

Item 8. Financial Statements and Supplementary Data

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

	December 31, 2019	December 31, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 2,548	\$ 1,854
Short-term investments	1,524	1,835
Accounts and other receivables	1,086	568
Inventories of parts and supplies, at cost	529	461
Prepaid expenses and other current assets	287	310
Total current assets	5,974	5,028
Property and equipment, at cost:		
Flight equipment	21,629	21,753
Ground property and equipment	5,672	4,960
Deposits on flight equipment purchase contracts	248	775
Assets constructed for others	164	1,768
	27,713	29,256
Less allowance for depreciation and amortization	10,688	9,731
	17,025	19,525
Goodwill	970	970
Operating lease right-of-use assets	1,349	—
Other assets	577	720
	\$ 25,895	\$ 26,243
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,574	\$ 1,416
Accrued liabilities	1,749	1,749
Current operating lease liabilities	353	—
Air traffic liability	4,457	4,134
Current maturities of long-term debt	819	606
Total current liabilities	8,952	7,905
Long-term debt less current maturities	1,846	2,771
Air traffic liability - noncurrent	1,053	936
Deferred income taxes	2,364	2,427
Construction obligation	164	1,701
Noncurrent operating lease liabilities	978	—
Other noncurrent liabilities	706	650
Stockholders' equity:		
Common stock, \$1.00 par value: 2,000,000,000 shares authorized; 807,611,634 shares issued in 2019 and 2018	808	808
Capital in excess of par value	1,581	1,510
Retained earnings	17,945	15,967
Accumulated other comprehensive income (loss)	(61)	20
Treasury stock, at cost: 288,547,318 and 255,008,275 shares in 2019 and 2018 respectively	(10,441)	(8,452)
Total stockholders' equity	9,832	9,853
	\$ 25,895	\$ 26,243

See accompanying notes.

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

	Year ended December 31,		
	2019	2018	2017
OPERATING REVENUES:			
Passenger	\$ 20,776	\$ 20,455	\$ 19,763
Freight	172	175	173
Other	1,480	1,335	1,210
Total operating revenues	22,428	21,965	21,146
OPERATING EXPENSES:			
Salaries, wages, and benefits	8,293	7,649	7,305
Fuel and oil	4,347	4,616	4,076
Maintenance materials and repairs	1,223	1,107	1,001
Landing fees and airport rentals	1,363	1,334	1,292
Depreciation and amortization	1,219	1,201	1,218
Other operating expenses	3,026	2,852	2,847
Total operating expenses	19,471	18,759	17,739
OPERATING INCOME	2,957	3,206	3,407
OTHER EXPENSES (INCOME):			
Interest expense	118	131	114
Capitalized interest	(36)	(38)	(49)
Interest income	(90)	(69)	(35)
Other (gains) losses, net	8	18	112
Total other expenses (income)	—	42	142
INCOME BEFORE INCOME TAXES	2,957	3,164	3,265
PROVISION (BENEFIT) FOR INCOME TAXES	657	699	(92)
NET INCOME	\$ 2,300	\$ 2,465	\$ 3,357
NET INCOME PER SHARE, BASIC	\$ 4.28	\$ 4.30	\$ 5.58
NET INCOME PER SHARE, DILUTED	\$ 4.27	\$ 4.29	\$ 5.57

See accompanying notes.

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

	Year ended December 31,		
	2019	2018	2017
NET INCOME	\$ 2,300	\$ 2,465	\$ 3,357
Unrealized gain (loss) on fuel derivative instruments, net of deferred taxes of (\$16), (\$7), and \$185	(53)	(26)	317
Unrealized gain (loss) on interest rate derivative instruments, net of deferred taxes of (\$8), \$1, and \$4	(25)	6	7
Unrealized gain (loss) on defined benefit plan items, net of deferred taxes of (\$9), \$15, and \$2	(29)	52	3
Other, net of deferred taxes of \$8, (\$2), and \$5	26	(6)	8
OTHER COMPREHENSIVE INCOME (LOSS)	\$ (81)	\$ 26	\$ 335
COMPREHENSIVE INCOME	\$ 2,219	\$ 2,491	\$ 3,692

See accompanying notes.

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

	Year ended December 31, 2019, 2018, and 2017					
	Common Stock	Capital in excess of par value	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	Total
Balance at December 31, 2016	\$ 808	\$ 1,410	\$ 10,761	\$ (323)	\$ (4,872)	\$ 7,784
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, \$.475 per share	—	—	(286)	—	—	(286)
Comprehensive income	—	—	3,357	335	—	3,692
Balance at December 31, 2017 (as reported)	\$ 808	\$ 1,451	\$ 13,832	\$ 12	\$ (6,462)	\$ 9,641
Cumulative effect of adopting Accounting Standards Update No. 2017-12, Targeted Improvements to Accounting for Hedging Activities (See Note 2 to the Consolidated Financial Statements for additional information)	—	—	18	(18)	—	—
Balance after adjustment for the new accounting standard	\$ 808	\$ 1,451	\$ 13,850	\$ (6)	\$ (6,462)	\$ 9,641
Repurchase of common stock	—	—	—	—	(2,000)	(2,000)
Issuance of common and treasury stock pursuant to Employee stock plans	—	13	—	—	10	23
Share-based compensation	—	46	—	—	—	46
Cash dividends, \$.605 per share	—	—	(348)	—	—	(348)
Comprehensive income	—	—	2,465	26	—	2,491
Balance at December 31, 2018 (as reported)	\$ 808	\$ 1,510	\$ 15,967	\$ 20	\$ (8,452)	\$ 9,853
Cumulative effect of adopting Accounting Standards Update No. 2016-02, Leases, codified in Accounting Standards Codification 842 (See Note 2 to the Consolidated Financial Statements for additional information)	—	—	55	—	—	55
Balance after adjustment for the new accounting standard	\$ 808	\$ 1,510	\$ 16,022	\$ 20	\$ (8,452)	\$ 9,908
Repurchase of common stock	—	—	—	—	(2,000)	(2,000)
Issuance of common and treasury stock pursuant to Employee stock plans	—	16	—	—	11	27
Share-based compensation	—	55	—	—	—	55
Cash dividends, \$.700 per share	—	—	(377)	—	—	(377)
Comprehensive income	—	—	2,300	(81)	—	2,219
Balance at December 31, 2019	\$ 808	\$ 1,581	\$ 17,945	\$ (61)	\$ (10,441)	\$ 9,832

See accompanying notes.

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

	Year ended December 31,		
	2019	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 2,300	\$ 2,465	\$ 3,357
Adjustments to reconcile net income to cash provided by (used in) operating activities:			
Depreciation and amortization	1,219	1,201	1,218
Boeing 737-300 aircraft grounding charge	—	—	63
Unrealized/realized gains on fuel derivative instruments	—	(14)	(50)
Deferred income taxes	(55)	301	(1,066)
Changes in certain assets and liabilities:			
Accounts and other receivables	(94)	117	(102)
Other assets	239	(227)	(262)
Accounts payable and accrued liabilities	298	545	233
Air traffic liability	440	506	343
Other liabilities	(277)	—	—
Cash collateral received from (provided to) derivative counterparties	25	(15)	316
Other, net	(108)	14	(121)
Net cash provided by operating activities	3,987	4,893	3,929
CASH FLOWS FROM INVESTING ACTIVITIES:			
Capital expenditures	(1,027)	(1,922)	(2,123)
Supplier proceeds	400	—	—
Assets constructed for others	—	(54)	(126)
Purchases of short-term investments	(2,122)	(2,409)	(2,380)
Proceeds from sales of short-term and other investments	2,446	2,342	2,221
Other, net	—	5	—
Net cash used in investing activities	(303)	(2,038)	(2,408)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of long-term debt	—	—	600
Proceeds from Employee stock plans	40	35	29
Reimbursement for assets constructed for others	—	170	126
Payments of long-term debt and finance lease obligations	(615)	(342)	(592)
Payments of cash dividends	(372)	(332)	(274)
Repayment of construction obligation	—	(30)	(10)
Repurchase of common stock	(2,000)	(2,000)	(1,600)
Other, net	(43)	3	15
Net cash used in financing activities	(2,990)	(2,496)	(1,706)
NET CHANGE IN CASH AND CASH EQUIVALENTS	694	359	(185)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	1,854	1,495	1,680
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 2,548	\$ 1,854	\$ 1,495
CASH PAYMENTS FOR:			
Interest, net of amount capitalized	\$ 88	\$ 107	\$ 81
Income taxes	\$ 779	\$ 327	\$ 992
SUPPLEMENTAL DISCLOSURE OF NONCASH TRANSACTIONS:			
Flight equipment under finance leases	\$ 1	\$ 32	\$ 233
Assets constructed for others	\$ 65	\$ 171	\$ 197

Supplier receivables	\$	428	\$	—	\$	—
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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.

Effective as of January 1, 2019, the Company adopted Accounting Standards Update ("ASU") No. 2016-02, Leases, codified in Accounting Standards Codification ("ASC") 842 (the "New Lease Standard"). All amounts and disclosures set forth in this Form 10-K for the year ended December 31, 2019, reflect the adoption of this ASU, while all periods prior to 2019 remain in accordance with prior accounting requirements. See Note 2 for further information.

Effective as of January 1, 2018, the Company adopted ASU No. 2017-12, Targeted Improvements to Accounting for Hedging Activities (the "New Hedging Standard"). All amounts and disclosures set forth in this Form 10-K reflect the adoption of this ASU. See Note 2 for further information.

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, 2019, \$25 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, 2018, no cash collateral deposits were held by or provided 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. 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 the Company's business partners and other suppliers, credit card companies associated with sales of tickets for future travel, and amounts due from business partners in the Company's loyalty program. See Note 15 for further information. The allowance for doubtful accounts was immaterial at December 31, 2019 and 2018. In addition, the provision for doubtful accounts and write-offs for 2019, 2018, and 2017 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 immaterial at December 31, 2019, and 2018. In addition, the Company's provision for obsolescence and write-offs for 2019, 2018, and 2017 were each immaterial.

Property and Equipment

Property and equipment is stated at cost. Capital expenditures include 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, and 5 to 30 years for ground property and equipment. Residual values estimated for aircraft are approximately 15 percent, and generally range from 0 to 10 percent for ground property and equipment. Assets constructed for others consists of airport improvement projects in which the Company is considered to have control of the asset during the construction period. Once construction is effectively completed, the sale-leaseback model would apply when control passes from the lessee to the lessor. See Note 4 for further information.

In September 2017, the Company retired its remaining 61 Boeing 737-300 ("Classic") aircraft as part of an accelerated retirement schedule. This resulted in a change in anticipated retirement dates, which 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 leased aircraft fleet. The impact on expense and earnings from the accelerated depreciation were as follows:

(in millions, except per share amounts)	Year ended December 31, 2017
Depreciation and amortization expense	\$ 21
Net income *	\$ (19)
Net income per basic share	\$ (0.03)
Net income per diluted share	\$ (0.03)

* net of profitsharing benefit and income taxes

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.

Leases

The Company determines if an arrangement is a lease at inception. Operating leases are included in Operating lease right-of-use assets, Current operating lease liabilities, and Noncurrent operating lease liabilities in the Consolidated Balance Sheet. Finance leases are included in Property and equipment, Current maturities of long-term debt, and Long-term debt less current maturities in the Consolidated Balance Sheet.

Right-of-use assets represent the Company's right to use an underlying asset for the lease term, and lease liabilities represent the Company's obligation to make lease payments arising from the lease. The lease liability is measured as the present value of the unpaid lease payments, and the right-of-use asset value is derived from the calculation of the lease liability. Lease payments 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 do not include (i) variable lease payments other than those that depend on an index or rate, (ii) any guarantee by the lessee of the lessor's debt, or (iii) any amount allocated to non-lease components, if such election is made upon adoption, per the provisions of the New Lease Standard. The Company uses its estimated incremental borrowing rate, which is derived from information available at the lease commencement date, in determining the present value of lease payments, since the Company does not know the actual implicit rates in its leases. The Company gives consideration to its recent debt issuances as well as publicly available data for instruments with similar characteristics when calculating its incremental borrowing rate. Lease expense for operating lease payments is recognized on a straight-line basis over the lease term. The Company combines lease and nonlease components for all asset groups. The Company's lease term includes any option to extend the lease when it is reasonably certain to be exercised based on considering all relevant economic factors.

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 within the accompanying Consolidated Statement of Income as incurred.

The Company has maintenance agreements related to certain of its aircraft engines with external service providers, including agreements that effectively transfer the risk of performance of such work to the service provider. Under the agreements where the risk of performance is deemed transferred to the counterparty, the appropriate expense is recorded commensurate with the period in which the corresponding level of service is provided. Generally, expense is recorded on a straight-line basis over the term of the agreement based on the Company's best estimate of expected future aircraft utilization. For its engine maintenance contracts that do not transfer risk to the service provider, the Company records expense on a time and materials basis when an engine repair event takes place.

Modifications that significantly enhance the operating performance or extend the useful lives of aircraft or engines are capitalized and amortized over the remaining life of the asset.

Goodwill and Intangible Assets

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

is used to assess the asset's implied fair value and the amount of the impairment. Under a quantitative approach, the implied fair value of the Company's identifiable assets and liabilities is calculated based on key assumptions. If the Company assets' carrying value exceeds the fair value calculated using the quantitative approach, an impairment charge is recorded for the difference in fair value and carrying value.

The following table is a summary of the Company's intangible assets, which are included as a component of Other assets in the Company's Consolidated Balance Sheet, as of December 31, 2019 and 2018:

(in millions)	Weighted-average useful life (in years)	Year ended December 31, 2019		Year ended December 31, 2018	
		Gross carrying amount	Accumulated amortization	Gross carrying amount	Accumulated Amortization
Customer relationships/marketing agreements	12	\$ 14	\$ 13	\$ 27	\$ 25
Owned domestic slots (a)	Indefinite	295	n/a	295	n/a
Gate leasehold rights (b)	—	—	—	180	78
Total	12	\$ 309	\$ 13	\$ 502	\$ 103

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

(b) Airport gate leasehold rights are classified as right-of-use assets upon adoption of the New Lease Standard. See Note 7.

The Company's definite lived intangible assets are amortized on a straight-line basis over the useful life of the asset. The aggregate amortization expense for 2019, 2018, and 2017 was \$15 million, \$16 million, and \$13 million, respectively. Estimated aggregate amortization expense for the five succeeding years and thereafter is immaterial.

Revenue Recognition

Tickets sold are initially deferred as Air traffic liability. Passenger revenue is recognized and Air traffic liability is reduced when transportation is provided. Air traffic liability primarily represents tickets sold for future travel dates, funds that are past flight date and remain unused, but are expected to be used in the future, and the Company's liability for loyalty benefits that are expected to be redeemed in the future. The majority of the Company's tickets sold are nonrefundable. Southwest 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. Nonrefundable tickets that are sold but not flown on the travel date, and are canceled in accordance with the No Show policy, can be applied to future travel. Refundable tickets that are sold but not flown on the travel date can also be applied to future travel. A small percentage of tickets (or partial tickets) expire unused. The Company estimates the amount of tickets that expire unused and recognizes such amounts in Passenger revenue once the scheduled flight date has lapsed in proportion to the pattern of flights taken by the Customer. 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 as the Company has then fulfilled its performance obligation. Amounts collected from passengers for ancillary services are also recognized when the service is provided, which is typically the flight date.

Initial spoilage estimates for both tickets and funds available for future use 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 Company's Customers' historical travel behavior as well as assumptions about the Customers' future travel behavior. Assumptions used to generate spoilage estimates can be impacted by several factors including, but not limited to: fare increases, fare sales, changes to the Company's ticketing policies, changes to the Company's refund, exchange and unused funds policies, seat availability, and economic factors. See Note 5 for further information.

Approximately \$615 million, approximately \$566 million, and approximately \$489 million of the Company's Operating revenues in 2019, 2018, and 2017, respectively, were attributable to foreign operations. The remainder of the Company's

Operating revenues, approximately \$21.8 billion, approximately \$21.4 billion, and approximately \$20.7 billion in 2019, 2018, and 2017, respectively, were attributable to domestic operations.

Loyalty Program

The Company records a liability for the relative fair value of providing free travel under its loyalty program for all points earned from flight activity or sold to companies participating in the Company's Rapid Rewards loyalty program as business partners that are expected to be redeemed for future travel. The loyalty liability represents performance obligations that will be satisfied when a Rapid Rewards loyalty member redeems points for travel or other goods and services. Points earned from flight activity are valued at their relative standalone selling price by applying fair value based on historical redemption patterns. Points earned from business partner activity, which primarily consist of points sold, along with related marketing services, to companies participating in the Rapid Rewards loyalty program, are valued using a relative fair value methodology based on the contractual rate which partners pay to Southwest to award Rapid Rewards points to the business partner's customers. For points that are expected to remain unused, the Company recognizes spoilage in proportion to the pattern of points used by the Customer, which approximates the average period over which the population of Rapid Reward Members redeem their points. The Company records passenger revenue related to air transportation when the transportation is delivered. The marketing elements are recognized as Other - net revenue when earned. The Company's liability for loyalty benefits includes a portion that is expected to be redeemed during the following twelve months (classified as a component of Air traffic liability), and a portion that is not expected to be redeemed during the following twelve months (classified as Air traffic liability - noncurrent). The Company continually updates this analysis and adjusts the split between current and non-current liabilities as appropriate. See Note 5 for further information.

Advertising

Advertising costs are charged to expense as incurred. Advertising and promotions expense for the years ended December 31, 2019, 2018, and 2017 was \$212 million, \$215 million, and \$224 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 are accounted for as cash flow hedges upon proper qualification. 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. The Company has forward-starting interest rate swap agreements, the primary objective of which is to hedge forecasted debt issuances and aircraft leases. The majority of 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.

The Company adopted the New Hedging Standard as of January 1, 2018. See Note 2 for further information on this adoption.

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. 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 \$630 million and \$674 million at December 31, 2019, and 2018, respectively. Computer software depreciation expense was \$177 million, \$155 million, and \$168 million for the years ended December 31, 2019, 2018, and 2017, 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 will be recorded to write down the software to the lower of its carrying value or fair value. The Company had no significant impairments during 2019, 2018, or 2017.

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 accompanying Consolidated Statement of Income. There were no material amounts recorded for penalties and interest related to uncertain tax positions 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 percentage of the Company's unionized Employees, including its Flight Attendants, Customer Service Agents, Dispatchers, Flight Crew Training Instructors, and Meteorologists, which had contracts that became amendable on or before December 31, 2019, are in discussions on labor agreements. Those unionized Employee groups in discussions represent approximately 40 percent of the Company's full-time equivalent Employees as of December 31, 2019.

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, 2019, the Company operated an all-Boeing fleet, all of which are variations of the Boeing 737. The Boeing 737 MAX aircraft ("MAX") are crucial to the Company's growth plans and fleet modernization initiatives. On March 13, 2019, the FAA issued an emergency order for all U.S. airlines to ground the MAX aircraft, including the 34 MAX aircraft in the Company's fleet. The MAX aircraft remains grounded and, based on continued uncertainty around the timing of the MAX return to service, the Company has removed the MAX from its flight schedule through June 6, 2020. Based on recent guidance from Boeing estimating that the ungrounding of the MAX will be mid-2020, the Company will likely extend MAX-related flight schedule adjustments further to provide operational reliability and dependable flight schedules for our Customers booking their summer travel. Further, MAX deliveries have remained suspended following the MAX groundings and Boeing is not currently manufacturing new MAX aircraft. The Company does not know whether, on what conditions, or when the MAX groundings will end. Regulatory approval of MAX return to service is subject to Boeing's ongoing work with the FAA, who will determine the timing of MAX return to service.

The MAX groundings adversely affected operating results for the year ended December 31, 2019, and could have a material, adverse effect on the Company's operating results in future periods. A continued prolonged extension or permanent grounding of the MAX aircraft would require additional flight schedule adjustments and result in further delays in aircraft deliveries, as well as lower operating revenues, operating income, and net income due to a variety of factors, including, among others, (i) lost revenue due to flight cancellations and disruptions as a result of a smaller operating aircraft fleet, (ii) the lack of ability to make corresponding reductions in expenses because of the fixed nature of many expenses, and (iii) possible negative effects on Customer confidence and airline choice.

Boeing no longer manufactures versions of the 737 other than the 737 MAX family of aircraft. If the 737 MAX aircraft were to remain unavailable for the Company's flight operations, the Company's growth would be restricted unless and until it could procure and operate other types of aircraft from Boeing or another manufacturer, seller, or lessor, and the Company's operations would be materially adversely affected. In particular, if the Company's growth were to be dependent upon the introduction of a new aircraft make and model to the Company's fleet, the Company would need to, among other things, (i) develop and implement new maintenance, operating, and training programs, (ii) secure extensive regulatory approvals, and (iii) implement new technologies. The requirements associated with operating a new aircraft make and model could take an extended period of time to fulfill and would likely impose substantial costs on the Company. A shift away from a single fleet type could also add complexity to the Company's operations, present operational and compliance risks, and materially increase the Company's costs. Any of these events would have a material, adverse effect on the Company's business, operating results, and financial condition. The Company could also be materially adversely affected if the pricing or operational attributes of its aircraft were to become less competitive. See Note 16 for further information.

The Company is also dependent on sole or limited suppliers for aircraft engines and certain other aircraft parts and services and would, therefore, also be materially adversely impacted in the event of the unavailability of, inadequate support for, 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, which typically are for five to seven years, but none of which are more than ten years in length. Some of these agreements automatically renew on an annual basis, unless either party objects to such extension. 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 29, 2018, the Financial Accounting Standards Board (the "FASB") issued ASU No. 2018-15, Intangibles—Goodwill and Other—Internal-Use Software. This new standard requires a customer in a cloud computing arrangement that is a service contract to follow the internal-use software guidance in ASC 350-40, Accounting for Internal-Use Software, to determine which implementation costs to (i) capitalize as assets and amortize over the term of the hosting arrangement or (ii) expense as incurred. This new standard is effective for public business entities in fiscal years beginning after December 15, 2019, and for interim periods within those fiscal years. Entities have the option to apply this standard prospectively to all implementation costs incurred after the date of adoption or retrospectively. The Company will be adopting this ASU prospectively as of January 1, 2020. The adoption of the new standard will impact the presentation of these costs as prepaid assets (versus Property and equipment under the existing guidance), however the impacts are not expected to be material.

On August 28, 2018, the FASB issued ASU No. 2018-13, Fair Value Measurement. This standard is effective for public business entities in fiscal years beginning after December 15, 2019, and for interim periods within those fiscal years. This new standard requires changes to the disclosure requirements for fair value measurements for certain Level 3 items, and specifies that some of the changes must be applied prospectively, while others should be applied retrospectively. The Company will be adopting this ASU as of January 1, 2020. While the Company is still evaluating this new standard, it does not expect it to have a significant impact on its financial statement disclosures. See Note 11 for further information on the Company's fair value measurements.

On August 28, 2017, the FASB issued the New Hedging Standard. The New Hedging Standard amended 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 New Hedging Standard also simplified the application of hedge accounting in certain situations. The New Hedging Standard was 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 elected to early adopt the New Hedging Standard as of January 1, 2018, utilizing a modified retrospective approach, as required. The most significant impacts of the New Hedging Standard on the Company's accounting were the elimination of the requirement to separately measure and record ineffectiveness for all cash flow hedges in a hedging relationship, as well as a change in classification of premium expense associated with option contracts. Such premium expense for the Company's fuel hedges was previously reflected as a component of Other (gains) losses, net, in the Consolidated Statement of Income, but under the New Hedging Standard is reflected as a component of the line item to which the hedge relates, which is Fuel and oil expense. As such, premium expense for the year ended December 31, 2017, was reclassified in order to be comparative with current period results in the accompanying Consolidated Statement of Income. The impact of the cumulative effect of the adjustment to move the reporting of ineffectiveness as of January 1, 2018, to AOCI from Retained earnings, was a \$20 million loss, net of taxes. The adoption and resulting reclassification had no impact on the Company's Net income, earnings per share, or cash flows. As a result of the adoption of the New Hedging Standard, however, the Company incurred no gains or losses due to ineffectiveness in Other (gains) losses, net, in the Consolidated Statement of Income, during 2018.

On February 25, 2016, the FASB issued the New Lease Standard. The New Lease Standard 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, as defined in the New Lease Standard) at the lease commencement date and recognize expenses on the income statement in a similar manner to the legacy guidance in ASC 840, Leases ("ASC 840").

The Company adopted the provisions of the New Lease Standard effective January 1, 2019, using the modified retrospective adoption method, utilizing the simplified transition option available in the New Lease Standard, which allows entities to continue to apply the legacy guidance in ASC 840, including its disclosure requirements, in the comparative periods presented in the year of adoption. The Company elected the package of practical expedients available under the transition provisions of the New Lease Standard, including (i) not reassessing whether expired or existing contracts contain leases, (ii) not reassessing lease classification, and (iii) not revaluing initial direct costs for existing leases.

In addition, the New Lease Standard eliminated the previous build-to-suit lease accounting guidance and resulted in derecognition of build-to-suit assets and liabilities that remained on the balance sheet after the end of the construction period, including the related deferred taxes. However, given the Company's guarantee associated with the bonds issued to fund the Dallas Love Field Modernization Program (the "LFMP"), the remaining debt service amount as of the adoption date was considered a minimum rental payment under the New Lease Standard, and therefore was recorded as a lease liability with a corresponding right-of-use asset on the Consolidated Balance Sheet that will be reduced through debt service payments made in 2019 and beyond. See Note 7 for disclosures related to the New Lease Standard, and Note 4 for further information on the Company's build-to-suit projects.

The following table provides the Consolidated Balance Sheet impact of applying the New Lease Standard effective as of January 1, 2019. The impact to the Company's results of operations and cash flows was not significant:

(in millions)	Balance as of January 1, 2019		
	Balances removed under prior accounting	Balances added under New Lease Standard	Net impact of New Lease Standard
Prepaid expenses and other current assets	\$ 1	\$ —	\$ (1)
Flight equipment	—	(110)	(110)
Assets constructed for others	1,669	—	(1,669)
Less allowance for depreciation and amortization	(166)	(2)	164
Operating lease right-of-use assets	—	1,466	1,466
Other assets	121	—	(121)
Total assets	\$ 1,625	\$ 1,354	\$ (271)
Accounts payable	\$ 8	\$ —	\$ (8)
Accrued liabilities	37	—	(37)
Current operating lease liabilities	—	355	355
Current maturities of long-term debt	—	(14)	(14)
Long-term debt less current maturities	—	(96)	(96)
Deferred income taxes	(17)	—	17
Construction obligation	1,602	—	(1,602)
Noncurrent operating lease liabilities	—	1,119	1,119
Other noncurrent liabilities	60	—	(60)
Retained earnings	(65)	(10)	55
Total liabilities and stockholders' equity	\$ 1,625	\$ 1,354	\$ (271)

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,		
	2019	2018	2017
NUMERATOR:			
Net income	\$ 2,300	\$ 2,465	\$ 3,357
DENOMINATOR:			
Weighted-average shares outstanding, basic	538	573	601
Dilutive effect of restricted stock units	1	1	2
Adjusted weighted-average shares outstanding, diluted	539	574	603
NET INCOME PER SHARE:			
Basic	\$ 4.28	\$ 4.30	\$ 5.58
Diluted	\$ 4.27	\$ 4.29	\$ 5.57

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, 2019, the Company leased three new 737 MAX 8 aircraft. The Company has firm orders in place with Boeing for 219 737 MAX 8 aircraft and 30 737 MAX 7 aircraft, as well as options for 115 737 MAX 8 aircraft as of December 31, 2019. All 34 of the Company's Boeing 737 MAX 8 aircraft have remained grounded since March 13, 2019, upon the FAA emergency order for all U.S. airlines to ground all MAX aircraft. See Note 16 to the Consolidated Financial Statements for further information. In addition, MAX deliveries were suspended as of March 13, 2019, and the timeline of future deliveries is uncertain. The FAA will ultimately determine the timing of MAX return to service, and the Company therefore offers no assurances that current estimations and timelines are correct. Based on the Company's current contractual obligations and shifting 40 MAX aircraft originally scheduled for delivery in 2019 into 2020 and one into 2021, the Company's capital commitments associated with these contractual firm orders and additional aircraft are as follows: \$2.1 billion in 2020, \$1.7 billion in 2021, \$1.2 billion in 2022, \$1.6 billion in 2023, \$1.9 billion in 2024, and \$1.5 billion thereafter.

The Company adopted the provisions of the New Lease Standard effective January 1, 2019, using the modified retrospective adoption method. The New Lease Standard eliminated the previous build-to-suit lease accounting guidance and resulted in the derecognition of build-to-suit assets and liabilities that remained on the balance sheet after the end of the construction period. See Note 2 for further information. Descriptions of the Company's recently completed and current build-to-suit projects follows.

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 ("FLL"), to oversee and manage the design and construction of the airport's Terminal 1 Modernization Project. In addition to significant improvements to the existing Terminal 1, the project included the design and construction of a new five-gate Concourse A with an international processing facility. Funding for the project came directly from Broward County aviation sources, but flowed through the Company in its capacity as manager of the project. Construction of Concourse A was completed during second quarter 2017, and construction on Terminal 1 was substantially complete and operational as of the end of third quarter 2018. As construction was completed prior to adoption of the New Lease Standard, the Company derecognized the FLL related Assets constructed for others ("ACFO") and Construction obligation within the Consolidated Balance Sheet as of January 1, 2019.

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 oversaw and managed the design, development, financing, construction, and commissioning of the airport's Terminal 1 Modernization Project. Construction on the Terminal 1 Modernization Project began during 2014 and was substantially complete and operational during fourth quarter 2018. As construction was completed prior to adoption of the New Lease Standard, the Company derecognized the LAX T1 Lease related ACFO and Construction obligation within the Consolidated Balance Sheet as of January 1, 2019.

In October 2017, the Company executed a separate lease agreement with LAWA (the "T1.5 Lease"). Under the T1.5 Lease, the Company is overseeing and managing 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. 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 role in the project, it is considered the owner of the Terminal 1.5 Project for accounting purposes under the New Lease Standard.

As a result, the costs incurred to fund the Terminal 1.5 Project 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. Upon completion of the Terminal 1.5 Project, the Company will perform an evaluation to determine the treatment of these associated assets and liabilities.

Funding for the Terminal 1.5 Project is primarily through the Regional Airports Improvement Corporation (the "RAIC"), which is a quasi-governmental special purpose entity that acts as a conduit borrower under a syndicated credit facility provided by a group of lenders. A loan made under the credit facility for the Terminal 1.5 Project is being used to reimburse the Company for the site improvements and non-proprietary improvements of the Terminal 1.5 Project, and the outstanding loan will be repaid with the proceeds of LAWA's payments to purchase completed construction phases. The Company guaranteed the obligation of the RAIC under the credit facility associated with the T1.5 Lease. As of December 31, 2019, the Company's outstanding guaranteed obligation under the credit facility for the Terminal 1.5 Project was \$176 million.

Dallas Love Field

During 2008, the City of Dallas approved the 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 the "LFAMC," a Texas non-profit "local government corporation" established by the City of Dallas to act on the City of Dallas' behalf to facilitate the development of the LFMP), the Company managed this project. Major construction was effectively completed in 2014. During second quarter 2017, the City of Dallas approved using the remaining bond funds for additional terminal construction projects, which were effectively completed in 2018. As construction was completed prior to adoption of the New Lease Standard, the Company derecognized the LFMP Terminal related ACFO and Construction obligation within the Consolidated Balance Sheet as of January 1, 2019.

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, 2019, \$407 million of principal remained outstanding. The net present value of the future principal and interest payments associated with the bonds was \$444 million as of December 31, 2019, and was reflected as part of the Company's operating lease right-of-use assets and lease obligations in the Consolidated Balance Sheet. See Notes 2 and 7 for further information.

During 2015, the City of Dallas issued additional bonds for the construction of a new parking garage at Dallas Love Field, which was completed and operational in fourth quarter 2018. As construction was completed prior to adoption of the New Lease Standard, the Company derecognized the LFMP Parking Garage related ACFO and Construction obligation within the Consolidated Balance Sheet as of January 1, 2019. The Company has not guaranteed the principal or interest payments on these bonds.

Construction costs recorded in ACFO for the Company's various projects as of December 31, 2019, and December 31, 2018, were as follows:

(in millions)	December 31, 2019			December 31, 2018		
	ACFO	ACFO, Net (a)	Construction Obligation	ACFO	ACFO, Net (a)	Construction Obligation
FLL Terminal	\$ —	\$ —	\$ —	\$ 313	\$ 304	\$ 308
LAX Terminal 1	—	—	—	485	459	476
LAX Terminal 1.5 (b)	164	164	164	99	99	99
LFMP Terminal	—	—	—	545	460	502
LFMP Parking Garage	—	—	—	200	200	200
HOU International Terminal (c)	—	—	—	126	115	116
	<u>\$ 164</u>	<u>\$ 164</u>	<u>\$ 164</u>	<u>\$ 1,768</u>	<u>\$ 1,637</u>	<u>\$ 1,701</u>

(a) Net of accumulated depreciation.

(b) Project still in progress.

(c) 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. REVENUE

Passenger Revenues

The Company's contracts with its Customers primarily consist of its tickets sold, which are initially deferred as Air traffic liability. Passenger revenue associated with tickets is recognized when the performance obligation to the Customer is satisfied, which is primarily when travel is provided.

Revenue is categorized by revenue source as the Company believes it best depicts the nature, amount, timing, and uncertainty of revenue and cash flow. The following table provides the components of Passenger revenue recognized for the years ended December 31, 2019, 2018, and 2017:

(in millions)	Year ended December 31,		
	2019	2018	2017
Passenger non-loyalty	\$ 17,578	\$ 17,506	\$ 16,934
Passenger loyalty - air transportation	2,487	2,307	2,263
Passenger ancillary sold separately	711	642	566
Total passenger revenues	<u>\$ 20,776</u>	<u>\$ 20,455</u>	<u>\$ 19,763</u>

Passenger non-loyalty includes all revenues recognized from Passengers related to flights paid for primarily with cash or credit card. All Customers purchasing a ticket on Southwest Airlines are generally able to check up to two bags at no extra charge (with certain exceptions as stated in the Company's published Contract of Carriage), and the Company also does not charge a fee for a Customer to make a change to their flight after initial purchase, although fare differences may apply. Passenger loyalty - air transportation primarily consists of the revenue recognized associated with award flights taken by loyalty program members upon redemption of loyalty points. Passenger ancillary sold separately

includes any revenue recognized associated with ancillary fees charged separately, such as in-flight purchases, EarlyBird Check-In[®], and Upgraded Boarding.

In order to determine the value of each loyalty point, certain assumptions must be made at the time of measurement, which include the following:

- *Allocation of Passenger Revenue* - Revenues from Passengers, related to travel, who also earn Rapid Rewards Points have been allocated between flight (recognized as revenue when transportation is provided) and Rapid Rewards Points (deferred until points are redeemed) based on each obligation's relative standalone selling price. The Company utilizes historical earning patterns to assist in this allocation.
- *Fair Value of Rapid Rewards Points* - Determined from the base fare value of tickets which were purchased using prior point redemptions for travel and other products and services, which the Company believes to be indicative of the fair value of points as perceived by Customers and representative of the value of each point at the time of redemption. The Company's booking site allows a Customer to toggle between fares utilizing either cash or point redemptions, which provides the Customer with an approximation of the equivalent value of their points. The value can differ, however, based on demand, the amount of time prior to the flight, and other factors. The fare mix during the period measured represents a constraint, which could result in the assumptions above changing at the measurement date, as fare classes can have different coefficients used to determine the total loyalty points needed to purchase an award ticket. The mixture of these fare classes and changes in the coefficients used by the Company could cause the fair value per point to increase or decrease.

For points that are expected to remain unused, the Company recognizes spoilage in proportion to the pattern of points used by the Customer, which approximates the average period over which the population of Rapid Reward Members redeem their points. The Company utilizes historical behavioral data to develop a predictive statistical model to analyze the amount of spoilage expected for points sold to business partners and earned through flight. The Company continues to evaluate expected spoilage annually and applies appropriate adjustments in the fourth quarter of each year, or other times, if changes in Customer behavior are detected. Changes to spoilage estimates impact revenue recognition prospectively. Due to the size of the Company's liability for loyalty benefits, changes in Customer behavior and/or expected future redemption patterns could result in significant variations in Passenger revenue.

The Company allocates consideration received to performance obligations based on the relative fair value of those obligations. The Company has a co-branded credit card agreement ("Agreement") with Chase Bank USA, N.A. ("Chase"), through which the Company sells loyalty points and certain marketing components, which consist of the use of Southwest Airlines' brand and access to Rapid Rewards Member lists, licensing and advertising elements, and the use of the Company's resource team. 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 two performance obligations identified in the Agreement, which have been characterized as a transportation component and a marketing component. The allocations utilized are reviewed to determine if adjustment is necessary any time there is a modification to the Agreement. The Company records Passenger revenue related to loyalty point redemptions for air travel when the travel is delivered, and the marketing elements are recognized as Other revenue when the performance obligations related to those services are satisfied, which is generally the same period consideration is received from Chase.

As performance obligations to Customers are satisfied, the related revenue is recognized. The events that result in revenue recognition that are associated with performance obligations identified as a part of the Rapid Rewards Program are as follows:

- *Tickets and Rapid Rewards Points* - When a flight occurs, the related performance obligation is satisfied and the related value provided by the Customer, whether from purchased tickets or Rapid Rewards Points, is recognized as revenue.
- *Loyalty points redeemed for goods and/or services other than travel* - Rapid Rewards Members have the option to redeem points for goods and services offered through a third party vendor, who acts as principal. The performance obligation related to the purchase of these goods and services is satisfied when the good and/or service is delivered to the Customer.

- *Marketing Royalties* - As part of its Agreement with Chase, Southwest provides certain deliverables, including use of the Southwest Airlines' brand, access to Rapid Rewards Member lists, advertising elements, and the Company's resource team. These performance obligations are satisfied each month that the Agreement is active.

As of the years ended December 31, 2019 and 2018, the components of Air traffic liability, including contract liabilities based on tickets sold, unused funds available to the Customer, and loyalty points available for redemption, net of expected spoilage, within the Consolidated Balance Sheet were as follows:

(in millions)	Balance as of	
	December 31, 2019	December 31, 2018
Air traffic liability - passenger travel and ancillary passenger services	\$ 2,125	\$ 2,059
Air traffic liability - loyalty program	3,385	3,011
Total Air traffic liability	\$ 5,510	\$ 5,070

The balance in Air traffic liability – passenger travel and ancillary passenger services also includes unused funds that are available for use by Customers and are not currently associated with a ticket, but represent funds effectively refunded and made available for use to purchase a ticket for a flight that occurs prior to their expiration. These funds are typically created as a result of a prior ticket cancellation or exchange. These performance obligations are expected to have a duration of twelve months or less; therefore, the Company has elected to not disclose the amount of the remaining transaction price and its expected timing of recognition for passenger tickets. Recognition of revenue associated with the Company's loyalty liability can be difficult to predict, as the number of award seats available to members is not currently restricted and they could choose to redeem their points at any time that a seat is available. The performance obligations classified as a current liability related to the Company's loyalty program were estimated based on expected redemptions utilizing historical redemption patterns, and forecasted flight availability, fares, and coefficients. The entire balance classified as Air traffic liability – noncurrent relates to loyalty points that were estimated to be redeemed in periods beyond 12 months following the representative balance sheet date. The Company expects the majority of loyalty points to be redeemed within two years. Rollforwards of the Company's Air traffic liability - loyalty program for the years ended December 31, 2019 and 2018 were as follows (in millions):

	Year ended December 31,	
	2019	2018
Air traffic liability - loyalty program - beginning balance	\$ 3,011	\$ 2,667
Amounts deferred associated with points awarded	2,941	2,717
Revenue recognized from points redeemed - Passenger	(2,487)	(2,307)
Revenue recognized from points redeemed - Other	(80)	(66)
Air traffic liability - loyalty program - ending balance	\$ 3,385	\$ 3,011

Air traffic liability includes consideration received for ticket and loyalty related performance obligations which have not been satisfied as of a given date. Rollforwards of the amounts included in Air traffic liability as of December 31, 2019 and 2018 were as follows (in millions):

	Air traffic liability
Balance at December 31, 2018	\$ 5,070
Current period sales (passenger travel, ancillary services, flight loyalty, and partner loyalty)	21,296
Revenue from amounts included in contract liability opening balances	(3,816)
Revenue from current period sales	(17,040)
Balance at December 31, 2019	\$ 5,510

	Air traffic liability
Balance at December 31, 2017	\$ 4,565
Current period sales (passenger travel, ancillary services, flight loyalty, and partner loyalty)	21,026
Revenue from amounts included in contract liability opening balances	(3,479)
Revenue from current period sales	(17,042)
Balance at December 31, 2018	\$ 5,070

All performance obligations related to freight services sold are completed within twelve months or less; therefore, the Company has elected to not disclose the amount of the remaining transaction price and its expected timing of recognition for freight shipments.

Other revenues primarily consist of marketing royalties associated with the Company's co-branded Chase® Visa credit card, but also include commissions and advertising associated with Southwest.com®. All amounts classified as Other revenues are paid monthly, coinciding with the Company fulfilling its deliverables; therefore, the Company has elected to not disclose the amount of the remaining transaction price and its expected timing of recognition for such services provided.

The Company recognized revenue related to the marketing, advertising, and other travel-related benefits of the revenue associated with various loyalty partner agreements including, but not limited to, the Agreement with Chase, within Other operating revenues. For the years ended December 31, 2019, 2018, and 2017 the Company recognized \$1.3 billion, \$1.1 billion, and \$1.0 billion, respectively.

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, are excluded from the contract transaction price, and are therefore 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.

6. LONG-TERM DEBT

(in millions)	December 31, 2019	December 31, 2018
2.75% Notes due November 2019	\$ —	\$ 300
Term Loan Agreement payable through May 2019 - 6.315%	—	23
Term Loan Agreement payable through July 2019 - 4.84%	—	10
2.65% Notes due 2020	500	492
Term Loan Agreement payable through 2020 - 5.223%	134	187
737 Aircraft Notes payable through 2020	20	67
2.75% Notes due 2022	300	300
Pass Through Certificates due 2022 - 6.24%	197	250
Term Loan Agreement payable through 2026 - 3.03%	178	197
3.00% Notes due 2026	300	300
3.45% Notes due 2027	300	300
7.375% Debentures due 2027	122	125
Finance leases	627	845
	\$ 2,678	\$ 3,396
Less current maturities	819	606
Less debt discount and issuance costs	13	19
	\$ 1,846	\$ 2,771

AirTran Holdings is party to aircraft purchase financing facilities, and as of December 31, 2019, three 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, 2019, the weighted average interest rate was 3.49 percent. Principal and interest under the notes are payable semi-annually or every three months as applicable. As of December 31, 2019, the remaining debt outstanding may be prepaid without penalty under all aircraft loans provided under such facilities. The remaining notes mature in 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.

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.

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.

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 began on 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 3.03 percent, and interest is payable semi-annually in installments.

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 November 2019. The notes bore interest at 2.75 percent, payable semi-annually in arrears. 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. The notes matured and were redeemed in full on November 6, 2019, utilizing available cash on hand.

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 bore interest at a fixed rate of 4.84 percent. The loan matured and was paid out in full on July 1, 2019, utilizing available cash on hand.

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 bore 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. The loan matured and was paid out in full on May 6, 2019, utilizing available cash on hand.

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 being repaid via quarterly installments of principal and interest that began 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 are 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 became 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.

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 \$148 million at December 31, 2019.

The Company has access to a \$1.0 billion unsecured revolving credit facility expiring in August 2022. The revolving credit agreement has an accordion feature that would allow the Company, subject to, among other things, the procurement of incremental commitments, to increase the size of the facility to \$1.5 billion. Interest on the facility is based on the Company's credit ratings at the time of borrowing. At the Company's current ratings, the interest cost would be LIBOR plus a spread of 100.0 basis points. The facility contains a financial covenant requiring a minimum coverage ratio of adjusted pre-tax income to fixed obligations, as defined. As of December 31, 2019, the Company was in compliance with this covenant and there were no amounts outstanding under the revolving credit facility.

The net book value of the assets pledged as collateral for the Company's secured borrowings, primarily aircraft, was \$990 million at December 31, 2019. In addition, the Company has pledged a total of up to 12 of its Boeing 737-700 and 37 of its Boeing 737-800 aircraft at a net book value of \$1.2 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, 2019, aggregate annual principal maturities of debt and finance leases (not including amounts associated with interest rate swap agreements, interest on finance leases, and amortization of purchase accounting adjustments) for the five-year period ending December 31, 2024, and thereafter, were \$819 million in 2020, \$170 million in 2021, \$475 million in 2022, \$103 million in 2023, \$103 million in 2024, and \$990 million thereafter.

7. LEASES

The Company enters into leases for aircraft, property, and other types of equipment in the normal course of business. The accounting for these leases follows the requirements of the New Lease Standard, which the Company adopted as of January 1, 2019. See Note 2 for further information.

As of December 31, 2019, the Company held aircraft leases with remaining terms ranging from one month to 12 years. The aircraft leases generally can be renewed for one to six years at rates based on fair market value at the end of the lease term. Residual value guarantees included in the Company's lease agreements are not material. On July 9, 2012, the Company signed an agreement with Delta Air Lines, Inc. and Boeing Capital Corp. to lease or sublease 88 AirTran Airways, Inc. Boeing 717-200 aircraft ("B717s") to Delta at agreed-upon lease rates. Three operating leases expired during 2018. Of the 85 B717s remaining at the beginning of 2019, ten owned B717s were sold in 2019. The proceeds from the sale, which were not material, were netted within Capital expenditures in the Consolidated Statement of Cash Flows. Excluding the eight aircraft for which operating leases expired during 2019, the following remained: 65 on operating leases and two on finance leases. The sublease terms for the 65 B717s on operating lease and the two B717s on finance lease coincide with the Company's remaining lease terms for these aircraft from the original lessor, which have remaining lease terms ranging from approximately one month to five years. The Company's future sublease income associated with the 65 B717s on operating lease as of December 31, 2019 was as follows: \$78 million in 2020, \$41 million in 2021, \$17 million in 2022, \$7 million in 2023, and \$1 million in 2024. The two B717s classified by the Company as finance leases are accounted for as direct financing leases, and the remaining 65 subleases are accounted for as operating leases. There are no contingent payments and no significant residual value conditions associated with the transaction.

At each airport where the Company conducts flight operations, the Company has lease agreements, generally with a governmental unit or authority, for the use of airport terminals, airfields, office space, cargo warehouses, gates, and/or maintenance facilities. These leases are classified as operating lease agreements and have lease terms remaining ranging from one month to 27 years. Certain leases can be renewed from one to ten years. The majority of the airport terminal leases contain certain provisions for periodic adjustments to rates that depend upon airport operating costs or use of the facilities, and are reset at least annually. Due to the nature and variability of the rates, the majority of these leases are not recorded on the Consolidated Balance Sheet.

The Company also leases certain technology assets, fuel storage tanks, and various other equipment that qualify as leases under the New Lease Standard. The remaining lease terms range from two months to seven years. Certain leases can be renewed from six months to five years.

Lease-related assets and liabilities recorded on the Consolidated Balance Sheet were as follows:

(in millions)	Balance Sheet location	December 31, 2019
Assets		
Operating	Operating lease right-of-use assets (net)	\$ 1,349
Finance	Property and equipment (net of allowance for depreciation and amortization of \$455)	779
Total lease assets		<u>\$ 2,128</u>
Liabilities		
Current		
Operating	Current operating lease liabilities	\$ 353
Finance	Current maturities of long-term debt	85
Noncurrent		
Operating	Noncurrent operating lease liabilities	978
Finance	Long-term debt less current maturities	542
Total lease liabilities		<u>\$ 1,958</u>

The components of lease costs, included in the Consolidated Statement of Comprehensive Income, were as follows:

(in millions)	Statement of Comprehensive Income location	Year ended December 31, 2019
Operating lease cost - aircraft (a)	Other operating expenses	\$ 182
	Landing fees and airport rentals, and Other operating expenses	
Operating lease cost - other		89
Short-term lease cost	Other operating expenses	4
	Landing fees and airport rentals, and Other operating expenses	
Variable lease cost		1,377
Finance lease cost:		
	Depreciation and amortization	
Amortization of lease liabilities		116
Interest on lease liabilities	Interest expense	26
Total net finance lease cost		\$ 142

(a) Net of sublease income of \$97 million for the year ended December 31, 2019.

Supplemental cash flow information related to leases, included in the Consolidated Statement of Cash Flows, was as follows:

(in millions)	Year ended December 31, 2019
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows for operating leases	\$ 379
Operating cash flows for finance leases	26
Financing cash flows for finance leases	85
Right-of-use assets obtained in exchange for lease obligations:	
Operating leases	230
Finance leases	1

As of December 31, 2019, maturities of lease liabilities were as follows:

(in millions)	Operating leases	Finance leases
2020	\$ 392	\$ 107
2021	257	102
2022	141	98
2023	113	94
2024	92	90
Thereafter	661	230
Total lease payments	\$ 1,656	\$ 721
Less imputed interest	(325)	(94)
Total lease obligations	1,331	627
Less current obligations	(353)	(85)
Long-term lease obligations	\$ 978	\$ 542

The table below presents additional information related to the Company's leases as of December 31, 2019:

Weighted average remaining lease term

Operating leases	9 years
Finance leases	8 years

Weighted average discount rate

Operating leases (a)	3.7%
Finance leases	3.8%

(a) Upon adoption of the New Lease Standard, the incremental borrowing rate used for existing leases was established as of January 1, 2019.

As of December 31, 2019, the Company had additional operating lease commitments that had not yet commenced of approximately \$543 million for 16 Boeing 737 MAX 8 aircraft contractually to be delivered in 2020, each with lease terms that range from eight to nine years.

Disclosures related to periods prior to the adoption of the New Lease Standard

As of December 31, 2018, the Company's fleet included 51 aircraft on operating lease and 72 aircraft on capital lease. Amounts applicable to these aircraft on capital lease that were included in property and equipment were \$1.3 billion for flight equipment and \$304 million in accumulated amortization.

Total rental expense for operating leases, both aircraft and other, charged to operations in 2018 and 2017 was \$935 million and \$939 million, respectively. The majority of the Company's terminal operations space, as well as 124 aircraft, including 73 B717s subleased to Delta, were under operating leases at December 31, 2018. For aircraft operating leases and for terminal operating leases and other real estate leases, expense is recorded on a straight-line basis and included in Other operating expenses and in Landing fees and airport rentals, respectively, in the Consolidated Statement of Income. The majority of the Company's terminal operations space 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, 2018, were:

(in millions)	Capital leases	Operating leases	Subleases	Operating leases, net
2019	\$ 111	\$ 348	\$ (92)	\$ 256
2020	109	357	(78)	279
2021	105	244	(41)	203
2022	100	172	(17)	155
2023	97	146	(7)	139
Thereafter	335	474	(1)	473
Total minimum lease payments	\$ 857	\$ 1,741	\$ (236)	\$ 1,505
Less amount representing interest	126			
Present value of minimum lease payments (a)	731			
Less current portion	85			
Long-term portion	\$ 646			

(a) Excludes lease incentive obligation of \$114 million.

In 2017, the Company recorded a charge of \$63 million, within Other operating expenses in the accompanying Consolidated Statement of Income, 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. As of December 31, 2018, the remaining amounts associated with the cease-use liability had been paid in full.

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, 2019, the Company had 60 million shares of common stock reserved for issuance pursuant to Employee equity plans (of which 27 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, 2019, 2018, and 2017, reflects share-based compensation expense of \$55 million, \$46 million, and \$37 million, respectively. The total tax benefit recognized in earnings from share-based compensation arrangements for the years ended December 31, 2019, 2018, and 2017, was not material. As of December 31, 2019, there was \$64 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"), which has been approved by Shareholders, the Company granted restricted stock units ("RSUs") and performance-based restricted stock units ("PBRsUs") to certain Employees during 2019, 2018, and 2017. Outstanding RSUs vest over three years, subject generally to the individual's continued employment or service. The PBRsUs granted in 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, for the defined performance period and are also subject generally to the individual's continued employment or service. The PBRsUs granted in January 2018 and January 2019 are subject to the Company's performance with respect to a three-year simple average of Return on Invested Capital, after taxes and excluding special items, for the defined performance period and are also subject generally to the individual's continued employment or service. The number of PBRsUs vesting on the vesting date will be interpolated based on the Company's Return on Invested Capital 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, 2016	1,439	\$ 36.52
Granted	717 (a)	52.73
Vested	(806)	30.23
Surrendered	(56)	43.86
Outstanding December 31, 2017	1,294	45.32
Granted	782 (b)	60.80
Vested	(670)	45.11
Surrendered	(64)	47.05
Outstanding December 31, 2018, Unvested	1,342	52.56
Granted	994 (c)	57.49
Vested	(744)	42.42
Surrendered	(47)	57.72
Outstanding December 31, 2019, Unvested	1,545	57.65

(a) Includes 235 thousand PBRsUs

(b) Includes 308 thousand PBRsUs

(c) Includes 387 thousand PBRsUs

In addition, the Company granted approximately 31 thousand shares of unrestricted stock at a weighted average grant price of \$52.01 in 2019, approximately 28 thousand shares at a weighted average grant price of \$53.01 in 2018, and approximately 26 thousand shares at a weighted average grant price of \$57.04 in 2017, to members of its Board of Directors.

A remaining balance of up to 20 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 and Restated 1991 Employee Stock Purchase Plan ("ESPP"), which has been approved by Shareholders, the Company is authorized to issue up to a remaining balance of 7 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.

The following table provides information about the Company's ESPP activity during 2019, 2018, and 2017:

Employee Stock Purchase Plan			
Year ended	Total number of shares purchased (in thousands)	Average price paid per share	(a) Weighted-average fair value of each purchase right under the ESPP
December 31, 2017	544	\$ 50.13	\$ 5.57
December 31, 2018	661	\$ 50.73	\$ 5.64
December 31, 2019	821	\$ 47.60	\$ 5.29

(a) The weighted-average fair value of each purchase right under the ESPP granted is equal to a ten percent discount from the market value of the Common Stock at the end of each monthly purchase period.

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 represents 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 timeframes, 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 2019, the Company had fuel derivative instruments in place for up to 73 percent of its fuel consumption. As of December 31, 2019, the Company also had fuel derivative instruments in place to provide coverage at varying price levels, but up to a maximum of approximately 59 percent of its 2020 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:

Period (by year)	Maximum fuel hedged as of	Derivative underlying commodity type as of
	December 31, 2019 (gallons in millions) (a)	December 31, 2019
2020	1,301	WTI crude oil, Brent crude oil, and Heating oil
2021	1,169	WTI crude and Brent crude oil
2022	603	WTI crude and Brent crude oil
Beyond 2022	32	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. All periodic changes in fair value of the derivatives designated as hedges are recorded in AOCI until the underlying jet fuel is consumed. See Note 12.

The Company's results are subject to the possibility that the derivatives will no longer qualify for hedge accounting, in which case any change in the fair value of derivative instruments since the last reporting period would be recorded in 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. Factors that have and may continue to lead to the loss of hedge accounting include: significant fluctuation in energy prices, 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. Increased volatility in these commodity markets for an extended period of time, especially if such volatility were to worsen, could cause the Company to lose hedge accounting altogether for the commodities used in its fuel hedging program, which would create further volatility in the Company's GAAP financial results. 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. 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 2019, 2018, or 2017.

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. This statistical analysis involves utilizing regression 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 12/31/2019	Fair value at 12/31/2018	Fair value at 12/31/2019	Fair value at 12/31/2018
Derivatives designated as hedges (a)					
Fuel derivative contracts (gross)	Prepaid expenses and other current assets	\$ 48	\$ 43	\$ —	\$ —
Fuel derivative contracts (gross)	Other assets	62	95	—	—
Interest rate derivative contracts	Other assets	2	—	—	—
Interest rate derivative contracts	Accrued liabilities	—	—	5	2
Interest rate derivative contracts	Other noncurrent liabilities	—	—	1	12
Total derivatives designated as hedges		\$ 112	\$ 138	\$ 6	\$ 14

(a) 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.

The following table presents the amounts recorded on the Consolidated Balance Sheet related to fair value hedges:

(in millions)	Carrying amount of the hedged liabilities		Cumulative amount of fair value hedging adjustment included in the carrying amount of the hedged liabilities (a)	
	December 31,		December 31,	
	2019	2018	2019	2018
Current maturities of long-term debt	\$ 500	\$ —	\$ —	\$ —
Long-term debt less current maturities	—	791	19	11
	\$ 500	\$ 791	\$ 19	\$ 11

(a) At December 31, 2019 and 2018, these amounts include the cumulative amount of fair value hedging adjustments remaining for which hedge accounting has been discontinued of \$19 million and \$20 million, respectively.

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

(in millions)	Balance Sheet location	December 31, 2019	December 31, 2018
Cash collateral deposits held from counterparties for fuel contracts - current	Offset against Prepaid expenses and other current assets	\$ 10	\$ —
Cash collateral deposits held from counterparties for fuel contracts - noncurrent	Offset against Other assets	15	—

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. 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 asset 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. No cash collateral deposits were provided by or held by the Company based on its outstanding interest rate swap agreements.

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

Offsetting of derivative assets

(in millions)

Description	Balance Sheet location	(i)		(ii)		(iii) = (i) + (ii)		(i)		(ii)		(iii) = (i) + (ii)	
		December 31, 2019						December 31, 2018					
		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	\$	48	\$	(10)	\$	38	\$	43	\$	—	\$	43
Fuel derivative contracts	Other assets	\$	62	\$	(15)	\$	47	(a) \$	95	\$	—	\$	95 (a)
Interest rate derivative contracts	Other assets	\$	2	\$	—	\$	2	(a) \$	—	\$	—	\$	— (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 15.

Offsetting of derivative liabilities

(in millions)

		(i)	(ii)	(iii) = (i) + (ii)		(i)	(ii)	(iii) = (i) + (ii)	
		December 31, 2019			December 31, 2018				
Description	Balance Sheet location	Gross amounts of recognized liabilities	Gross amounts offset in the Balance Sheet	Net amounts of liabilities presented in the Balance Sheet	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	\$ 10	\$ (10)	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Fuel derivative contracts	Other assets	\$ 15	\$ (15)	\$ — (a)	\$ —	\$ —	\$ —	\$ —	\$ — (a)
Interest rate derivative contracts	Accrued liabilities	\$ 5	\$ —	\$ 5	\$ 2	\$ —	\$ —	\$ 2	\$ 2
Interest rate derivative contracts	Other noncurrent liabilities	\$ 1	\$ —	\$ 1	\$ 12	\$ —	\$ —	\$ 12	\$ 12

(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 15.

The following tables present the impact of derivative instruments and their location within the Consolidated Statement of Income for the year ended December 31, 2019 and 2018:

Location and amount recognized in income on cash flow and fair value hedging relationships

(in millions)	Year ended December 31, 2019		Year ended December 31, 2018	
	Fuel and oil	Interest expense	Fuel and oil	Interest expense
Total	\$ 48	\$ 29	\$ (33)	\$ 37
(Gain) loss on cash flow hedging relationships:				
Commodity contracts:				
Amount of (gain) loss reclassified from AOCI into income	48	—	(33)	—
Interest contracts:				
Amount of loss reclassified from AOCI into income	—	5	—	6
Impact of fair value hedging relationships:				
Interest contracts:				
Hedged items	—	22	—	23
Derivatives designated as hedging instruments	—	2	—	8

Derivatives designated and qualified in cash flow hedging relationships

(in millions)	(Gain) loss recognized in AOCI on derivatives, net of tax	
	Year ended December 31,	
	2019	2018
Fuel derivative contracts	\$ 90	\$ 1
Interest rate derivatives	29	(1)
Total	\$ 119	\$ —

Derivatives not designated as hedges

	(Gain) loss recognized in income on derivatives		
	Year ended December 31,		Location of (gain) loss recognized in income on derivatives
(in millions)	2019	2018	
Interest rate derivatives	\$ —	\$ (2)	Interest Expense

The Company also recorded expense associated with premiums paid for fuel derivative contracts that settled/expired during 2019, 2018, and 2017 of \$95 million, \$135 million, and \$136 million, respectively. These amounts are recognized through changes in fair value within AOCI for designated hedges, and are ultimately recorded as a component of Fuel and oil in the Consolidated Statement of Income during the period the contracts settle.

The fair values of the derivative instruments, depending on the type of instrument, were determined by the use of present value methods or option value models with assumptions about commodity prices based on those observed in

underlying markets or provided by third parties. Included in the Company's cumulative net unrealized losses from fuel hedges as of December 31, 2019, recorded in AOCI, were approximately \$36 million in unrealized losses, net of taxes, which are expected to be realized in earnings during the twelve months subsequent to December 31, 2019.

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" or "critical terms match" methods of accounting, ineffectiveness is assessed at each reporting period. If hedge accounting is achieved, all periodic changes in fair value of the interest rate swaps are recorded in AOCI. The ineffectiveness associated with all of the Company's 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 \$4 million are fair value hedges, cash flow hedges, and interest rate derivatives not utilizing hedge accounting, and are classified as components of Other assets, 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 a fixed-to-floating interest rate swap agreement in place associated with its \$500 million 2.65 percent Notes due 2020 that is accounted for as a fair value hedge. As a result of the fixed-to-floating interest rate swap agreement in place, the average floating rate recognized during 2019 was approximately 3.01 percent on the \$500 million Notes.

The Company has a floating-to-fixed interest rate swap agreement associated with its \$600 million floating-rate term loan agreement due 2020 that is accounted for as a cash flow hedge. The interest rate hedge has fixed the interest rate on the \$600 million floating-rate term loan agreement at 5.223 percent until maturity.

There are also two 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 in 2020, AirTran Holdings pays fixed rates between 4.35 percent and 4.50 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, 2019, was \$13 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, 2019, 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's 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. In certain cases, the Company has the ability to substitute among these different forms of collateral in its discretion. The following

table provides the fair values of fuel derivatives, amounts posted as collateral, and applicable collateral posting threshold amounts as of December 31, 2019, at which such postings are triggered:

(in millions)	Counterparty (CP)						Total
	A	B	C	D	E	Other(a)	
Fair value of fuel derivatives	\$ 22	\$ 16	\$ 36	\$ 12	\$ 8	\$ 16	\$ 110
Cash collateral held from CP	25	—	—	—	—	—	25
Aircraft collateral pledged to CP	—	—	—	—	—	—	—
Letters of credit (LC)	—	—	—	—	—	—	—
Option to substitute LC for aircraft	(200) to (600) (b)	N/A	(150) to (550) (c)	(150) to (550)(c)	N/A		
Option to substitute LC for cash	N/A	N/A	(75) to (150) or >(550)(c)	(125) to (150) or >(550)(d)	(d)		
If credit rating is investment grade, fair value of fuel derivative level at which:							
Cash is provided to CP	>(100)	>(50)	(75) to (150) or >(550)(e)	(125) to (150) or >(550)(e)	>(40)		
Cash is received from CP	>0(e)	>150(e)	>250(e)	>125(e)	>100(e)		
Aircraft or cash can be pledged to CP as collateral	(200) to (600) (f)	N/A	(150) to (550) (c)	(150) to (550)(c)	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)	(g)	(0) to (150) or >(550)	(0) to (150) or >(550)	(g)		
Cash is received from CP	(g)	(g)	(g)	(g)	(g)		
Aircraft or cash can be pledged to CP as collateral	(200) to (600)	N/A	(150) to (550)	(150) to (550)	N/A		

(a) Individual counterparties with fair value of fuel derivatives <\$7 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 requirements.

(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, 2019, the Company held certain items that are required to be measured at fair value on a recurring basis. These included cash equivalents, short-term investments (primarily treasury bills and certificates of deposit), interest rate derivative contracts, fuel derivative contracts, and available-for-sale securities. The majority of the Company's short-term investments consist of instruments classified as Level 1. However, the Company has certificates of deposit, commercial paper, and time deposits that are classified as Level 2, due to the fact that the fair value for

these instruments is determined utilizing observable inputs in non-active markets. Other available-for-sale securities primarily consist of investments associated with the Company's excess benefit plan.

The Company's fuel and interest rate derivative instruments consist of over-the-counter contracts, which are not traded on a public exchange. Fuel derivative instruments currently consist solely 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, 2019, and December 31, 2018:

Description	December 31, 2019	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)	\$ 1,999	\$ 1,999	\$ —	\$ —
Commercial paper	535	—	535	—
Certificates of deposit	14	—	14	—
Short-term investments:				
Treasury bills	1,196	1,196	—	—
Certificates of deposit	268	—	268	—
Time deposits	60	—	60	—
Interest rate derivatives (see Note 10)	2	—	2	—
Fuel derivatives:				
Option contracts (b)	110	—	—	110
Other available-for-sale securities	197	197	—	—
Total assets	\$ 4,381	\$ 3,392	\$ 879	\$ 110
Liabilities				
Interest rate derivatives (see Note 10)	\$ (6)	\$ —	\$ (6)	\$ —

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

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

Description	December 31, 2018	Fair value measurements at reporting date using:			
		Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs	
		(Level 1)	(Level 2)	(Level 3)	
Assets		(in millions)			
Cash equivalents					
Cash equivalents (a)	\$ 1,392	\$ 1,392	\$ —	\$ —	
Commercial paper	454	—	454		
Certificates of deposit	8	—	8		
Short-term investments:					
Treasury bills	1,582	1,582	—		
Certificates of deposit	228	—	228		
Time deposits	25	—	25		
Fuel derivatives:					
Option contracts (b)	138	—	—		138
Other available-for-sale securities	127	127	—		—
Total assets	\$ 3,954	\$ 3,101	\$ 715	\$ 138	
Liabilities					
Interest rate derivatives (see Note 10)	\$ (14)	\$ —	\$ (14)	\$ —	

(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.

The Company had no transfers of assets or liabilities between any of the above levels during the years ended December 31, 2019 or 2018. The Company did not have any assets or liabilities measured at fair value on a nonrecurring basis as of December 31, 2019 or 2018. 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 2019 and 2018:

Fair value measurements using significant unobservable inputs (Level 3)		
(in millions)	Fuel derivatives	
Balance at December 31, 2018	\$	138
Total losses (realized or unrealized) included in other comprehensive income		(112)
Purchases		133 (a)
Sales		(2) (a)
Settlements		(47)
Balance at December 31, 2019	\$	110

(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 was purchased as a single instrument or separate instruments.

Fair value measurements using significant unobservable inputs (Level 3)

<u>(in millions)</u>	Fuel derivatives	
Balance at December 31, 2017	\$	248
Total losses (realized or unrealized) included in other comprehensive income		(1)
Purchases		66 (a)
Sales		(4) (a)
Settlements		(171)
Balance at December 31, 2018	\$	138

(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 was 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, 2019:

Quantitative information about Level 3 fair value measurements				
	Valuation technique	Unobservable input	Period (by year)	Range
Fuel derivatives	Option model	Implied volatility	2020	13-34%
			2021	17-23%
			2022	17-19%
			Beyond 2022	18-19%

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, 2019, 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 three 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.

<u>(in millions)</u>	Carrying value	Estimated fair value	Fair value level hierarchy
2.65% Notes due 2020	\$ 500	\$ 503	Level 2
Term Loan Agreement payable through 2020 - 5.223%	134	134	Level 3
737 Aircraft Notes payable through 2020	20	20	Level 3
2.75% Notes due 2022	300	304	Level 2
Pass Through Certificates due 2022 - 6.24%	197	208	Level 2
Term Loan Agreement payable through 2026 - 3.03%	178	178	Level 3
3.00% Notes due 2026	300	308	Level 2
3.45% Notes due 2027	300	317	Level 2
7.375% Debentures due 2027	122	150	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 2019 and 2018:

(in millions)	Fuel derivatives	Interest rate derivatives	Defined benefit plan items	Other	Deferred tax impact	Accumulated other comprehensive income (loss)
Balance at December 31, 2017	\$ 3	\$ (7)	\$ (9)	\$ 33	\$ (8)	\$ 12
ASU 2017-12 adoption adjustment (a)	(26)	—	—	—	6	(20)
ASU 2018-02 stranded AOCI adoption adjustment (b)	—	—	—	—	2	2
Changes in fair value	—	1	67	(8)	(14)	46
Reclassification to earnings	(33)	6	—	—	7	(20)
Balance at December 31, 2018	\$ (56)	\$ —	\$ 58	\$ 25	\$ (7)	\$ 20
Changes in fair value	(117)	(38)	(38)	34	37	(122)
Reclassification to earnings	48	5	—	—	(12)	41
Balance at December 31, 2019	\$ (125)	\$ (33)	\$ 20	\$ 59	\$ 18	\$ (61)

(a) The Company adopted the New Hedging Standard as of January 1, 2018. See Note 2 for further information on this adoption.

(b) The Company adopted the Reclassification of Certain Tax Effects from AOCI as of January 1, 2018, which allowed the Company to reclassify to Retained earnings any tax effects stranded in AOCI as a result of the Tax Cuts and Jobs Act enacted in December 2017.

The following table illustrates the significant amounts reclassified out of each component of AOCI for the year ended December 31, 2019:

Year ended December 31, 2019		
(in millions)		
AOCI components	Amounts reclassified from AOCI	Affected line item in the Consolidated Statement of Comprehensive Income
Unrealized loss on fuel derivative instruments	\$ 48	Fuel and oil expense
	11	Less: Tax expense
	\$ 37	Net of tax
Unrealized loss on interest rate derivative instruments	\$ 5	Interest expense
	1	Less: Tax expense
	\$ 4	Net of tax
Total reclassifications for the period	\$ 41	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 2019, 2018, and 2017, reflected as a component of Salaries, wages, and benefits, were \$1.2 billion, \$1.0 billion, and \$1.0 billion, 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, 2019 and 2018:

(in millions)	2019	2018
APBO at beginning of period	\$ 232	\$ 275
Service cost	17	18
Interest cost	10	9
Benefits paid	(9)	(5)
Actuarial (gain)/loss	38	(69)
Plan amendments	—	4
APBO at end of period	<u>\$ 288</u>	<u>\$ 232</u>

During 2019, the Company recorded a \$38 million actuarial loss as an increase to the APBO with an offset to AOCI. This actuarial loss is reflected above and resulted from changes in certain key assumptions used to determine the Company's year-end obligation. The assumption change that resulted in the largest portion of the actuarial loss was the change in the discount rate used.

All plans are unfunded, and benefits are paid as they become due. Estimated future benefit payments expected to be paid are \$9 million in 2020, \$10 million in 2021, \$12 million in 2022, \$13 million in 2023, \$15 million in 2024, and \$107 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, 2019 and 2018.

(in millions)	2019	2018
Funded status	\$ (288)	\$ (232)
Unrecognized net actuarial gain	(24)	(64)
Unrecognized prior service cost	4	5
Accumulated other comprehensive income	20	59
Cost recognized on Consolidated Balance Sheet	<u>\$ (288)</u>	<u>\$ (232)</u>

The consolidated periodic postretirement benefit cost for the years ended December 31, 2019, 2018, and 2017, included the following:

(in millions)	2019	2018	2017
Service cost	\$ 17	\$ 18	\$ 18
Interest cost	10	9	11
Amortization of prior service cost	1	3	3
Amortization of net gain	(2)	—	—
Net periodic postretirement benefit cost	<u>\$ 26</u>	<u>\$ 30</u>	<u>\$ 32</u>

Service cost is recognized within Salaries, wages, and benefits expense, and all other costs are recognized in Other (gains) losses, net in the Consolidated Statement of Income. 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, 2019, 2018, and 2017:

	2019	2018	2017
Weighted-average discount rate	3.30%	4.35%	3.65%
Assumed healthcare cost trend rate (a)	7.13%	7.13%	7.08%

(a) The assumed healthcare cost trend rate is expected to be 6.79% for 2020, then decline gradually to 5.19% by 2027 and remain level thereafter.

The selection of a discount rate is made annually and is selected by the Company based upon comparison of the expected 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 2019 due to market conditions. The assumed healthcare trend rate is also reviewed at least annually and is determined based upon both historical experience with the Company's healthcare benefits paid and expectations of how those trends may or may not change in future years.

14. INCOME TAXES

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The components of deferred tax assets and liabilities at December 31, 2019 and 2018, are as follows:

(in millions)	2019	2018
DEFERRED TAX LIABILITIES:		
Accelerated depreciation	\$ 3,096	\$ 3,395
Operating lease right-of-use assets	293	—
Other	93	92
Total deferred tax liabilities	3,482	3,487
DEFERRED TAX ASSETS:		
Construction obligation	38	355
Accrued employee benefits	346	329
Rapid rewards loyalty liability	305	267
Operating lease liabilities	308	—
Other	121	109
Total deferred tax assets	1,118	1,060
Net deferred tax liability	\$ 2,364	\$ 2,427

The provision (benefit) for income taxes is composed of the following:

(in millions)	2019	2018	2017
CURRENT:			
Federal	\$ 610	\$ 338	\$ 904
State	102	60	72
Total current	712	398	976
DEFERRED:			
Federal	(18)	299	200
State	(6)	2	2
Change in federal statutory tax rate (a)	(31)	—	(1,270)
Total deferred	(55)	301	(1,068)
	\$ 657	\$ 699	\$ (92)

(a) The Tax Cuts and Jobs Act was enacted in December 2017, which reduced the U.S. federal corporate tax rate from the previous rate of 35 percent to 21 percent.

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

(in millions)	2019	2018	2017
Tax at statutory U.S. tax rates	\$ 621	\$ 664	\$ 1,143
State income taxes, net of federal benefit	76	49	50
Change in federal statutory tax rate (a)	(31)	—	(1,270)
Other, net	(9)	(14)	(15)
Total income tax provision (benefit)	\$ 657	\$ 699	\$ (92)

(a) The Tax Cuts and Jobs Act was enacted in December 2017, which reduced the U.S. federal corporate tax rate from the previous rate of 35 percent to 21 percent.

The only periods subject to examination for the Company's federal tax return are the 2018 and 2019 tax years. The Company is also subject to various examinations from state and local income tax jurisdictions in the ordinary course of business. These examinations are not expected to have a material effect on the financial results of the Company.

15. SUPPLEMENTAL FINANCIAL INFORMATION

(in millions)	December 31, 2019	December 31, 2018
Trade receivables	\$ 53	\$ 57
Credit card receivables	112	107
Business partners and other suppliers	779	319
Income tax receivable	87	22
Other	55	63
Accounts and other receivables	<u>\$ 1,086</u>	<u>\$ 568</u>

(in millions)	December 31, 2019	December 31, 2018
Derivative contracts	\$ 49	\$ 95
Intangible assets, net	296	400
Finance lease receivable	—	61
Other	232	164
Other assets	<u>\$ 577</u>	<u>\$ 720</u>

(in millions)	December 31, 2019	December 31, 2018
Accounts payable trade	\$ 304	\$ 263
Salaries payable	231	216
Taxes payable excluding income taxes	227	220
Aircraft maintenance payable	162	69
Fuel payable	129	122
Other payable	521	526
Accounts payable	<u>\$ 1,574</u>	<u>\$ 1,416</u>

(in millions)	December 31, 2019	December 31, 2018
Profitsharing and savings plans	\$ 695	\$ 580
Vacation pay	434	403
Health	120	107
Workers compensation	166	166
Property and income taxes	79	68
Other	255	425
Accrued liabilities	<u>\$ 1,749</u>	<u>\$ 1,749</u>

(in millions)	December 31, 2019	December 31, 2018
Postretirement obligation	\$ 288	\$ 232
Other deferred compensation	313	247
Other	105	171
Other noncurrent liabilities	<u>\$ 706</u>	<u>\$ 650</u>

For further information on supplier receivables, see Note 16. 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.

16. BOEING 737 MAX AIRCRAFT GROUNDING

On March 13, 2019, the FAA issued an emergency order for all U.S. airlines to ground all Boeing MAX aircraft. The Company immediately complied with the order and grounded all 34 MAX aircraft in its fleet. The Company will continue to monitor the situation and any potential future accounting implications that arise. The most significant financial impacts of this grounding to the Company thus far have been lost revenues, operating income, and operating cash flows, and delayed capital expenditures, directly associated with its grounded MAX fleet and other new aircraft that have not been able to be delivered. In July 2019, the Boeing Company announced a \$4.9 billion after-tax charge for "potential concessions and other considerations to customers for disruptions related to the 737 MAX grounding." In January 2020, the Boeing Company announced an additional pre-tax charge of \$2.6 billion related to "estimated potential concessions and other considerations to customers related to the 737 MAX grounding."

During fourth quarter 2019, the Company entered into a Memorandum of Understanding with Boeing to compensate Southwest for financial damages incurred during 2019 related to the grounding of the MAX. The terms of the agreement are confidential, but are intended to provide for a substantial portion of the Company's financial damages associated with both the 34 MAX aircraft that were grounded as of March 13, 2019, as well as the 41 additional MAX aircraft the Company was scheduled to receive (28 owned MAX from Boeing and 13 leased MAX from third parties) from March 13, 2019 through December 31, 2019. In accordance with applicable accounting principles, the Company will account for substantially all of the proceeds received from Boeing as a reduction in cost basis spread across both the existing 31 owned MAX in the Company's fleet, plus the Company's future firm aircraft deliveries as of the date of the agreement. No material financial impacts of the agreement were realized in the Company's earnings during fourth quarter or the year ended December 31, 2019. Amounts received in cash from Boeing are reflected within Investing Activities in the Consolidated Statement of Cash Flows for the year ended December 31, 2019. Amounts agreed to but not yet received are recorded within Accounts and Other Receivables and are also reflected as a Supplemental Noncash Transaction in the Consolidated Statement of Cash Flows. Approximately \$86 million of the amount agreed to has been allocated as a reduction of Flight equipment (for aircraft already in the Company's MAX fleet) and the remainder has been reflected as a reduction of Deposits on flight equipment purchase contracts, within the Consolidated Balance Sheet as of December 31, 2019.

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, 2019 and 2018, 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, 2019, 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, 2019 and 2018, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2019, 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, 2019, 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 3, 2020 expressed an unqualified opinion thereon.

Adoption of New Accounting Standards

As discussed in Note 2 to the consolidated financial statements, the Company changed its method of accounting for its leases in 2019 due to the modified retrospective adoption of ASU 2016-02, *Leases (Topic 842)*, and the Company changed its method of accounting for financial derivative instruments in 2018 due to the modified retrospective adoption of ASU 2017-12, *Targeted Improvements to Accounting for Hedging Activities*.

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.

Critical audit matters

The critical audit matters communicated below are matters arising from the current period audit of the financial statements that were communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

Southwest Rapid Rewards loyalty program spoilage

Description of the Matter As explained in Notes 1 and 5 to the consolidated financial statements, the Company recognizes revenue associated with award flights taken by Southwest Rapid Rewards loyalty program members upon the redemption of loyalty points. The Company estimates the portion of loyalty points that will not be redeemed (spoilage) in estimating the revenue to recognize each period. The Company uses a predictive statistical model that considers the member's past behavior, as well as several other factors related to the member's account that management believes are expected to be indicative of the likelihood of future point redemption, to estimate the amount of spoilage. These factors include, but are not limited to, tenure with the program, points accrued in the program, and points redeemed in the program.

Auditing the Company's estimate of spoilage for loyalty points requires significant judgment due to the complexity of the predictive statistical model and the subjectivity related to the assumptions that are used by management to estimate the likelihood of a member's future point redemption. Additionally, due to the magnitude of the Company's liability for loyalty benefits, changes in customer behavior and/or expected future redemption patterns could result in significant variations in the amount of passenger revenue recognized.

How We Addressed the Matter in Our Audit We obtained an understanding, evaluated the design and tested the operating effectiveness of controls over management's determination of the spoilage estimate, including the statistical model, significant underlying assumptions selected by management and the data inputs used in the statistical model.

To test the Company's use of the predictive statistical model, among other procedures, we involved our internal specialists to assist in our evaluation of the Company's methodology and the predictive factors described above. Our internal specialists also performed corroborative calculations of the resulting estimated spoilage rates. Additionally, we tested the completeness and accuracy of the data used in the predictive statistical model.

Valuation of financial derivative instruments

Description of the Matter As explained in Notes 1, 10, and 11 to the financial statements, the Company's fuel derivative instruments consist of over-the-counter contracts, which are not traded on a public exchange and require the Company to estimate their fair values. The fair value of fuel derivative option contracts are determined using option pricing models with inputs about commodity prices, strike prices, risk-free interest rates, term 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 fair value measures. The Company analyzes volatility information for reasonableness and compares it to similar information received from external sources. The fair value of the option contracts considers both the intrinsic value and any remaining time value associated with the derivatives that have not settled. Auditing the fair value measurement of fuel option contracts is complex and requires significant judgment in order to evaluate the application of the option pricing model and evaluating the unobservable input of implied volatility used in the fair value measurement of the Company's fuel option contracts.

How We Addressed the Matter in Our Audit We obtained an understanding, evaluated the design and tested the operating effectiveness of controls over the Company's process to calculate the fair value of fuel option derivative contracts, including controls that related to the volatility input.

Among other procedures, we involved internal valuation specialists to assist in the testing of the significant inputs in the option pricing model by comparing the market data inputs, including volatility, to external sources. With the support of our specialists, we also tested the application of and the computational accuracy of the option pricing model by performing independent corroborative calculations. Additionally, we compared the Company's fuel option contract valuations to the counterparty valuations, which were independently obtained as part of our audit procedures.

/s/ Ernst & Young LLP

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

Dallas, Texas

February 3, 2020

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, 2019, 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, 2019, 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, 2019 and 2018, 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, 2019, and the related notes (collectively referred to as the "financial statements") of the Company and our report dated February 3, 2020 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 3, 2020

QUARTERLY FINANCIAL DATA
(unaudited)

(in millions except per share amounts)	Three months ended			
	March 31	June 30	Sept. 30	Dec. 31
2019				
Operating revenues	\$ 5,149	\$ 5,909	\$ 5,639	\$ 5,729
Operating income	505	968	819	665
Income before income taxes	504	968	819	666
Net income	387	741	659	514 (a)
Net income per share, basic	0.70	1.37	1.24	0.98 (a)
Net income per share, diluted	0.70	1.37	1.23	0.98 (a)
	March 31	June 30	Sept. 30	Dec. 31
2018				
Operating revenues	\$ 4,944	\$ 5,742	\$ 5,575	\$ 5,704
Operating income	616	972	798	820
Income before income taxes	602	960	786	817
Net income	463	733	615	654
Net income per share, basic	0.79	1.27	1.08	1.17
Net income per share, diluted	0.79	1.27	1.08	1.17

(a) In addition to the ongoing impact of the Boeing 737 MAX aircraft ("MAX") grounding that impacted all four quarters of 2019, fourth quarter 2019 also included the impact of the pre-tax \$124 million discretionary, special profitsharing award accrual authorized by the Company's Board of Directors during fourth quarter 2019 for compensation received from Boeing related to the Company's estimated 2019 financial damages related to the grounding of the Boeing 737 MAX. See Note 16 to the Consolidated Financial Statements for further information on the MAX groundings. The impact of this accrual resulted in a decrease to Net income of approximately \$97 million and reduced Basic and Diluted net income per share by approximately \$.18 for the fourth quarter 2019.