Company is considered the accounting owner of the facilities. See Note 4 for further information.

During first quarter 2016, the Company made the decision to further simplify its operations and accelerate the retirement of its less-efficient Boeing 737-300 ("Classic") fleet. In September 2017, the Company retired the remaining 61 Classic aircraft as part of this accelerated retirement schedule. This change in retirement dates was considered a change in estimate and was accounted for on a prospective basis as of the dates the decisions were finalized. Therefore, the Company recorded accelerated depreciation expense over the remainder of the useful lives for each Classic aircraft and related parts. See Note 7 for further information regarding the Company's aircraft fleet.

The impacts on expense and earnings from the accelerated depreciation were as follows:

<u>(in millions, except per share amounts)</u>	Year ended December 31, 2017	Year ended December 31, 2016
Depreciation and amortization expense	\$ 21	\$ 123
Net income *	\$ (19)	\$ (66)
Net income per basic share	\$ (0.03)	\$ (0.11)
Net income per diluted share	\$ (0.03)	\$ (0.10)
* net of profitsharing benefit		

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 has maintenance agreements related to certain of its aircraft engines with external service providers, including a "power-by-the-hour" agreement associated with its Boeing 737-700 fleet. 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. During 2016, the Company recorded a \$21 million impairment charge associated with leased slots at Newark Liberty International Airport as a result of the FAA announcement, in April 2016, that this airport was being changed to a Level 2 schedule-facilitated airport from its previous designation as Level 3. This impairment loss was reflected in Other Operating Expenses within the accompanying Consolidated Statement of Income. The Company does not believe this FAA decision is indicative of a similar decision being made at the Company's other slot-controlled airports, Washington Reagan and New York LaGuardia.

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, 2017 and 2016 :

(in millions)	Weighted-average useful life (in years)	Year ended December 31, 2017		Year ended December 31, 2016	
		Gross carrying amount	Accumulated amortization	Gross carrying amount	Accumulated Amortization
Customer relationships/marketing agreements	10	\$ 27	\$ 23	\$ 38	\$ 32
Owned domestic slots (a)	Indefinite	295	n/a	295	n/a
Gate leasehold rights (a)	15	180	66	180	55
Total	14	\$ 502	\$ 89	\$ 513	\$ 87

(a) Intangible assets primarily consist of acquired leasehold rights to certain airport owned gates, takeoff and landing slots (a "slot" is the right of an air carrier, pursuant to regulations of the FAA, to operate a takeoff or landing at a specific time at certain airports) at certain domestic slot-controlled airports, and certain intangible assets acquired.

The Company's definite lived assets are amortized on a straight-line basis over the useful life of the asset. The aggregate amortization expense for 2017, 2016, and 2015 was \$13 million, \$17 million, and \$19 million, respectively. Estimated aggregate amortization expense for the five succeeding years and thereafter is as follows: 2018 – \$13 million, 2019 – \$13 million, 2020 – \$12 million, 2021 – \$12 million, 2022 – \$12 million, and thereafter – \$56 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, subject to certain conditions. A small percentage of tickets (or partial tickets) expire unused. The Company has a No Show policy that applies to 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 Passenger 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, events leading to significant flight cancellations, changes to the Company's ticketing policies, changes to the Company's refund, exchange and unused funds policies, and 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.

The Company also sells frequent flyer points and related services to companies participating in its frequent flyer program. Historically, until July 1, 2015, 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 were flown. Effective July 1, 2015, the Company entered into 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 a required accounting change under Accounting Standards Update ("ASU") No. 2009-13, which was 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 No. 2009-13, which required that the Company adjust the existing deferred revenue balance, classified within Air traffic liability, 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 residual method, 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 2015. The estimated impacts on revenue and earnings associated with the Agreement and the resulting required change in accounting methodology recognized subsequent to the effective date of July 1, 2015, are as follows:

(in millions, except per share amounts)	Year ended December 31, 2017	Year ended December 31, 2016	Year ended December 31, 2015
Passenger revenue	\$ (364)	\$ (250)	\$ (89)
Special revenue adjustment	—	—	172
Other revenue	908	794	344
Operating revenues	\$ 544	\$ 544	\$ 427
Net income	\$ 496	\$ 293	\$ 227
Net income per basic share	\$ 0.82	\$ 0.47	\$ 0.34
Net income per diluted share	\$ 0.82	\$ 0.46	\$ 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 \$1.6 billion and \$1.4 billion as of December 31, 2017, and 2016, respectively, which is classified within Air traffic liability. The Company continues to evaluate spoilage annually in October, but these analyses have not resulted in material adjustments in 2015, 2016, or 2017.

Advertising

Advertising costs are charged to expense as incurred. Advertising and promotions expense for the years ended December 31, 2017, 2016, and 2015 was \$224 million, \$232 million, and \$218 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 is typically 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 \$654 million and \$544 million at December 31, 2017 , and 2016 , respectively. Computer software depreciation expense was \$168 million , \$111 million , and \$106 million for the years ended December 31, 2017 , 2016 , and 2015 , respectively, and is included as a component of Depreciation and amortization expense in the accompanying Consolidated Statement of Income. The Company evaluates internal use software for impairment on a quarterly basis; if it is determined the value of an asset was not recoverable or it qualifies for impairment, a charge would be recorded to write down the software to the lower of its carrying value or fair value. The Company had no significant impairments during 2017 , 2016 , or 2015 .

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.

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. See Note 14 for further information.

Concentration Risk

Approximately 83 percent of the Company's full-time equivalent Employees are unionized and are covered by collective-bargaining agreements. A small percentage of the Company's unionized Employees, including its Mechanics and Material Specialists, are in discussions on labor agreements. Those unionized Employee groups in discussions represent approximately 4.9 percent of the Company's full-time equivalent Employees as of December 31, 2017 .

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, 2017 , the Company operated an all-Boeing fleet, all of which are variations of the Boeing 737. If the Company was unable to acquire additional aircraft or associated aircraft parts from Boeing, or Boeing was 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 agreements, 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 August 28, 2017, the Financial Accounting Standards Board (the "FASB") issued ASU No. 2017-12, Targeted Improvements to Accounting for Hedging Activities. The standard amends the hedge accounting model to enable entities to better portray the economics of their risk management activities in the financial statements and enhance the transparency and understandability of hedge results. The amendments also simplify the application of hedge accounting in certain situations. This ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018, with early adoption permitted in any interim or annual period. The Company plans to adopt this ASU as of January 1, 2018. See Note 10 for further information on current accounting for financial derivative instruments. The most significant impacts of this ASU on the Company's financial statements is the elimination of the requirement to separately measure and report ineffectiveness for all cash flow hedges in a hedging relationship, as well as a change in classification of premium expense associated with option contracts. The estimate of the cumulative effect of the adjustment to move the reporting of ineffectiveness as of January 1, 2018, to Accumulated other comprehensive income (loss) from Retained earnings, is an approximate \$20 million loss, net of taxes. Historically

amounts that are paid or received in connection with the purchase or sale of financial derivative instruments (i.e., premium costs of option contracts) have been 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. Under the new ASU, such amounts are reflected as a component of the line item to which the hedge relates, which in the case of the Company's jet fuel hedges is Fuel and oil expense. This ASU requires prospective adoption. However, as previous hedge accounting rules did not specify the classification of such premium expense, and such provision only consists of a reclassification of expense between income statement line items, the Company will retrospectively apply this reclassification to prior period financial statements in 2018 in order to enhance comparability. For the Company's full year 2017 and 2016 results, the amounts to be reclassified in 2018 are \$135 million and \$153 million, respectively.

On March 10, 2017, the FASB issued ASU No. 2017-07, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. The standard requires employers to present the service cost component of the net periodic benefit cost in the same income statement line item as other employee compensation costs arising from services rendered during the period. The other components of net benefit cost, including amortization of prior service cost/credit, and settlement and curtailment effects, are to be included in nonoperating expenses. This ASU requires retrospective application and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. The Company thus will reclassify \$14 million and \$12 million of Salaries, wages, and benefits expense to Other (gains) and losses within the Consolidated Statement of Income for years ended 2017 and 2016, respectively. The Company will adopt this guidance as of January 1, 2018.

On January 26, 2017, the FASB issued ASU No. 2017-04, Simplifying the Test for Goodwill Impairment. The standard simplifies the accounting for goodwill impairment by removing Step 2 of the goodwill impairment test (as defined by the FASB), which requires a hypothetical purchase price allocation (implied fair value of goodwill) to measure impairment loss. This ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2019, with early adoption permitted. The Company does not expect this ASU to have a significant impact on its financial statement presentation or results.

On February 25, 2016, the FASB issued ASU No. 2016-02, Leases. The standard is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018, with early adoption permitted. The guidance requires lessees to recognize a right-of-use asset and a lease liability on the balance sheet for all leases (with the exception of short-term leases) at the lease commencement date and recognize expenses on the income statement in a similar manner to the current guidance in Accounting Standards Codification 840, Leases. The lease liability will be measured at the present value of the unpaid lease payments and the right-of-use asset will be derived from the calculation of the lease liability. Lease payments will include fixed and in-substance fixed payments, variable payments based on an index or rate, reasonably certain purchase options, termination penalties, fees paid by the lessee to the owners of a special-purpose entity for restructuring the transaction, and probable amounts the lessee will owe under a residual value guarantee. Lease payments will not include variable lease payments other than those that depend on an index or rate, any guarantee by the lessee of the lessor's debt, or any amount allocated to non-lease components.

The Company has formed a project team to evaluate and implement the standard, and currently believes the most significant impact of this ASU on its accounting will be the balance sheet impact of its aircraft operating leases, which will significantly increase assets and liabilities. See Note 7 for further information on leases. The future lease commitments disclosed in Note 7 include contractual payments due to lessors, but does not consider certain items that the standard requires to be assessed in determining the final asset and liability to be reflected on the Company's balance sheet, such as lease renewal options and potential impairments, nor does it consider the sublease income that is due from third parties (which will be disclosed separately). The Company also has operating leases related to terminal operations space and other real estate leases. Although the real estate leases may also have a substantial impact to the balance sheet, the Company does not expect the leases related to terminal operations space to have a significant impact since variable lease payments, other than those based on an index or rate, are excluded from the measurement of the lease liability. The Company also does not expect the adoption of this ASU to impact any of its existing debt covenants.

In addition, the standard eliminates the current build-to-suit lease accounting guidance and could result in derecognition of build-to-suit assets and liabilities that remained on the balance sheet after the end of the construction period. The underlying leases for these facilities will be subject to evaluation under the new standard.

The Company anticipates utilizing the modified retrospective transition approach to adopt the standard, which requires application of the new guidance for all periods presented with an option to use certain practical expedients. The Company continues to assess early adoption of this ASU as of an interim period in 2018, and will continue to provide updates to its plans in future periods.

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 after December 15, 2017. The Company will adopt the ASU in first quarter 2018. The most significant impact of this ASU on the Company's accounting will be the elimination of the incremental cost method for frequent flyer accounting, which will require the Company to re-value its liabilities associated with Customer flight points with a relative fair value approach, resulting in a significant increase in the liabilities. The Company's liabilities associated with these flight points were \$59 million at December 31, 2017, and the Company currently estimates that applying a relative fair value would increase the liabilities by approximately \$1.0 billion to \$1.2 billion. The adoption of the new standard is also expected to result in different income statement classification for certain types of revenues which are currently classified as Other revenues, but under the new ASU would be included in Passenger revenues, and certain expenses, which are currently classified as Other operating expenses, but under the new ASU would be offset against Passenger revenues. Based on the Company's full year 2017 and 2016 results, the amounts to be reclassified from Other revenues to Passenger revenues would have been \$638 million and \$610 million, respectively. For full year 2017 and 2016, the amounts to be reclassified from Other operating expenses to be offset against Passenger revenues would have been approximately \$40 million in each year. The estimated impact of this ASU is expected to be a less than one percent reduction to Operating revenues for both full year 2017 and 2016, and it will not impact any of the Company's existing debt covenants. The Company will adopt the standard as of January 1, 2018, utilizing the full retrospective method of adoption allowed by the standard, in order to provide for comparative results in all periods presented. The Company is in the process of completing its analysis of information necessary to recast prior period results, however it does not believe there are any remaining significant implementation topics associated with the adoption of this ASU that have not yet been addressed.

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,		
	2017	2016	2015
NUMERATOR:			
Net income	\$ 3,488	\$ 2,244	\$ 2,181
Incremental income effect of interest on 5.25% convertible notes	—	2	4
Net income after assumed conversion	\$ 3,488	\$ 2,246	\$ 2,185
DENOMINATOR:			
Weighted-average shares outstanding, basic	601	627	661
Dilutive effect of Employee stock options and restricted stock units	2	1	2
Dilutive effect of 5.25% convertible notes	—	5	6
Adjusted weighted-average shares outstanding, diluted	603	633	669
NET INCOME PER SHARE:			
Basic	\$ 5.80	\$ 3.58	\$ 3.30
Diluted	\$ 5.79	\$ 3.55	\$ 3.27

4 . COMMITMENTS AND CONTINGENCIES

Commitments

The Company has contractual obligations and commitments primarily with regard to future purchases of aircraft, repayment of debt (see Note 6), and lease arrangements (see Note 7). During the year ended December 31, 2017, the Company purchased 13 new 737 MAX 8 aircraft

and 39 new 737-800 aircraft from Boeing and acquired 18 used 737-700 aircraft from third parties under capital leases. The Company has firm orders in place for 197 737 MAX 8 aircraft, 30 737 MAX 7 aircraft, and 26 737-800 aircraft, as well as options for 155 737 MAX 8 aircraft as of December 31, 2017, which are outlined in Part I, Item 2. The Company's capital commitments associated with these firm orders and additional aircraft are as follows: \$874 million in 2018, \$666 million in 2019, \$1.1 billion in 2020, \$1.3 billion in 2021, \$877 million in 2022, and \$5.2 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. Pursuant to an addendum entered into during 2016, the cost of the project is not to exceed \$333 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 has come directly from Broward County aviation sources, but flows through the Company in its capacity as manager of the project. Major construction on the project began during third quarter 2015. Construction of Concourse A was completed during second quarter 2017, and construction on Terminal 1 is expected to be completed by mid-2018. The Company has determined 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 ("ACFO") 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.

Los Angeles International Airport

In March 2013, the Company executed a lease agreement (the "T1 Lease") with Los Angeles World Airports ("LAWA"), which owns and operates Los Angeles International Airport ("LAX"). Under the T1 Lease, which was amended in June 2014 and September 2017, the Company is overseeing and managing the design, development, financing, construction, and commissioning of the airport's Terminal 1 Modernization Project at a cost not to exceed \$526 million (including proprietary renovations, or \$510 million excluding proprietary renovations). In October 2017, the Company executed a separate lease agreement with LAWA (the "T1.5 Lease"). The Company will oversee and manage the design, development, financing, construction, and commissioning of a passenger processing facility between Terminal 1 and 2 (the "Terminal 1.5 Project"). The Terminal 1.5 Project is expected to include ticketing, baggage claim, passenger screening, and a bus gate at a cost not to exceed \$479 million for site improvements and non-proprietary improvements.

These projects are being funded primarily using the Regional Airports Improvement Corporation (the "RAIC"), which is a quasi-governmental special purpose entity that acts as a conduit borrower under syndicated credit facilities provided by groups of lenders. Loans made under the separate credit facilities for the Terminal 1 Modernization Project and the Terminal 1.5 Project are being used to fund the development of each of these projects, and the outstanding loans will be repaid with the proceeds of LAWA's payments to purchase completed construction phases. The Company has guaranteed the obligations of the RAIC under each of the credit facilities of the respective lease agreements. At December 31, 2017, the Company's outstanding remaining guaranteed obligations under the credit facilities for the Terminal 1 Modernization Project and the Terminal 1.5 Project were \$230 million and \$36 million, respectively.

Construction on the Terminal 1 Modernization Project began during 2014 and is estimated to be completed during 2018. Construction on the Terminal 1.5 Project began during third quarter 2017 and is estimated to be completed during 2020. The Company has determined that due to its agreed upon role in overseeing and managing these projects, it is considered the owner of these projects for accounting purposes. LAWA is reimbursing the Company (through the RAIC credit facilities) for the site improvements and non-proprietary improvements, while proprietary improvements will not be reimbursed. As a result, the costs incurred to fund these projects are included within ACFO 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.

Although the City of Dallas received commitments from various sources that helped to fund portions of the LFMP project, including the FAA, the Transportation Security Administration, and the City of Dallas' Aviation Fund, the majority of the funds used were from the issuance of bonds. The Company guaranteed principal and interest payments on \$456 million of such bonds issued by the LFAMC. As of December 31, 2017, \$424 million of principal remained outstanding. The Company utilized the accounting guidance provided for lessees involved in asset construction. 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 corresponding LFMP liabilities are being reduced primarily through the Company's airport rental payments to the City of Dallas as the construction costs of this project are passed through to the Company via recurring airport rates and charges. Major construction was effectively completed

by December 31, 2014. During second quarter 2017, the City of Dallas approved using the remaining bond funds for additional terminal construction projects which began during second quarter and are expected to be completed in 2018.

During 2015, the City of Dallas issued additional bonds for the construction of a new parking garage at Dallas Love Field. The Company has not guaranteed the principal or interest payments on these bonds, but remains the accounting owner of this project.

Construction costs recorded in ACFO for the Company's various projects as of December 31, 2017, and December 31, 2016, were as follows:

(in millions)		December 31, 2017			December 31, 2016		
		ACFO	ACFO, Net (a)	Construction Obligation (b)	ACFO	ACFO, Net (a)	Construction Obligation (b)
FLL Terminal	(c)	\$ 258	\$ 256	\$ 258	\$ 132	\$ 132	\$ 132
LAX Terminal 1	(c)	433	417	433	344	336	344
LAX Terminal 1.5	(c)	31	31	31	—	—	—
LFMP - Terminal	(c)	543	474	516	538	486	522
LFMP - Parking Garage	(c)	152	152	152	80	80	80
HOU International Terminal	(d)	126	118	—	126	122	—
		<u>\$ 1,543</u>	<u>\$ 1,448</u>	<u>\$ 1,390</u>	<u>\$ 1,220</u>	<u>\$ 1,156</u>	<u>\$ 1,078</u>

(a) Net of accumulated depreciation.

(b) Construction obligation will be reduced through future facility rent payments. These future payments are not fixed per the lease agreement, but are variable and fluctuate based on various market and other factors outside the control of the Company.

(c) Projects still in progress.

(d) Project completed in 2015 at Houston William P. Hobby Airport ("HOU").

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 Internal Revenue Service ("IRS"). The Company's management does not expect that the outcome of 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, 2017	December 31, 2016
Derivative contracts	\$ 136	\$ 120
Intangible assets, net	413	426
Capital lease receivable	76	90
Other	161	138
Other assets	<u>\$ 786</u>	<u>\$ 774</u>

(in millions)	December 31, 2017	December 31, 2016
Accounts payable trade	\$ 186	\$ 138
Salaries payable	201	200
Taxes payable	203	184
Aircraft maintenance payable	38	26
Fuel payable	123	95
Other payable	569	535
Accounts payable	<u>\$ 1,320</u>	<u>\$ 1,178</u>

(in millions)	December 31, 2017	December 31, 2016
Profitsharing and savings plans	\$ 579	\$ 645
Aircraft and other lease related obligations	40	55
Permanently grounded aircraft liability	34 (a)	—
Vacation pay	365	355
Contract ratification bonuses	83	188
Health	100	96
Derivative contracts	1	158
Workers compensation	172	183
Property and income taxes	57	68
Other	346	237
Accrued liabilities	<u>\$ 1,777</u>	<u>\$ 1,985</u>

(in millions)	December 31, 2017	December 31, 2016
Postretirement obligation	\$ 275	\$ 256
Non-current lease-related obligations	85	125
Permanently grounded aircraft liability	13 (a)	—
Other deferred compensation	237	204
Derivative contracts	21	35
Other	76	108
Other noncurrent liabilities	<u>\$ 707</u>	<u>\$ 728</u>

(a) These amounts represent the current and noncurrent portion of the Company's cease-use liability recorded during third quarter 2017, as a result of the Company grounding its remaining leased Boeing 737-300 aircraft on September 29, 2017. The liability reflects the remaining net lease payments due and certain lease return requirements that could have to be performed on these leased aircraft prior to their return to the lessors as of the cease-use date, but does not include the write-off of approximately \$15 million in net prepaid rents associated with the aircraft at the grounding date, which were included in the \$63 million charge recorded. See Note 7 for further information. This loss related to the grounding of the Classic fleet was recorded to Other operating expenses in the Consolidated Statement of Income during third quarter 2017. Approximately \$3 million of this liability was paid during fourth quarter 2017.

For further information on fuel derivative and interest rate derivative contracts, see Note 10 .

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, 2017	December 31, 2016
5.125% Notes due March 2017	\$ —	\$ 301
French Credit Agreements due 2018 - 2.54%	1	14
Fixed-rate 737 Aircraft Notes payable through 2018 - 7.03%	3	8
2.75% Notes due 2019	300	301
Term Loan Agreement payable through 2019 - 6.315%	66	106
Term Loan Agreement payable through 2019 - 4.84%	19	28
2.65% Notes due 2020	491	492
Term Loan Agreement payable through 2020 - 5.223%	237	284
737 Aircraft Notes payable through 2020	155	206
Term Loan Agreements payable through 2021 - 7.94%	—	20
2.75% Notes due 2022	300	—
Pass Through Certificates due 2022 - 6.24%	294	324
Term Loan Agreement payable through 2026 - 2.67%	215	215
3.00% Notes due 2026	300	300
3.45% Notes due 2027	300	—
7.375% Debentures due 2027	127	130
Capital leases	885	681
	\$ 3,693	\$ 3,410
Less current maturities	348	566
Less debt discount and issuance costs	25	23
	\$ 3,320	\$ 2,821

AirTran Holdings is party to aircraft purchase financing facilities, and as of December 31, 2017, 17 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, 2017, the weighted average interest rate was 4.81 percent. Principal and interest under the notes are payable semi-annually or every three months as applicable. As of December 31, 2017, the remaining debt outstanding may be prepaid without penalty under all aircraft loans provided under such facilities. The remaining notes mature in years 2018 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 as the underlying notes mature.

At December 31, 2017, AirTran Holdings was party to an additional aircraft purchase financing facility, and one Boeing 737 aircraft was financed under the fixed-rate facility. The note is secured by a first mortgage on the aircraft to which it relates. As of December 31, 2017, the interest rate was 7.03 percent. The remaining note matured on January 11, 2018.

In October 2009, AirTran Holdings completed a public offering of \$115 million of convertible senior notes due November 1, 2016. Such notes bore interest at 5.25 percent payable semi-annually, in arrears, on May 1 and November 1. As a result of the Company's acquisition of AirTran in 2011 and subsequent dividends declared by the Company, the convertible senior notes were convertible into AirTran conversion units of 169.8265 per \$1,000 in principal amount of such notes. Based on the terms of the merger agreement, the holders of these notes could receive shares of the Company's common stock at a conversion rate of 54.5143 shares and \$615.16 in cash per \$1,000 in principal amount of such notes. During 2016, all the bonds matured, the majority of which had been converted prior to the maturity date, with approximately 6 million shares issued and cash paid of approximately \$68 million.

During November 2017, the Company issued \$300 million senior unsecured notes due 2022 . The notes bear interest at 2.75 percent . Interest is payable semi-annually in arrears on May 16 and November 16, beginning in 2018.

Also during November 2017, the Company issued \$300 million senior unsecured notes due 2027 . The notes bear interest at 3.45 percent . Interest is payable semi-annually in arrears on May 16 and November 16, beginning in 2018.

During November 2016, the Company issued \$300 million senior unsecured notes due 2026 . The notes bear interest at 3.00 percent . Interest is payable semi-annually in arrears on May 15 and November 15.

During October 2016, the Company entered into a term loan agreement providing for loans to the Company aggregating up to \$215 million , to be secured by mortgages on seven of the Company's 737-800 aircraft. The Company borrowed the full \$215 million and secured this loan with the requisite seven aircraft mortgages. The loan matures on October 31, 2026, and is repayable via semi-annual installments of principal that begin April 30, 2018. The loan bears interest at the LIBO Rate (as defined in the term loan agreement) plus 1.10 percent , which equates to a current rate of 2.67 percent , and interest is payable semi-annually in installments.

During third quarter 2016, the Company entered into term loan agreements to purchase the equity interest in four aircraft that were previously classified as operating leases, for a total of \$20 million . The loans were set to mature in years 2018 to 2021, but were paid in full on August 1, 2017, utilizing available cash on hand.

During November 2015, the Company issued \$500 million senior unsecured notes due 2020 . The notes bear interest at 2.65 percent , 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 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 and interest that began January 1, 2010 . The loan bears interest at a fixed rate of 4.84 percent . 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, 2017 .

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 and interest that began August 6, 2009 . The loan bears interest at the LIBO Rate (as defined in the term loan agreement) plus 3.30 percent . 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 and interest, 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 . 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 percent Series A certificates and \$88 million 6.65 percent 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. Beginning February 1, 2008, principal and interest 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 February 2005 , the Company issued \$300 million senior unsecured notes due 2017 . The notes bore interest at 5.125 percent , payable semi-annually in arrears. The notes matured and were redeemed in full on March 1, 2017, utilizing available cash on hand.

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 percent 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.

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 \$167 million at December 31, 2017 .

The Company has pledged a total of up to 77 of its Boeing 737-700 and 7 of its Boeing 737-800 aircraft at a net book value of \$1.8 billion , as collateral for the Company's secured borrowings at December 31, 2017 . In addition, the Company has pledged a total of up to 82 of its Boeing 737-700 and 37 of its Boeing 737-800 aircraft at a net book value of \$2.8 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, 2017 , 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, 2022, and thereafter, were \$335 million in 2018, \$586 million in 2019, \$817 million in 2020, \$169 million in 2021, \$473 million in 2022, and \$1.2 billion thereafter.

7. LEASES

The Company's fleet included 53 aircraft on operating lease and 69 aircraft on capital lease as of December 31, 2017, compared with 83 aircraft on operating lease and 51 aircraft on capital lease, as of December 31, 2016. Amounts applicable to these aircraft on capital lease that are included in property and equipment were:

(in millions)	2017	2016
Flight equipment	\$ 1,207	\$ 923
Less: accumulated amortization	172	82
	<u>\$ 1,035</u>	<u>\$ 841</u>

Total rental expense for operating leases, both aircraft and other, charged to operations in 2017, 2016, and 2015 was \$939 million, \$932 million, and \$909 million, respectively. The majority of the Company's terminal operations space, as well as 144 aircraft, including 76 B717s subleased to Delta and 15 Classic aircraft grounded in September 2017, were under operating leases at December 31, 2017. For aircraft operating leases and for terminal operations leases and other real estate leases, expense is recorded on a straight-line basis and included in Aircraft rentals and in Landing fees and other rentals, respectively, in the Consolidated Statement of Income. The majority of the Company's terminal operations space was under operating leases at December 31, 2017; however, due to the nature of airport terminal lease arrangements, most of those future lease payments are considered variable, and thus excluded from the Company's disclosures of future minimum lease payments. 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, 2017, were:

(in millions)	Capital leases	Operating leases (b)	Subleases	Operating leases, net
2018	\$ 107	\$ 359	\$ (102)	\$ 257
2019	106	331	(98)	233
2020	105	264	(78)	186
2021	100	155	(41)	114
2022	96	85	(17)	68
Thereafter	416	177	(8)	169
Total minimum lease payments	<u>\$ 930</u>	<u>\$ 1,371</u>	<u>\$ (344)</u>	<u>\$ 1,027</u>
Less amount representing interest	150			
Present value of minimum lease payments (a)	<u>780</u>			
Less current portion	79			
Long-term portion	<u>\$ 701</u>			

* See Note 4 for further details

(a) Excludes lease incentive obligation of \$105 million.

(b) Includes 15 remaining Classic aircraft on operating leases, which net remaining lease payments were included in the \$63 million grounding charge recorded during 2017.

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 Airways' B717s to Delta at agreed-upon lease rates. As of December 31, 2016, the Company had delivered all B717s to Delta. A total of 76 of the B717s are on operating lease, ten are owned, and two are on capital lease.

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 two to seven 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 six 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. There are no contingent payments and no significant residual value conditions associated with the transaction.

During 2017, the Company retired its remaining 87 Classic aircraft, which included 61 Classic aircraft grounded in September 2017 as part of an accelerated retirement schedule. The Company recorded a charge of \$63 million related to the leased portion of the Classic fleet, representing the remaining net lease payments due and certain lease return requirements that could have to be performed on these leased aircraft prior to their return to the lessors, as of the cease-use date.

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, 2017, the Company had 60 million shares of common stock reserved for issuance pursuant to Employee equity plans (of which 30 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, 2017, 2016, and 2015, reflects share-based compensation expense of \$37 million, \$33 million, and \$29 million, respectively. The total tax benefit recognized in earnings from share-based compensation arrangements for the years ended December 31, 2017, 2016, and 2015, was not material. As of December 31, 2017, there was \$35 million of total unrecognized compensation cost related to share-based compensation arrangements, which is expected to be recognized over a weighted-average period of 1.8 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") and performance-based restricted stock units ("PBRsUs") to certain Employees during 2015, 2016, and 2017. Outstanding RSUs vest over three years, subject generally to the individual's continued employment or service. The PBRsUs granted in January 2015, January 2016, and February 2017 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. Forfeiture rates are estimated at the time of grant based on historical actuals for similar grants, and are true-up to actuals over the vesting period. 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.

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, 2014	2,077	\$ 16.92
Granted	561 (a)	45.80
Vested	(1,095)	13.33
Surrendered	(58)	25.49
Outstanding December 31, 2015	1,485	30.17
Granted	675 (b)	37.29
Vested	(665)	23.29
Surrendered	(56)	36.29
Outstanding December 31, 2016, Unvested	1,439	36.52
Granted	717 (c)	52.73
Vested	(806)	30.23
Surrendered	(56)	43.86
Outstanding December 31, 2017, Unvested	1,294	\$ 45.32

(a) Includes 183 thousand PBRsUs

(b) Includes 247 thousand PBRsUs

(c) Includes 235 thousand PBRsUs

In addition, the Company granted approximately 26 thousand shares of unrestricted stock at a weighted average grant price of \$57.04 in 2017 , approximately 27 thousand shares at a weighted average grant price of \$42.90 in 2016 , and approximately 28 thousand shares at a weighted average grant price of \$41.27 in 2015 , to members of its Board of Directors.

A remaining balance of up to 22 million shares of the Company's common stock may be issued pursuant to grants under the 2007 Equity Plan.

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 9 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, 2017 , 2016 , and 2015 , participants under the plan purchased 544 thousand shares, 622 thousand shares, and 597 thousand shares at average prices of \$50.13 , \$36.57 , and \$36.40 , respectively. The weighted-average fair value of each purchase right under the ESPP granted for the years ended December 31, 2017 , 2016 , and 2015 , 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 \$5.57 , \$4.06 , and \$4.04 , respectively.

Taxes

Grants of RSUs result in the creation of a deferred tax asset, which is a temporary difference, until the time the RSU vests. All excess tax benefits and tax deficiencies are recorded through the income statement. Due to the treatment of RSUs 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.

For the purpose of evaluating its net cash spend for jet fuel and for forecasting its future estimated jet fuel expense, 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 2017, the Company had fuel derivative instruments in place for up to 63 percent of its fuel consumption. As of December 31, 2017, the Company also had fuel derivative instruments in place to provide coverage at varying price levels, but up to a maximum of approximately 78 percent of its 2018 estimated fuel consumption, depending on where market prices settle. The following table provides information about the Company's volume of fuel hedging on an economic basis considering current market prices:

Period (by year)	Maximum fuel hedged as of	Derivative underlying commodity type as of
	December 31, 2017	December 31, 2017
	(gallons in millions) (a)	
2018	1,647	WTI crude and Brent crude oil
2019	1,377	WTI crude and Brent crude oil
2020	685	WTI crude oil
Beyond 2020	315	WTI 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 in the period of the change. 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 2015 , 2016 , or 2017 .

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 derivative instruments within the Consolidated Balance Sheet:

(in millions)	Balance Sheet location	Asset derivatives		Liability derivatives	
		Fair value at 12/31/2017	Fair value at 12/31/2016	Fair value at 12/31/2017	Fair value at 12/31/2016
Derivatives designated as hedges*					
Fuel derivative contracts (gross)	Prepaid expenses and other current assets	\$ 112	\$ 7	\$ —	\$ 44
Fuel derivative contracts (gross)	Other assets	136	126	—	—
Fuel derivative contracts (gross)	Accrued liabilities	—	4	—	412
Interest rate derivative contracts	Other noncurrent liabilities	—	—	20	35
Total derivatives designated as hedges		\$ 248	\$ 137	\$ 20	\$ 491
Derivatives not designated as hedges*					
Fuel derivative contracts (gross)	Prepaid expenses and other current assets	\$ 35	\$ 54	\$ 35	\$ —
Fuel derivative contracts (gross)	Other assets	—	52	—	52
Fuel derivative contracts (gross)	Accrued liabilities	—	201	—	262
Interest rate derivative contracts	Accrued liabilities	—	—	1	—
Interest rate derivative contracts	Other noncurrent liabilities	—	—	1	—
Total derivatives not designated as hedges		\$ 35	\$ 307	\$ 37	\$ 314
Total derivatives		\$ 283	\$ 444	\$ 57	\$ 805

* 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, 2017	December 31, 2016
Cash collateral deposits held from counterparties for fuel contracts - current	Offset against Prepaid expenses and other current assets	\$ 15	\$ 4
Cash collateral deposits held from counterparties for fuel contracts - noncurrent	Offset against Other assets	—	6
Cash collateral deposits provided to counterparties for fuel contracts - current	Offset against Accrued liabilities	—	311
Due to third parties for fuel contracts	Accounts payable	29	75

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 standards 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)

		(i)	(ii)	(iii) = (i) + (ii)		(i)	(ii)	(iii) = (i) + (ii)	
		December 31, 2017			December 31, 2016				
Description	Balance Sheet location	Gross amounts of recognized assets	Gross amounts offset in the Balance Sheet	Net amounts of assets presented in the Balance Sheet		Gross amounts of recognized assets	Gross amounts offset in the Balance Sheet	Net amounts of assets presented in the Balance Sheet	
Fuel derivative contracts	Prepaid expenses and other current assets	\$ 147	\$ (50)	\$ 97		\$ 61	\$ (48)	\$ 13	
Fuel derivative contracts	Other assets	\$ 136	\$ —	\$ 136	(a)	\$ 178	\$ (58)	\$ 120	(a)
Fuel derivative contracts	Accrued liabilities	\$ —	\$ —	\$ —	(a)	\$ 516	\$ (516)	\$ —	(a)

(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 .

Offsetting of derivative liabilities

(in millions)

Description	Balance Sheet location	(i)		(ii)		(iii) = (i) + (ii)		(i)		(ii)		(iii) = (i) + (ii)	
		December 31, 2017						December 31, 2016					
		Gross amounts of recognized liabilities	Gross amounts offset in the Balance Sheet	Net amounts of liabilities presented in the Balance Sheet	Gross amounts of recognized liabilities	Gross amounts offset in the Balance Sheet	Net amounts of liabilities presented in the Balance Sheet						
Fuel derivative contracts	Prepaid expenses and other current assets	\$ 50	\$ (50)	\$ —	\$ 48	\$ (48)	\$ —						
Fuel derivative contracts	Other assets	\$ —	\$ —	\$ — (a)	\$ 58	\$ (58)	\$ — (a)						
Fuel derivative contracts	Accrued liabilities	\$ —	\$ —	\$ — (a)	\$ 674	\$ (516)	\$ 158 (a)						
Interest rate derivative contracts	Accrued liabilities	\$ 1	\$ —	\$ 1 (a)	\$ —	\$ —	\$ — (a)						
Interest rate derivative contracts	Other noncurrent liabilities	\$ 21	\$ —	\$ 21 (a)	\$ 35	\$ —	\$ 35 (a)						

(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, 2017 and 2016 :

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,	
	2017	2016	2017	2016	2017	2016
Fuel derivative contracts	\$ 32 *	\$ (122) *	\$ 349 *	\$ 613 *	\$ 31	\$ (11)
Interest rate derivatives	— *	2 *	7 *	9 *	1	(3)
Total	\$ 32	\$ (120)	\$ 356	\$ 622	\$ 32	\$ (14)

*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)	2017	2016	
Fuel derivative contracts	\$ 75	\$ 14	Other (gains) losses, net
Interest rate derivatives	(4)	(2)	Interest Expense
Total	\$ 71	\$ 12	

The Company also recorded expense associated with premiums paid for fuel derivative contracts that settled/expired during 2017 , 2016 , and 2015 of \$ 135 million , \$ 153 million , and \$ 124 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 gains from fuel hedges as of December 31, 2017 , recorded in AOCI, were approximately \$11 million in unrealized losses , net of taxes, which are expected to be realized in earnings during the twelve months subsequent to December 31, 2017 .

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 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 a net liability of \$22 million are fair value hedges, cash flow hedges, and interest rate derivatives not utilizing hedge accounting, and are classified as components of Accrued liabilities and Other noncurrent liabilities. The corresponding adjustment related to the net liability associated with the Company's cash flow hedges is to AOCI, fair value hedges is to the carrying value of the long-term debt, and interest rate derivatives not utilizing hedge accounting is to Interest expense. See Note 12 .

The Company has fixed-to-floating interest rate swap agreements in place associated with its \$500 million 2.65 percent Notes due 2020 and its \$300 million 2.75 percent 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 2017 was approximately 2.47 percent on the \$500 million Note, and approximately 2.29 percent on the \$300 million Note, based on actual and forward rates as of December 31, 2017 .

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.

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 2018 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, 2017 , was \$124 million . The mark-to-market impact associated with these hedges for all periods presented was not material.

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, 2017 , 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 as collateral 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, 2017 , at which such postings are triggered:

(in millions)	Counterparty (CP)							Total
	A	B	C	D	E	F	Other (a)	
Fair value of fuel derivatives	\$ 89	\$ 44	\$ 54	\$ 35	\$ 15	\$ 6	\$ 5	\$ 248
Cash collateral held from CP	15	—	—	—	—	—	—	15
Aircraft collateral pledged to CP	—	—	—	—	—	—	—	—
Letters of credit (LC)	—	—	—	—	—	—	—	—
Option to substitute LC for aircraft	(200) to (600) (b)	(100) to (500)(c)	(150) to (550) (c)	(150) to (550)(c)	N/A	N/A		
Option to substitute LC for cash	N/A	>(500)(c)	(75) to (150) or >(550)(c)	(125) to (150) or >(550)(d)	(d)	N/A		

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)	(75) to (150) or >(550)(e)	(125) to (150) or >(550)(e)	>(125)	>(65)(e)		
Cash is received from CP	>50(e)	>150(e)	>250(e)	>75(e)	>100(e)	>30(e)		
Aircraft or cash can be pledged to CP as collateral	(200) to (600) (f)	(100) to (500)(c)	(150) to (550) (c)	(150) to (550)(c)	N/A	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)	(0) to (150) or >(550)	(0) to (150) or > (550)	(g)	(g)		
Cash is received from CP	(g)	(g)	(g)	(g)	(g)	(g)		
Aircraft or cash can be pledged to CP as collateral	(200) to (600)	(100) to (500)	(150) to (550)	(150) to (550)	N/A	N/A		

(a) Individual counterparties with fair value of fuel derivatives < \$5 million .

(b) 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.

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

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

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

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

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

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, 2017 , 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 and commercial paper 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 deferred compensation plans, which consist of mutual funds that are publicly traded and for which market prices are readily available. These plans are non-qualified deferred compensation plans designed to hold contributions in excess of limits established by the Internal Revenue Code of 1986, as amended. The distribution timing and payment amounts under these plans are made based on the participant's distribution election and plan balance. Assets related to the funded portions of the deferred compensation plans are held in a rabbi trust, and the Company remains liable to these participants for the unfunded portion of the plans. The Company records changes in the fair value of the assets 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, 2017 , and December 31, 2016 :

Description	December 31, 2017	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)	\$ 1,133	\$ 1,133	\$ —	\$ —
Commercial paper	350	—	350	—
Certificates of deposit	12	—	12	—
Short-term investments:				
Treasury bills	1,491	1,491	—	—
Certificates of deposit	287	—	287	—
Fuel derivatives:				
Option contracts (b)	283	—	—	283
Other available-for-sale securities	107	107	—	—
Total assets	\$ 3,663	\$ 2,731	\$ 649	\$ 283
Liabilities				
Fuel derivatives:				
Option contracts (b)	(35)	—	—	(35)
Interest rate derivatives (see Note 10)	(22)	—	(22)	—
Total liabilities	\$ (57)	\$ —	\$ (22)	\$ (35)

(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 .

Description	December 31, 2016	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)	\$ 1,344	\$ 1,344	\$ —	\$ —
Commercial paper	325	—	325	—
Certificates of deposit	11	—	11	—
Short-term investments:				
Treasury bills	1,345	1,345	—	—
Certificates of deposit	280	—	280	—
Fuel derivatives:				
Swap contracts (c)	42	—	42	—
Option contracts (b)	239	—	—	239
Option contracts (c)	163	—	—	163
Other available-for-sale securities	83	83	—	—
Total assets	\$ 3,832	\$ 2,772	\$ 658	\$ 402
Liabilities				
Fuel derivatives:				
Swap contracts (c)	\$ (110)	\$ —	\$ (110)	\$ —
Option contracts (b)	(96)	—	—	(96)
Option contracts (c)	(564)	—	—	(564)
Interest rate derivatives (see Note 10)	(35)	—	(35)	—
Total liabilities	\$ (805)	\$ —	\$ (145)	\$ (660)

(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 .

The Company had no transfers of assets or liabilities between any of the above levels during the years ended December 31, 2017 or 2016 . The Company did not have any assets or liabilities measured at fair value on a nonrecurring basis as of December 31, 2017 or 2016 . 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 2017 and 2016 :

Fair value measurements using significant unobservable inputs (Level 3)

(in millions)	Fuel derivatives	
Balance at December 31, 2016	\$	(258)
Total losses (realized or unrealized)		
Included in earnings		(125)
Included in other comprehensive income		(50)
Purchases		142 (a)
Sales		— (a)
Settlements		539
Balance at December 31, 2017	\$	248
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, 2017	\$	(42)

(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.

Fair value measurements using significant unobservable inputs (Level 3)

(in millions)	Fuel derivatives		Other securities		Total
Balance at December 31, 2015	\$	(1,676)	\$	27	\$ (1,649)
Total gains (losses) (realized or unrealized)					
Included in earnings		175		(2)	173
Included in other comprehensive income		201		8	209
Purchases		221 (a)		—	221
Sales		(61) (a)		(33)	(94)
Settlements		882		—	882
Balance at December 31, 2016	\$	(258)	\$	—	\$ (258)
The amount of total gains for the period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at December 31, 2016	\$	93	\$	—	\$ 93

(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, an increase (decrease) in implied volatility would result in a 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, 2017 :

Quantitative information about Level 3 fair value measurements

	Valuation technique	Unobservable input	Period (by year)	Range
Fuel derivatives	Option model	Implied volatility	2018	11-26%
			2019	17-22%
			2020	17-21%
			Beyond 2020	18-20%

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, 2017, 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. Debt under seven of the Company's debt agreements is 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
French Credit Agreements due 2018 - 2.54%	\$ 1	\$ 1	Level 3
Fixed-rate 737 Aircraft Notes payable through 2018 - 7.03%	3	3	Level 3
2.75% Notes due 2019	300	302	Level 2
Term Loan Agreement payable through 2019 - 6.315%	66	66	Level 3
Term Loan Agreement payable through 2019 - 4.84%	19	20	Level 3
2.65% Notes due 2020	491	494	Level 2
Term Loan Agreement payable through 2020 - 5.223%	237	240	Level 3
737 Aircraft Notes payable through 2020	155	154	Level 3
2.75% Notes due 2022	300	300	Level 2
Pass Through Certificates due 2022 - 6.24%	294	318	Level 2
Term Loan Agreement payable through 2026 - 2.67%	215	215	Level 3
3.00% Notes due 2026	300	293	Level 2
3.45% Notes due 2027	300	299	Level 2
7.375% Debentures due 2027	127	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 2017 and 2016 :

(in millions)	Fuel derivatives	Interest rate derivatives	Defined benefit plan items	Other	Deferred tax impact	Accumulated other comprehensive income (loss)
Balance at December 31, 2015	\$ (1,666)	\$ (30)	\$ 22	\$ 6	\$ 617	\$ (1,051)
Changes in fair value	194	(3)	(36)	14	(63)	106
Reclassification to earnings	973	15	—	—	(366)	622
Balance at December 31, 2016	\$ (499)	\$ (18)	\$ (14)	\$ 20	\$ 188	\$ (323)
Changes in fair value	(50)	—	5	13	11	(21)
Reclassification to earnings	552	11	—	—	(207)	356
Balance at December 31, 2017	\$ 3	\$ (7)	\$ (9)	\$ 33	\$ (8)	\$ 12

The following table illustrates the significant amounts reclassified out of each component of AOCI for the year ended December 31, 2017 :

Year ended December 31, 2017		
(in millions)		
AOCI components	Amounts reclassified from AOCI	Affected line item in the Consolidated Statement of Comprehensive Income
Unrealized loss on fuel derivative instruments	\$ 552	Fuel and oil expense
	203	Less: Tax expense
	\$ 349	Net of tax
Unrealized loss on interest rate derivative instruments	\$ 11	Interest expense
	4	Less: Tax expense
	\$ 7	Net of tax
Total reclassifications for the period	\$ 356	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. The Southwest Airlines Co. 401(k) Plan includes Company matching contributions and the Southwest Airlines Pilots Retirement Saving Plan has non-elective Company 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.

Amounts associated with the Company's defined contribution plans expensed in 2017 , 2016 , and 2015 , reflected as a component of Salaries, wages, and benefits, were \$1.0 billion , \$937 million , and \$945 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, 2017 and 2016 :

(in millions)	2017	2016
APBO at beginning of period	\$ 256	\$ 201
Service cost	18	13
Interest cost	11	9
Benefits paid	(8)	(6)
Actuarial (gain)/loss	(2)	38
Plan amendments	—	1
APBO at end of period	<u>\$ 275</u>	<u>\$ 256</u>

All plans are unfunded, and benefits are paid as they become due. Estimated future benefit payments expected to be paid are \$8 million in 2018 , \$10 million in 2019 , \$11 million in 2020 , \$12 million in 2021 , \$14 million in 2022 , and \$101 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, 2017 and 2016 .

(in millions)	2017	2016
Funded status	\$ (275)	\$ (256)
Unrecognized net actuarial loss	5	7
Unrecognized prior service cost	4	7
Accumulated other comprehensive loss	(9)	(14)
Cost recognized on Consolidated Balance Sheet	<u>\$ (275)</u>	<u>\$ (256)</u>

The consolidated periodic postretirement benefit cost for the years ended December 31, 2017 , 2016 , and 2015 , included the following:

(in millions)	2017	2016	2015
Service cost	\$ 18	\$ 13	\$ 11
Interest cost	11	9	7
Amortization of prior service cost	3	3	3
Recognized actuarial gain	—	—	(3)
Net periodic postretirement benefit cost	<u>\$ 32</u>	<u>\$ 25</u>	<u>\$ 18</u>

Unrecognized prior service cost is expensed using a straight-line amortization of the cost over the average future service of Employees expected to receive benefits under the 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, 2017 , 2016 , and 2015 :

	2017	2016	2015
Weighted-average discount rate	3.65%	4.25%	4.50%
Assumed healthcare cost trend rate (1)	7.08%	7.08%	7.08%

(1) The assumed healthcare cost trend rate is assumed to remain at 7.08% for 2018, then decline gradually to 5.19% by 2028 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, 2017, would have the following effects:

(in millions)	1% increase		1% decrease	
Increase (decrease) in total service and interest costs	\$	5	\$	(4)
Increase (decrease) in the APBO	\$	37	\$	(32)

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 decreased during 2017 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 Tax Cuts and Jobs Act (the "Act") was enacted on December 22, 2017. The Act reduces the U.S. federal corporate tax rate from the previous rate of 35 percent to 21 percent, requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred, and creates new taxes on certain foreign sourced earnings. At December 31, 2017, the Company has calculated the accounting for the tax effects of enactment of the Act as written, and made a reasonable estimate of the effects on the existing deferred tax balances. The Company will continue to refine the calculations as additional analysis is completed. In addition, these estimates may also be affected as the Company gains a more thorough understanding of the tax law, including those related to the deductibility of purchased assets, state tax treatment, and amounts related to Employee compensation. This re-measurement in 2017 resulted in a reduction in the Company's net deferred tax liability, as noted by the change in federal statutory tax rate as noted in the provision for income taxes below. The components of deferred tax assets and liabilities at December 31, 2017 and 2016, are as follows:

(in millions)	2017	2016
DEFERRED TAX LIABILITIES:		
Accelerated depreciation	\$ 3,193	\$ 4,726
Other	86	134
Total deferred tax liabilities	3,279	4,860
DEFERRED TAX ASSETS:		
Fuel derivative instruments	12	233
Construction obligation	326	402
Accrued employee benefits	309	451
Other	274	400
Total deferred tax assets	921	1,486
Net deferred tax liability	\$ 2,358	\$ 3,374

The provision for income taxes is composed of the following:

(in millions)	2017	2016	2015
CURRENT:			
Federal	\$ 904	\$ 778	\$ 1,292
State	72	69	114
Total current	976	847	1,406
DEFERRED:			
Federal	192	426	(97)
State	5	30	(11)
Change in federal statutory tax rate	(1,410)	—	—
Total deferred	(1,213)	456	(108)
	<u>\$ (237)</u>	<u>\$ 1,303</u>	<u>\$ 1,298</u>

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

(in millions)	2017	2016	2015
Tax at statutory U.S. tax rates	\$ 1,138	\$ 1,241	\$ 1,218
State income taxes, net of federal benefit	50	64	66
Change in federal statutory tax rate	(1,410)	—	—
Other, net	(15)	(2)	14
Total income tax provision	<u>\$ (237)</u>	<u>\$ 1,303</u>	<u>\$ 1,298</u>

The only periods subject to examination for the Company's federal tax return are the 2016 and 2017 tax years.

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of Southwest Airlines Co.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Southwest Airlines Co. (the Company) as of December 31, 2017 and 2016 , 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, 2017 , and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the consolidated financial position of the Company at December 31, 2017 and 2016 , and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2017 , in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2017 , 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 7, 2018 expressed an unqualified opinion thereon.

Adoption of ASU No. 2009-13

As discussed in Note 1 to the consolidated financial statements, the Company changed its method of accounting for its co-brand credit card agreement in 2015 due to the adoption of ASU No. 2009-13, *Multiple Deliverable Revenue Arrangements* .

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to fraud or error, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Ernst & Young LLP

We have served as the Company's auditor since 1971.

Dallas, Texas
February 7, 2018

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of Southwest Airlines Co.

Opinion on Internal Control over Financial Reporting

We have audited Southwest Airlines Co.'s internal control over financial reporting as of December 31, 2017, 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). In our opinion, Southwest Airlines Co. (the Company) maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of Southwest Airlines Co. as of December 31, 2017 and 2016, 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, 2017, and the related notes (collectively referred to as the "financial statements") of the Company and our report dated February 7, 2018 expressed an unqualified opinion thereon.

Basis for Opinion

The Company'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 are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. 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.

Definition and Limitations of Internal Control over Financial Reporting

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.

/s/ Ernst & Young LLP

Dallas, Texas
February 7, 2018

QUARTERLY FINANCIAL DATA
(unaudited)

(in millions except per share amounts)	Three months ended			
	March 31	June 30	Sept. 30	Dec. 31
2017				
Operating revenues	\$ 4,883	\$ 5,744	\$ 5,271	\$ 5,274
Operating income	658	1,250	834	773
Income before income taxes	553	1,170	791	737
Net income	351	746	503	1,888 (a)
Net income per share, basic	0.57	1.24	0.84	3.19 (a)
Net income per share, diluted	0.57	1.23	0.84	3.18 (a)
	March 31	June 30	Sept. 30	Dec. 31
2016				
Operating revenues	\$ 4,826	\$ 5,384	\$ 5,139	\$ 5,076
Operating income	944	1,276	695	846
Income before income taxes	816	1,304	618	809
Net income	513	820	388	522
Net income per share, basic	0.80	1.30	0.63	0.85
Net income per share, diluted	0.79	1.28	0.62	0.84

(a) Includes a \$1.4 billion reduction in Provision for income taxes related to the Tax Cuts and Jobs Act legislation enacted in December 2017, which resulted in a re-measurement of the Company's deferred tax assets and liabilities at the new federal corporate tax rate of 21 percent . See Note 14 to the Consolidated Financial Statements for further information.