

Item 8. Financial Statements and Supplementary Data

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

	December 31, 2021	December 31, 2020
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 12,480	\$ 11,063
Short-term investments	3,024	2,271
Accounts and other receivables	1,357	1,130
Inventories of parts and supplies, at cost	537	414
Prepaid expenses and other current assets	638	295
Total current assets	18,036	15,173
Property and equipment, at cost:		
Flight equipment	21,226	20,877
Ground property and equipment	6,342	6,083
Deposits on flight equipment purchase contracts	—	305
Assets constructed for others	6	309
	27,574	27,574
Less allowance for depreciation and amortization	12,732	11,743
	14,842	15,831
Goodwill	970	970
Operating lease right-of-use assets	1,590	1,892
Other assets	882	722
	<u>\$ 36,320</u>	<u>\$ 34,588</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,282	\$ 931
Accrued liabilities	1,624	2,259
Current operating lease liabilities	239	306
Air traffic liability	5,566	3,790
Current maturities of long-term debt	453	220
Total current liabilities	9,164	7,506
Long-term debt less current maturities	10,274	10,111
Air traffic liability - noncurrent	2,159	3,343
Deferred income taxes	1,770	1,634
Construction obligation	—	309
Noncurrent operating lease liabilities	1,315	1,562
Other noncurrent liabilities	1,224	1,247
Stockholders' equity:		
Common stock, \$1.00 par value; 2,000,000,000 shares authorized; 888,111,634 shares issued in 2021 and 2020	888	888
Capital in excess of par value	4,224	4,191
Retained earnings	15,774	14,777
Accumulated other comprehensive income (loss)	388	(105)
Treasury stock, at cost: 295,991,525 and 297,637,297 shares in 2021 and 2020, respectively	(10,860)	(10,875)
Total stockholders' equity	10,414	8,876
	<u>\$ 36,320</u>	<u>\$ 34,588</u>

See accompanying notes.

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

	Year ended December 31,		
	2021	2020	2019
OPERATING REVENUES:			
Passenger	\$ 14,066	\$ 7,665	\$ 20,776
Freight	187	161	172
Other	1,537	1,222	1,480
Total operating revenues	15,790	9,048	22,428
OPERATING EXPENSES, NET:			
Salaries, wages, and benefits	7,743	6,811	8,293
Payroll support and voluntary Employee programs, net	(2,960)	(967)	—
Fuel and oil	3,310	1,849	4,347
Maintenance materials and repairs	854	750	1,223
Landing fees and airport rentals	1,456	1,240	1,363
Depreciation and amortization	1,272	1,255	1,219
Other operating expenses	2,394	1,926	3,026
Total operating expenses, net	14,069	12,864	19,471
OPERATING INCOME (LOSS)	1,721	(3,816)	2,957
OTHER EXPENSES (INCOME):			
Interest expense	467	349	118
Capitalized interest	(36)	(35)	(36)
Interest income	(13)	(32)	(90)
Other (gains) losses, net	(22)	158	8
Total other expenses (income)	396	440	—
INCOME (LOSS) BEFORE INCOME TAXES	1,325	(4,256)	2,957
PROVISION (BENEFIT) FOR INCOME TAXES	348	(1,182)	657
NET INCOME (LOSS)	\$ 977	\$ (3,074)	\$ 2,300
NET INCOME (LOSS) PER SHARE, BASIC	\$ 1.65	\$ (5.44)	\$ 4.28
NET INCOME (LOSS) PER SHARE, DILUTED	\$ 1.61	\$ (5.44)	\$ 4.27

See accompanying notes.

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

	Year ended December 31,		
	2021	2020	2019
NET INCOME (LOSS)	\$ 977	\$ (3,074)	\$ 2,300
Unrealized gain (loss) on fuel derivative instruments, net of deferred taxes of \$142, \$2, and (\$16)	469	4	(53)
Unrealized gain (loss) on interest rate derivative instruments, net of deferred taxes of \$2, (\$8), and (\$8)	7	(25)	(25)
Unrealized gain (loss) on defined benefit plan items, net of deferred taxes of \$25, (\$15), and (\$9)	84	(48)	(29)
Other, net of deferred taxes of (\$13), \$7, and \$8	(47)	25	26
OTHER COMPREHENSIVE INCOME (LOSS)	\$ 513	\$ (44)	\$ (81)
COMPREHENSIVE INCOME (LOSS)	<u>\$ 1,490</u>	<u>\$ (3,118)</u>	<u>\$ 2,219</u>

See accompanying notes.

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

	Year ended December 31, 2021, 2020, and 2019					
	Common Stock	Capital in excess of par value	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	Total
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	—	—	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, \$0.700 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
Repurchase of common stock	—	—	—	—	(451)	(451)
Issuance of common stock, net of issuance costs	80	2,144	—	—	—	2,224
Issuance of common and treasury stock pursuant to Employee stock plans	—	17	—	—	17	34
Share-based compensation	—	17	—	—	—	17
Cash dividends, \$0.180 per share	—	—	(94)	—	—	(94)
Stock warrants	—	40	—	—	—	40
Equity feature of convertible notes, net of issuance costs	—	392	—	—	—	392
Comprehensive loss	—	—	(3,074)	(44)	—	(3,118)
Balance at December 31, 2020	\$ 888	\$ 4,191	\$ 14,777	\$ (105)	\$ (10,875)	\$ 8,876
Cumulative effect of adopting Accounting Standards Update No. 2016-01, Financial Instruments	—	—	20	(20)	—	—
Issuance of common and treasury stock pursuant to Employee stock plans	—	22	—	—	15	37
Share-based compensation	—	58	—	—	—	58
Stock warrants	—	45	—	—	—	45
Equity feature of partial extinguishment of convertible notes	—	(92)	—	—	—	(92)
Comprehensive income	—	—	977	513	—	1,490
Balance at December 31, 2021	\$ 888	\$ 4,224	\$ 15,774	\$ 388	\$ (10,860)	\$ 10,414

See accompanying notes.

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

	Year ended December 31,		
	2021	2020	2019
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss)	\$ 977	\$ (3,074)	\$ 2,300
Adjustments to reconcile net income (loss) to cash provided by (used in) operating activities:			
Depreciation and amortization	1,272	1,255	1,219
Impairment of long-lived assets	12	32	—
Unrealized/realized (gain) loss on fuel derivative instruments	(15)	15	—
Deferred income taxes	(21)	(716)	(55)
Gain on sale-leaseback transactions	—	(222)	—
Loss on partial extinguishment of convertible notes	28	—	—
Changes in certain assets and liabilities:			
Accounts and other receivables	(701)	(294)	(94)
Other assets	75	415	239
Accounts payable and accrued liabilities	38	231	298
Air traffic liability	591	1,623	440
Other liabilities	(103)	(306)	(277)
Cash collateral received from derivative counterparties	141	9	25
Other, net	28	(95)	(108)
Net cash provided by (used in) operating activities	2,322	(1,127)	3,987
CASH FLOWS FROM INVESTING ACTIVITIES:			
Capital expenditures	(505)	(515)	(1,027)
Supplier proceeds	—	428	400
Proceeds from sale-leaseback transactions	—	815	—
Assets constructed for others	(6)	—	—
Purchases of short-term investments	(5,824)	(5,080)	(2,122)
Proceeds from sales of short-term and other investments	5,071	4,336	2,446
Net cash used in investing activities	(1,264)	(16)	(303)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Issuance of common stock	—	2,294	—
Proceeds from issuance of long-term debt	—	5,622	—
Proceeds from term loan credit facility	—	3,683	—
Proceeds from revolving credit facility	—	1,000	—
Proceeds from convertible notes	—	2,300	—
Proceeds from Payroll Support Program loan and warrants	1,136	1,016	—
Proceeds from Employee stock plans	51	48	40
Repurchase of common stock	—	(451)	(2,000)
Payments of long-term debt and finance lease obligations	(612)	(839)	(615)
Payments of term loan credit facility	—	(3,683)	—
Payments of revolving credit facility	—	(1,000)	—
Payments of cash dividends	—	(188)	(372)
Payments of terminated interest rate derivative instruments	—	(59)	—
Payments for repurchases and conversions of convertible debt	(293)	—	—
Capitalized financing items	—	(134)	—
Other, net	77	49	(43)
Net cash provided by (used in) financing activities	359	9,658	(2,990)
NET CHANGE IN CASH AND CASH EQUIVALENTS	1,417	8,515	694
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	11,063	2,548	1,854
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 12,480	\$ 11,063	\$ 2,548
CASH PAYMENTS FOR:			
Interest, net of amount capitalized	\$ 336	\$ 212	\$ 88
Income taxes	\$ 445	\$ 19	\$ 779
SUPPLEMENTAL DISCLOSURE OF NONCASH TRANSACTIONS:			
Flight equipment acquired against supplier credit memo	\$ 569	\$ —	\$ —
Assets constructed for others	\$ 309	\$ 145	\$ 65
Supplier receivables	\$ —	\$ —	\$ 428
Remeasurement of right-of-use asset and lease liability	\$ 343	\$ —	\$ —

See accompanying notes.

Southwest Airlines Co.
Notes to Consolidated Financial Statements

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

Southwest Airlines Co. (the "Company" or "Southwest") 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., the former parent company of AirTran Airways, Inc., and Triple Crown Assurance Co., an insurance captive. The accompanying Consolidated Financial Statements include the results of operations and cash flows for all periods presented and all significant inter-entity balances and transactions have been eliminated. The preparation of financial statements in conformity with generally accepted accounting principles in the United States ("GAAP") requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

Cash and Cash Equivalents

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

As of December 31, 2021 and 2020, \$175 million and \$34 million, respectively, 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 for either period. 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 11 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 and other investments for the security relinquished, and Purchases of short-term 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 (Loss). 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 initially recorded at cost and are evaluated for collectability in every period. They primarily consist of the amounts due from the Company's business partners and other suppliers, amounts due from credit card companies associated with sales of tickets for future travel, amounts due from business partners in

the Company's loyalty program, and tax receivables from overpayment or net operating losses that are allowed to be carried back to prior periods to claim refunds against prior taxes paid. See Note 16 for further information. The allowance for doubtful accounts was immaterial at December 31, 2021 and 2020. In addition, the provision for doubtful accounts and write-offs for 2021, 2020, and 2019 were each immaterial.

Inventories

Inventories primarily consist of aircraft fuel and 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, 2021, and 2020. In addition, the Company's provision for obsolescence and write-offs for 2021, 2020, and 2019 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 5 for further information.

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 group are less than the carrying amounts of the asset group 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 group, a significant change in the long-lived asset group's physical condition, and operating or cash flow losses associated with the use of the long-lived asset group. If an asset group is deemed to be impaired, an impairment loss is recorded for the excess of the asset group's book value in relation to its estimated fair value. During 2021 and 2020, the Company recorded impairment charges of \$12 million and \$32 million, respectively, associated with the accelerated retirement of 8 and 20 of its 737-700 aircraft.

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 was made upon adoption, per the provisions of the Accounting Standards Codification ("ASC") 842. 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 non-lease 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 (Loss) as incurred.

The Company has maintenance agreements related to certain 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. 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 intangible assets under either a qualitative or quantitative approach. Under a qualitative approach, the Company considers various market factors, including applicable key assumptions also used in the quantitative assessment 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 or reporting unit goodwill is impaired, the quantitative approach is used to assess the asset or reporting unit fair value and the amount of the impairment. Under a quantitative approach, the fair value of the Company's indefinite-lived intangible asset or reporting unit is calculated based on key market participant assumptions. If the indefinite-lived intangible 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. If the reporting unit carrying value exceeds the reporting unit fair value calculated using the quantitative approach, an impairment charge is recorded for the difference between fair value and carrying value, limited to the amount of goodwill in the reporting unit. The Company's 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. Indefinite lived slots of \$295 million are included as a component of Other assets in the Company's Consolidated Balance Sheet, as of December 31, 2021 and 2020.

The Company applied the qualitative approach during its 2021 impairment tests, and no impairment was determined to exist for Goodwill or indefinite-lived intangible assets.

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 in proportion to the pattern of flights taken by the Customers, once the flight date has lapsed. 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 breakage 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. However, during 2020, the Company extended the expiration dates for a significant amount of tickets and funds beyond its normal twelve months. Breakage estimates are based on the Company's Customers' historical travel behavior as well as assumptions about the Customers' future travel behavior. Assumptions about the Customers' future travel behavior 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. Given the unprecedented amount of 2020 and 2021 Customer flight cancellations and the amount of flight credits provided, the Company expects additional variability in the amount of breakage revenue recorded in future periods, as the estimates of the portion of sold tickets that will expire unused may differ from historical experience. See Note 6 for further information.

Approximately \$475 million, approximately \$184 million, and approximately \$615 million of the Company's Operating revenues in 2021, 2020, and 2019, respectively, were attributable to foreign operations. The remainder of the Company's Operating revenues, approximately \$15.3 billion, approximately \$8.9 billion, and approximately \$21.8 billion in 2021, 2020, and 2019, 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 breakage 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 6 for further information.

Advertising

Advertising costs are charged to expense as incurred. Advertising and promotions expense for the years ended December 31, 2021, 2020, and 2019 was \$185 million, \$156 million, and \$212 million, respectively, and is included as a component of Other operating expense in the accompanying Consolidated Statement of Income (Loss).

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 10 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 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. These interest rate hedges are appropriately designated 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.

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 11 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 \$886 million and \$697 million at December 31, 2021, and 2020, respectively. Computer software depreciation expense was \$213 million, \$203 million, and \$177 million for the years ended December 31, 2021, 2020, and 2019, respectively, and is included as a component of Depreciation and amortization expense in the accompanying Consolidated Statement of Income (Loss). 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 2021, 2020, or 2019.

Insurance Reserves

The Company uses a combination of insurance and self-insurance mechanisms, including a wholly-owned captive insurance entity and participation in a reinsurance treaty, to provide for the potential liabilities associated with certain risks, including workers' compensation, healthcare benefits, general liability, and aviation liability.

Liabilities associated with the risks that are retained by the Company are not discounted and are estimated, in part, by considering historical claims experience, demographics, exposure and severity factors and other actuarial assumptions.

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 (loss) 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 (Loss). There were no material amounts recorded for penalties and interest related to uncertain tax positions for all years presented. See Note 15 for further information.

Concentration Risk

Approximately 82 percent of the Company's full-time equivalent Employees are unionized and are covered by collective-bargaining agreements. A portion of the Company's unionized Employees, including its Pilots, Flight Attendants, Customer Service Agents, Ramp Agents, Dispatchers, Aircraft Appearance Technicians, and Meteorologists, which had contracts that became amendable on or before December 31, 2021, are in discussions on labor agreements. Those unionized Employee groups in discussions represent approximately 77 percent of the Company's full-time equivalent Employees as of December 31, 2021.

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 11 for further information.

As of December 31, 2021, 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. On November 18, 2020, the FAA rescinded the emergency order and issued official requirements to enable U.S. airlines to return the MAX to service. The Company returned the MAX to revenue service on March 11, 2021, after the Company met all FAA requirements and its Pilots completed updated, MAX-related training.

Boeing no longer manufactures versions of the 737 other than the MAX family of aircraft. If the MAX aircraft were to again become 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 17 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, none of which currently extend beyond October 31, 2030. Some of these agreements automatically renew on an annual basis, unless either party objects to such extension. None of these agreements are more than 10 years in length. The Company believes the financial benefits generated by the exclusivity aspects of these arrangements outweigh the risks involved with such agreements.

2. WORLDWIDE PANDEMIC

As a result of the rapid spread of the novel coronavirus, COVID-19, throughout the world, including into the United States, on March 11, 2020, the World Health Organization classified the virus as a pandemic. The speed with which the effects of the COVID-19 pandemic changed the U.S. economic landscape, outlook, and in particular the travel industry, was swift and unexpected. The Company saw a negative impact on bookings for future travel throughout 2020. The Company proactively canceled a significant portion of its scheduled flights in March 2020 and continued adjusting capacity throughout 2020, as the Company grounded a significant portion of its fleet and operated a significantly reduced portion of its previously scheduled capacity. The Company continued to experience negative impacts to passenger demand and bookings early in 2021 due to the pandemic, in particular with respect to business travel, although as a result of declining reported COVID-19 cases throughout the United States, easing travel restrictions, lifting of business restrictions, and an increase in the number of individuals vaccinated, domestic leisure travel demand and bookings improved during second quarter 2021. In third quarter 2021, the Company experienced softness in bookings and elevated trip cancellations, especially close-in, as a result of the rise in COVID-19 cases associated with the Delta variant. In fourth quarter 2021, the Company experienced increased leisure travel bookings due to holiday demand, despite the surge in COVID-19 cases associated with the Omicron variant. The Company continues to monitor demand for air travel and proactively adjust its published flight schedules and capacity in response.

Since the start of the pandemic, the Company entered into definitive documentation with the United States Department of Treasury ("Treasury") with respect to payroll funding support ("Payroll Support") pursuant to three separate Payroll Support programs: the "PSP1 Payroll Support Program" in April 2020 under the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"); the "PSP2 Payroll Support Program" in January 2021 under the Consolidated Appropriations Act, 2021; and the "PSP3 Payroll Support Program" in April 2021 under the American Rescue Plan Act of 2021.

As consideration for each of these Payroll Support programs, the Company issued a promissory note in favor of Treasury and entered into a warrant agreement with Treasury, pursuant to which the Company agreed to issue warrants to purchase common stock of the Company to Treasury, subject to adjustment pursuant to the terms of the warrants. Under each of the three Payroll Support programs, funds were received in multiple disbursements. Upon each initial disbursement of Payroll Support under each of the three Payroll Support programs, the Company provided a promissory note and issued warrants to Treasury. Upon each subsequent disbursement of Payroll Support under each of the three Payroll Support programs, (i) the principal amount of the applicable promissory

note was increased and (ii) the Company issued additional warrants to Treasury. The following table provides the details from each of these programs:

(in millions, except shares in thousands)	Grant	Promissory Note	Warrants	Total Payroll Support Proceeds	Warrants (shares)
PSP1 Payroll Support Program					
April 21, 2020	\$ 1,152	\$ 459	\$ 18	\$ 1,630	1,258
May 29, 2020	448	196	8	652	536
June 30, 2020	448	196	9	652	536
July 30, 2020	225	97	3	326	268
September 30, 2020	64	28	2	94	78
	\$ 2,337	\$ 976	\$ 40	\$ 3,354	2,676
PSP2 Payroll Support Program					
January 15, 2021	\$ 625	\$ 229	\$ 9	\$ 864	495
March 5, 2021	591	259	14	864	560
April 23, 2021	177	78	4	259	168
	\$ 1,393	\$ 566	\$ 27	\$ 1,987	1,223
PSP3 Payroll Support Program					
April 23, 2021	\$ 670	\$ 248	\$ 9	\$ 926	424
June 3, 2021	640	278	9	926	475
	\$ 1,310	\$ 526	\$ 18	\$ 1,852	899
Total	\$ 5,040	\$ 2,068	\$ 85	\$ 7,193	4,798

The promissory note under the PSP1 Payroll Support Program ("PSP1 Note") matures in full on April 19, 2030, and is subject to mandatory prepayment requirements in connection with certain change of control triggering events that may occur prior to its maturity. Amounts outstanding under the PSP1 Note bear interest at a rate of 1.00 percent before April 20, 2025, and afterwards, at a rate equal to the Secured Overnight Financing Rate ("SOFR") or other benchmark replacement rate consistent with customary market conventions plus a margin of 2.00 percent. The PSP1 Note contains customary representations and warranties and events of default. Each warrant issued pursuant to the PSP1 Payroll Support Program is exercisable at a strike price of \$36.47 per share of common stock and will expire on the fifth anniversary of the issue date of such warrant.

The promissory note under the PSP2 Payroll Support Program ("PSP2 Note") matures in full on January 15, 2031, and is subject to mandatory prepayment requirements in connection with certain change of control triggering events that may occur prior to its maturity. Amounts outstanding under the PSP2 Note bear interest at a rate of 1.00 percent before January 15, 2026, and, afterwards, at a rate equal to the SOFR or other benchmark replacement rate consistent with customary market conventions plus a margin of 2.00 percent. The PSP2 Note contains customary representations and warranties and events of default. Each warrant issued pursuant to the PSP2 Payroll Support Program is exercisable at a strike price of \$46.28 per share of common stock and will expire on the fifth anniversary of the issue date of such warrant.

The promissory note under the PSP3 Payroll Support Program ("PSP3 Note") matures in full on April 23, 2031, and is subject to mandatory prepayment requirements in connection with certain change of control triggering events that may occur prior to its maturity. Amounts outstanding under the PSP3 Note bear interest at a rate of 1.00 percent before April 23, 2026, and afterwards, at a rate equal to the SOFR or other benchmark replacement rate consistent with customary market conventions plus a margin of 2.00 percent. The PSP3 Note contains customary representations and warranties and events of default. Each warrant issued pursuant to the PSP3 Payroll Support

Program is exercisable at a strike price of \$58.51 per share of common stock and will expire on the fifth anniversary of the issue date of such warrant.

In connection with the receipt of Payroll Support, the Company is subject to certain restrictions, including the elimination of share repurchases and dividends through September 30, 2022; and limits on executive compensation until April 1, 2023.

Under each of the three Payroll Support programs, funds received were used solely to pay qualifying employee salaries, wages, and benefits. As of December 31, 2021, all grant portions of the Payroll Support programs received had been allocated and classified as a contra-expense line item in the Consolidated Statement of Income (Loss). Although there is no directly applicable U.S. GAAP guidance related to such government assistance received, the Company analogized its facts and circumstances, and has utilized the accounting principles within International Accounting Standards 20, Accounting for Government Grants and Disclosure of Government Assistance, with respect to the Payroll Support funds received. The Company has an option to prepay the promissory notes at any time without premium or penalty. Warrants will be settled through net share settlement or net cash settlement, at the Company's option. The Company has also granted Treasury certain demand underwritten offering and piggyback registration rights with respect to the warrants and the underlying common stock. The warrants do not have voting rights and include adjustments for below market issuances, payment of dividends, and other customary anti-dilution provisions.

On June 1, 2020, the Company announced Voluntary Separation Program 2020 ("Voluntary Separation Program"), a voluntary separation program that allowed eligible Employees the opportunity to voluntarily separate from the Company in exchange for severance, medical/dental coverage for a specified period of time, and travel privileges based on years of service. A total of over 4,200 Employees initially elected to participate in Voluntary Separation Program.

In conjunction with Voluntary Separation Program, the Company also offered certain contract Employees the option to take voluntary Extended Emergency Time Off ("Extended ETO"), for periods between six and 18 months, with the exception of Pilots, who could elect to take Extended ETO for periods up to five years, all subject to early recalls. Approximately 12,000 Employees participated in the Extended ETO program in 2020 and 2021 combined. During 2021, approximately 11,400 Employees returned from the Extended ETO program and less than 250 Employees remained on Extended ETO as of December 31, 2021. The Company expects all remaining Employees on Extended ETO to be recalled in first quarter 2022. Contract employees who elected to take Extended ETO for periods between 12 and 18 months and had 10 or more years of service were given the opportunity to convert to the Voluntary Separation Program beginning on September 1, 2020, until up to 90 days before the end of their respective Extended ETO term. Approximately 360 Employees elected this conversion option during 2021.

The purpose of Voluntary Separation Program and Extended ETO was to maintain a reduced workforce to operate at reduced capacity relative to the Company's operations prior to the COVID-19 pandemic. In accordance with the accounting guidance in Accounting Standards Codification Topic 712 (Compensation — Nonretirement Postemployment Benefits), the Company accrued charges related to the special termination benefits described above upon Employees accepting Voluntary Separation Program or Extended ETO offers. The Company accrued expenses totaling \$1.4 billion for its Voluntary Separation Program and Extended ETO program in 2020, which are being reduced as program benefits are paid. For both the Voluntary Separation Program and Extended ETO programs combined, approximately \$446 million of the liability balances were relieved during 2021 through payments to Employees, leaving a balance of \$328 million as of December 31, 2021. During 2021, the Company determined that it was no longer probable that a portion of the Employees on Extended ETO would remain on such leave for their entire elected term. Therefore, a portion of the accruals previously recorded were reversed, resulting in a net \$140 million credit to expense during 2021. Both the initial charge and the partial reversal were classified within Payroll support and voluntary Employee programs, net, in the accompanying Consolidated Statement of Income (Loss), and are in addition to the allocation of the PSP2 Payroll Support Program and PSP3 Payroll Support Program funds utilized to fund salaries, wages, and benefits, which totaled \$2.7 billion for the year ended December 31, 2021.

In response to flight schedule adjustments due to the effects of the COVID-19 pandemic, a number of aircraft were taken out of the Company's schedule beginning in late March 2020, and placed in short-term storage, as well as some in a longer term storage program. As of December 31, 2021, six aircraft remained in storage, and given the expectation that this storage was temporary in nature, the Company has continued to record depreciation expense associated with them.

3. NEW ACCOUNTING PRONOUNCEMENTS AND ACCOUNTING CHANGES

On November 17, 2021, the Financial Accounting Standards Board (the "FASB") issued ASU 2021-10, Government Assistance (Topic 832): Disclosures by Business Entities about Government Assistance. The new standard increases transparency of government assistance by focusing on the types of assistance given, an entity's accounting for the assistance, and the effect of the assistance on the entity's financial statements to allow for more comparable information for investors and other financial statement users. This standard is effective for all entities under the scope for financial statements issued for annual periods beginning after December 15, 2021, but early adoption is permitted. The Company adopted the standard early as of December 31, 2021. See Note 2 for further information on the Company's treatment of government assistance received.

On May 3, 2021, the FASB issued ASU 2021-04, Earnings Per Share (Topic 260), Debt—Modifications and Extinguishments (Subtopic 470-50), Compensation—Stock Compensation (Topic 718), and Derivatives and Hedging—Contracts in Entity's Own Equity (Subtopic 815-40): Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options. This new standard provides clarification and reduces diversity in an issuer's accounting for modifications or exchanges of freestanding equity-classified written call options (such as warrants) that remain equity classified after modification or exchange. This standard is effective for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years. Under this standard, issuers should apply the new standard prospectively to modifications or exchanges occurring after the effective date of the new standard. Early adoption is permitted, including adoption in an interim period. If an issuer elects to early adopt the new standard in an interim period, the guidance should be applied as of the beginning of the fiscal year that includes that interim period. The Company is evaluating this new standard, but does not expect it to have a material impact on the Company's financial statements or disclosures.

On January 7, 2021, the FASB issued ASU No. 2021-01, Reference Rate Reform (Topic 848). This new standard provides optional temporary guidance for entities transitioning away from London Interbank Offered Rate ("LIBOR") to new reference interest rates so that derivatives affected by the discounting transition are explicitly eligible for certain optional expedients and exceptions with Topic 848. These amendments do not apply to any contract modifications made after December 31, 2022, any new hedging relationships entered into after December 31, 2022, or to existing hedging relationships evaluated for effectiveness existing as of December 31, 2022, that apply certain optional practical expedients. This standard was effective immediately and may be applied (i) on a full retrospective basis as of any date from the beginning of an interim period that includes or is subsequent to March 12, 2020, or (ii) on a prospective basis to new modifications from any date within an interim period that includes or is subsequent to the date of the issuance of a final update, up to the date that financial statements are available to be issued. The Company had no material LIBOR-related contract modifications during the year ended December 31, 2021.

On August 5, 2020, the FASB issued ASU No. 2020-06, Debt—Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging—Contracts in Entity's Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity's Own Equity. This new standard reduces the number of accounting models for convertible debt instruments and convertible preferred stock, makes targeted improvements to the disclosures for convertible instruments and earnings-per-share (EPS) guidance, and amends the guidance for the derivatives scope exception for contracts in an entity's own equity to reduce form-over-substance-based accounting conclusions. This standard is effective for fiscal years beginning after December 15, 2021 and the Company will adopt this standard as of January 1, 2022, utilizing the modified retrospective method. Under the modified approach, the Company will apply the guidance to all financial instruments that are outstanding as of the

beginning of the year of adoption with the cumulative effect recognized as an adjustment to the opening balance of retained earnings. Upon adoption, the Company will reclassify the remaining equity component, estimated at \$300 million, from Additional paid-in capital to Long-term debt associated with its convertible notes, and no longer record amortization of the debt discount to Interest expense. The cumulative effect from amortization of the debt discount that has been recorded to Interest expense, offset by reductions to Capital in excess of par value related to the requisition of the equity component through repurchases, will result in an estimated \$56 million adjustment to the opening balance of retained earnings upon adoption. The computation of diluted net income (loss) per share will be affected in the numerator as the Company will no longer record the debt discount amortization in Interest expense and may have to add back Interest expense to the numerator. The denominator could also be affected as the Company will be required to use the if-converted method to calculate diluted shares, which assumes all shares to have been converted at the beginning of the period.

4. NET INCOME (LOSS) PER SHARE

The following table sets forth the computation of basic and diluted net income (loss) per share (in millions except per share amounts). An immaterial number of shares related to the Company's restricted stock units, stock warrants, and convertible notes were excluded from the denominator for the fiscal year ended December 31, 2020, because inclusion of such shares would be antidilutive.

	Year ended December 31,		
	2021	2020	2019
NUMERATOR:			
Net income (loss)	\$ 977	\$ (3,074)	\$ 2,300
DENOMINATOR:			
Weighted-average shares outstanding, basic	592	565	538
Dilutive effects of convertible notes (a)	15	—	—
Dilutive effects of stock warrants	1	—	—
Dilutive effect of restricted stock units	1	—	1
Adjusted weighted-average shares outstanding, diluted	609	565	539
NET INCOME (LOSS) PER SHARE:			
Basic	\$ 1.65	\$ (5.44)	\$ 4.28
Diluted	\$ 1.61	\$ (5.44)	\$ 4.27

(a) Because the Company intends to settle conversions by paying cash up to the principal amount of the convertible notes, with any excess conversion value settled in cash or shares of common stock, the convertible notes are being accounted for using the treasury stock method for the purposes of Net income (loss) per share. Using this method, the denominator will be affected when the average share price of the Company's common stock for a given period is greater than the conversion price of approximately \$38.48 per share, and the Company reports Net income for the given period. For the year ended December 31, 2021, the average market price of the Company's common stock exceeded this conversion price per share and as such, the common shares underlying the convertible notes were included in the diluted calculation. See Note 7 for further information on the convertible notes.

5. COMMITMENTS AND CONTINGENCIES

Commitments

The Company has contractual obligations and commitments primarily with regard to future purchases of aircraft, repayment of debt (see Note 7), and lease arrangements (see Note 8). During the year ended December 31, 2021, the Company leased nine new Boeing 737 MAX 8 ("8") aircraft. The Company had firm orders in place with Boeing

for 130 -8 aircraft and 264 737 MAX 7 ("-7") aircraft, as well as options for 238 -8 aircraft, as of December 31, 2021. See Note 17 for further information on the Company's MAX aircraft.

Based on the Company's existing agreement with Boeing, capital commitments associated with its firm orders as of December 31, 2021, were: \$1.8 billion in 2022, \$1.6 billion in 2023, \$1.1 billion in 2024, \$837 million in 2025, \$961 million in 2026, and \$6.9 billion thereafter. In addition, subsequent to December 31, 2021, and through February 3, 2022, the Company has exercised 12 -8 options for delivery in 2022 and 12 -7 options for delivery in 2023, resulting in additional capital commitments associated with firm orders of \$474 million and \$254 million in 2022 and 2023, respectively.

Los Angeles International Airport

In October 2017, the Company executed a lease agreement with Los Angeles World Airports ("LAWA") (the "T1.5 Lease"). Under the T1.5 Lease, the Company oversaw and managed the design, development, financing, construction, and commissioning of a passenger processing facility between Terminals 1 and 2 (the "Terminal 1.5 Project"). The Terminal 1.5 Project included ticketing, baggage claim, passenger screening, and a bus gate. Construction on the Terminal 1.5 Project began during third quarter 2017 and was substantially completed at December 31, 2020. The project final cost was approximately \$410 million. During second quarter 2021, LAWA repaid the outstanding loan and purchased the remaining completed assets for accounting purposes, at which time the Terminal 1.5 Project right-of-use asset and lease liability of \$365 million on the balance sheet were de-recognized in accordance with applicable accounting guidance. This repayment was also reported as a supplemental noncash transaction on the Consolidated Statement of Cash Flows, net of Assets constructed for others additions during the period.

Dallas Love Field

During 2008, the City of Dallas approved the Love Field Modernization Project ("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.

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 bonds issued by LFAMC (the "Series 2010" bonds and the "Series 2012" bonds). Given the Company's guarantee associated with the bonds issued to fund LFMP, the remaining debt service amount was considered a minimum lease payment under the adoption of ASC Topic 842, Leases, and therefore was recorded as a lease liability with a corresponding right-of-use asset within the Company's Consolidated Balance Sheet.

All of the outstanding Series 2010 bonds, in the principal amount of \$310 million, were redeemed by LFAMC on September 28, 2021 (Redemption Date) at the redemption price plus accrued interest of \$7 million. The source of the funds used to pay the principal and interest on the Series 2010 bonds was proceeds from the sale of LFAMC General Airport Revenue Bonds, Series 2021, which also occurred on the Redemption Date. As the Series 2010 bonds have been fully repaid following the Redemption Date, the Company's guarantee associated with the Series 2010 bonds no longer exists. This refinancing transaction was considered a lease modification in accordance with applicable guidance, and the Company's obligation was remeasured as of the transaction date. This remeasurement resulted in a reduction of the Company's right-of-use asset and lease liability in the amount of \$343 million, which has been reflected in the Consolidated Balance Sheet as of December 31, 2021.

As of December 31, 2021, \$79 million of principal remained outstanding associated with the Series 2012 bonds. The net present values of the future principal and interest payments associated with the bonds were \$89 million and

\$433 million as of December 31, 2021 and 2020, respectively, and were reflected as part of the Company's operating lease right-of-use assets and lease obligations in the Consolidated Balance Sheet.

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.

6. 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, 2021, 2020, and 2019:

(in millions)	Year ended December 31,		
	2021	2020	2019
Passenger non-loyalty	\$ 11,377	\$ 6,303	\$ 17,578
Passenger loyalty - air transportation	2,136	1,003	2,487
Passenger ancillary sold separately	553	359	711
Total passenger revenues	\$ 14,066	\$ 7,665	\$ 20,776

Passenger non-loyalty includes all revenues recognized from Passengers for flights purchased 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 associated with award flights taken by loyalty program members upon redemption of loyalty points. Passenger ancillary sold separately includes any revenue 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 mix of fare classes 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 fluctuate.

For points that are expected to remain unused, the Company recognizes breakage 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 breakage expected for points sold to business partners and earned through flight. The Company continues to evaluate expected breakage annually and applies appropriate adjustments in the fourth quarter of each year, or other times, if significant changes in Customer behavior are detected. Changes to breakage 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 the Southwest Airlines brand and access to Rapid Rewards Member lists, licensing and advertising elements, and the use of the Company's resource team. In fourth quarter 2021, Chase and the Company executed a multi-year extension of the Agreement, extending the decades-long relationship between the parties. 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, 2021 and 2020, the components of Air traffic liability, including contract liabilities based on tickets sold and unused flight credits available to the Customer, both of which are net of recorded breakage, and loyalty points available for redemption, within the Consolidated Balance Sheet were as follows:

(in millions)	Balance as of	
	December 31, 2021	December 31, 2020
Air traffic liability - passenger travel and ancillary passenger services	\$ 2,936	\$ 2,686
Air traffic liability - loyalty program	4,789	4,447
Total Air traffic liability	\$ 7,725	\$ 7,133

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, although they remain reusable, for a period of time, in the form of a flight credit that can be applied towards the purchase of future travel. These flight credits are typically created as a result of a prior ticket cancellation or exchange. Rollforwards of the Company's Air traffic liability - loyalty program for the years ended December 31, 2021 and 2020 were as follows (in millions):

	Year ended December 31,	
	2021	2020
Air traffic liability - loyalty program - beginning balance	\$ 4,447	\$ 3,385
Amounts deferred associated with points awarded	2,523	1,958
Revenue recognized from points redeemed - Passenger	(2,136)	(1,003)
Revenue recognized from points redeemed - Other	(45)	(60)
Unused funds converted to loyalty points	—	167
Air traffic liability - loyalty program - ending balance	\$ 4,789	\$ 4,447

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, 2021 and 2020 were as follows (in millions):

	Air traffic liability
Balance at December 31, 2020	\$ 7,133
Current period sales (passenger travel, ancillary services, flight loyalty, and partner loyalty)	14,702
Revenue from amounts included in contract liability opening balances	(2,945)
Revenue from current period sales	(11,165)
Balance at December 31, 2021	\$ 7,725

	Air traffic liability
Balance at December 31, 2019	\$ 5,510
Current period sales (passenger travel, ancillary services, flight loyalty, and partner loyalty)	9,348
Revenue from amounts included in contract liability opening balances	(2,317)
Revenue from current period sales	(5,408)
Balance at December 31, 2020	\$ 7,133

During 2020 and in parts of 2021, the Company experienced a significantly higher number of Customer-driven flight cancellations as a result of the COVID-19 pandemic, including those associated with the Delta variant of the virus. See Note 2 for further information. As a result, the amount of Customer travel funds held in Air traffic liability that are estimated to be redeemed for future travel as of December 31, 2021, remains much higher than historical levels. The amount of such Customer funds represents approximately 16 percent and 28 percent of the total Air traffic liability balance, net of breakage, at December 31, 2021, and December 31, 2020, respectively, compared to approximately 2 percent of the Air traffic liability balance as of December 31, 2019. In order to provide additional flexibility to Customers who hold these funds, the Company has significantly relaxed its previous policies with regards to the time period within which these funds can be redeemed, which is typically twelve months from the original date of purchase. For all Customer travel funds created or that would have otherwise expired

between March 1 and September 7, 2020 associated with flight cancellations, the Company extended the expiration date to September 7, 2022. At December 31 2021, \$1.3 billion of extended Customer travel funds remain in Air traffic liability with a September 7, 2022 expiration date, although the Company has estimated that a portion of those will not be redeemed. The Company has limited data available to predict the occurrence or timing of performance obligation satisfaction on these funds due to certain constraints including, but not limited to, consumer confidence, economic health, vaccines, and uncertainty regarding customer travel fund redemption patterns for funds that exist longer than 12 months as this is unprecedented in Company history. As a result, recognition of these travel funds as flown revenue, refunds, or breakage revenue will likely be more volatile from period to period compared to what previous Customer behavior may indicate, as cumulative revenue recognized is constrained to amounts that are not probable of being reversed.

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, and fares. The entire balance classified as Air traffic liability—noncurrent relates to loyalty points that were estimated to be redeemed in periods beyond the twelve months following the representative balance sheet date. Based on historical experience as well as current forecasted redemptions, the Company expects the majority of loyalty points to be redeemed within approximately two years of the date the points are issued.

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, 2021, 2020, and 2019 the Company recognized \$1.4 billion, \$1.1 billion, and \$1.3 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; however, some of these ticket taxes were suspended during 2020 as allowed by the CARES Act. 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.

7. FINANCING ACTIVITIES

(in millions)	December 31, 2021	December 31, 2020
2.75% Notes due 2022	\$ 300	\$ 300
Pass Through Certificates due 2022 - 6.24%	71	137
4.75% Notes due 2023	1,250	1,250
1.25% Convertible Notes due 2025	1,842	1,945
5.25% Notes due 2025	1,550	1,550
Term Loan Agreement payable through 2025	—	119
3.00% Notes due 2026	300	300
Term Loan Agreement payable through 2026	—	159
3.45% Notes due 2027	300	300
5.125% Notes due 2027	2,000	2,000
7.375% Debentures due 2027	116	119
Term Loan Agreement payable through 2028	—	184
2.625% Notes due 2030	500	500
1.000% Payroll Support Program Loan due April 2030 (See Note 2)	976	976
1.000% Payroll Support Program Loan due January 2031 (See Note 2)	566	—
1.000% Payroll Support Program Loan due April 2031 (See Note 2)	526	—
Finance leases	459	542
	<u>\$ 10,756</u>	<u>\$ 10,381</u>
Less current maturities	453	220
Less debt discount and issuance costs	29	50
	<u>\$ 10,274</u>	<u>\$ 10,111</u>

During 2020, the Company entered into agreements with a financing institution to borrow \$125 million (\$121 million, net of fees) secured by four Boeing 737-800 aircraft. These borrowings, which were recorded as a financing transaction in the Company's Consolidated Statement of Cash Flows, and as debt in the accompanying Consolidated Balance Sheet, bore interest at a rate equal to the 3 month LIBOR plus 1.4 percent, and were payable in quarterly installments through September 29, 2025. The Company prepaid the loans in full on December 29, 2021, utilizing available cash on hand.

During 2020, the Company issued \$2.0 billion of unsecured notes due 2027, of which \$1.3 billion was issued June 8, 2020 (the "\$1.3 billion 2027 Notes") and \$700 million was issued July 31, 2020 (the "\$700 million 2027 Notes"). The notes bear interest at 5.125%. Interest is payable semi-annually in arrears on June 15 and December 15, beginning December 15, 2020. The \$700 million 2027 Notes were offered as an additional issuance of the Company's \$1.3 billion 2027 Notes issued on June 8, 2020. The \$700 million 2027 Notes were issued at a premium and this premium has been included within Capitalized financing items in the Consolidated Statement of Cash Flows. A portion of the proceeds from the \$1.3 billion 2027 Notes was used to repay a portion of the outstanding Amended and Restated 364-Day Credit Agreement balance. See below for more information regarding the Amended and Restated 364-Day Credit Agreement.

During 2020, the Company, through special purpose entities, entered into agreements with a financing institution and trusts to borrow \$197 million (\$190 million, net of fees) secured by six Boeing 737-800 aircraft. These borrowings, which were recorded as a financing transaction in the Company's Consolidated Statement of Cash Flows, and as debt in the accompanying Consolidated Balance Sheet, bore interest at a rate equal to the 3 month LIBOR plus 1.4 percent. The special purpose entities were determined to be variable interest entities for which the Company was the primary beneficiary, and therefore were consolidated in the accompanying Consolidated Financial Statements as of December 31, 2020. The Company prepaid the loans in full on December 31, 2021, utilizing available cash on hand.

During 2020, the Company issued \$1.55 billion of unsecured notes due 2025, of which \$1.25 billion was issued May 4, 2020 (the “\$1.25 billion 2025 Notes”) and \$300 million was issued July 31, 2020 (the “\$300 million 2025 Notes”). The notes bear interest at 5.250%. Interest is payable semi-annually in arrears on May 4 and November 4, beginning November 4, 2020. The \$300 million 2025 Notes were offered as an additional issuance of the Company’s \$1.25 billion 2025 Notes issued on May 4, 2020. The \$300 million 2025 Notes were issued at a premium and this premium has been included within Capitalized financing items in the Consolidated Statement of Cash Flows. The proceeds from the \$1.25 billion 2025 Notes were used to repay a portion of the outstanding Amended and Restated 364-Day Credit Agreement balance.

During 2020, the Company issued \$1.25 billion of unsecured notes due 2023, of which \$750 million was issued May 4, 2020 (the “\$750 million 2023 Notes”) and \$500 million was issued June 8, 2020 (the “\$500 million 2023 Notes”). The notes bear interest at 4.750%. Interest is payable semi-annually in arrears on May 4 and November 4, beginning November 4, 2020. The \$500 million 2023 Notes were offered as an additional issuance of the Company’s \$750 million 2023 Notes issued on May 4, 2020. The \$500 million 2023 Notes were issued at a premium and this premium has been included within Capitalized financing items in the Consolidated Statement of Cash Flows. The proceeds from the \$750 million 2023 Notes and a portion of the proceeds of the \$500 million 2023 Notes were used to repay a portion of the outstanding Amended and Restated 364-Day Credit Agreement balance.

On May 1, 2020, the Company completed the public offering of \$2.3 billion aggregate principal amount of 1.250% Convertible Senior Notes due 2025 (the “Convertible Notes”). The Convertible Notes bear interest at a rate of 1.25% and will mature on May 1, 2025. Interest on the notes is payable semi-annually in arrears on May 1 and November 1, beginning November 1, 2020. Upon conversion, the Company will pay or deliver, as the case may be, cash, shares of the Company’s common stock or a combination of cash and shares of common stock, at the Company’s election. The Company intends to settle conversions by paying cash up to the principal amount of the Convertible Notes, with any excess conversion value settled in cash or shares of common stock. The initial conversion rate is 25.9909 shares of common stock per \$1,000 principal amount of Convertible Notes (equivalent to an initial conversion price of approximately \$38.48 per share of common stock).

Upon issuance, the Company bifurcated the Convertible Notes for accounting purposes between a liability component and an equity component utilizing applicable guidance. The liability component was determined by estimating the fair value of a hypothetical issuance of an identical offering excluding the conversion feature of the Convertible Notes. The initial carrying amount of the equity component was calculated as the difference between the liability component and the face amount of the Convertible Notes. During the year ended December 31, 2021, the Company repurchased \$203 million in principal of the Convertible Notes for \$293 million in cash. The Company accounted for these repurchases as a partial debt extinguishment, which resulted in (i) a loss of \$28 million reflected in Other (gains) losses, net, in the accompanying Consolidated Statement of Income (Loss) for the year ended December 31, 2021, (ii) a \$30 million reduction in remaining unamortized debt discount and issuance costs, and (iii) a \$92 million reduction to Capital in excess of par value related to the reacquisition of the equity component in the accompanying Consolidated Balance Sheet. Additionally, an immaterial number of conversions were exercised and settled during 2021. The following table details the equity and liability component recognized related to the Convertible Notes as of December 31, 2021 and 2020:

(in millions)	December 31, 2021	December 31, 2020
Carrying amount of equity component	\$ 311	\$ 403
Liability component:		
Principal amount	\$ 2,097	\$ 2,300
Unamortized debt discount	(255)	(355)
Net carrying amount	\$ 1,842	\$ 1,945

The effective interest rate on the liability component was approximately 5.2 percent for the year ended December 31, 2021. The Company recognized \$110 million of interest expense associated with the Convertible Notes during the year ended December 31, 2021, including \$73 million of non-cash amortization of the debt

discount, \$9 million of non-cash amortization of debt issuance costs, and \$28 million of contractual coupon interest. The unamortized debt issuance costs have historically been recognized as non-cash interest expense based on the 5-year term of the notes, through May 1, 2025, less amounts that were or will be required to be accelerated immediately upon conversion or repurchases. Upon adoption of ASU 2020-06 as of January 1, 2022, the debt discount amortization will cease to be recorded to Interest expense. See Note 3 for further information.

As of December 31, 2021, the if-converted value of the Convertible Notes exceeded the principal amount by \$238 million, using the closing stock price on December 31, 2021. The Convertible Notes did not meet the criteria to be converted as of the date of the financial statements, and thus are classified as Long-term debt in the accompanying Consolidated Balance Sheet as of December 31, 2021.

On March 12, 2020, the Company entered into a \$1.0 billion 364-day term loan credit facility agreement (the “364-Day Credit Agreement”) with a syndicate of lenders identified in the 364-Day Credit Agreement. The 364-Day Credit Agreement was drawn in full on the closing date. On March 30, 2020, the Company amended and restated the 364-Day Credit Agreement (the “Amended and Restated 364-Day Credit Agreement”) with a syndicate of lenders identified in the Amended and Restated 364-Day Credit Agreement to add additional term loan commitments of approximately \$2.3 billion, add an uncommitted accordion increase provision to permit additional term loans in an aggregate amount not to exceed approximately \$417 million, amend the pricing, amend certain covenants, add certain covenants, and provide for the grant of a security interest in certain aircraft and related assets. The Company drew approximately \$2.3 billion under the Amended and Restated 364-Day Credit Agreement on April 1, 2020. On April 24, 2020, the Company drew an additional \$350 million under the \$417 million accordion feature. The Amended and Restated 364-Day Credit Agreement was originally set to mature in full on March 29, 2021. The outstanding Amended and Restated 364-Day Credit Agreement balance was repaid in full in second quarter 2020, and the agreement was terminated.

Concurrently with entering into the Amended and Restated 364-Day Credit Agreement on March 30, 2020, the Company also amended its existing \$1.0 billion revolving credit facility (the “Amended and Restated Revolving Credit Agreement”) to (i) amend the pricing and fees, (ii) amend certain covenants and provisions, (iii) add certain covenants, and (iv) provide for the grant of a security interest in certain aircraft and related assets. In second quarter 2020, the Company repaid in full the \$1.0 billion drawn on the Amended and Restated Revolving Credit Agreement.

On November 23, 2020, the Company amended the Amended and Restated Revolving Credit Agreement to (i) amend the pricing and fees, (ii) amend certain covenants and provisions, (iii) remove a financial covenant, and (iv) amend an exhibit for conforming changes to the compliance certificate (the “Second Amendment”). On July 28, 2021, the Company amended the Amended and Restated Revolving Credit Agreement, as amended by the Second Amendment, to (i) extend the maturity to August 3, 2023; (ii) add a covenant to prohibit the Company from purchasing any equity security of the Company listed on a national securities exchange and payment of dividends or other capital distributions with respect to the common stock of the Company during the period from July 28, 2021, through September 30, 2022; (iii) update certain provisions regarding a successor interest rate to LIBOR and certain other market changes; and (iv) amend certain other covenants and provisions (the “Third Amendment,” and the Amended and Restated Revolving Credit Agreement as amended by the Second Amendment and the Third Amendment, the “Amended A&R Credit Agreement”). The amount of the loan commitments and the collateral under the Amended and Restated Revolving Credit Agreement remain unchanged by the Second Amendment and the Third Amendment. As of December 31, 2021, there were no amounts outstanding under the Amended A&R Credit Agreement.

Generally, amounts outstanding under the Amended A&R Credit Agreement bear interest at interest rates based on either the LIBOR rate (selected by the Company for designated interest periods) or the “alternate base rate” (being the highest of (1) the Wall Street Journal prime rate, (2) one-month adjusted LIBOR (one-month LIBOR plus a statutory reserve rate) plus 1 percent, and (3) the New York Fed Bank Rate, plus 0.5 percent). The underlying LIBOR rate is subject to a floor of 1 percent per annum and the “alternate base rate” is subject to a floor of 1 percent per annum.

The Amended A&R Credit Agreement contains customary representations and warranties, covenants, and events of default. The Amended A&R Credit Agreement is secured by a pool of 73 aircraft and related assets, each with a minimum appraised value ratio requirement. Under the Amended A&R Credit Agreement, the Company is required to maintain a minimum level of liquidity of \$1.5 billion (defined as the sum of (i) the aggregate amount available to be borrowed under the Amended A&R Credit Agreement plus (ii) the aggregate amount of unrestricted cash and cash equivalents of the Company plus (iii) the aggregate amount of short-term investments of the Company). As of December 31, 2021, the Company was in compliance with this covenant and all other covenants in the Amended A&R Credit Agreement. The Amended A&R Credit Agreement is a series of short-term borrowings; at the end of each borrowing the Company must elect to roll the facility over into the next borrowing or pay down the facility. The Amended A&R 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.

During February 2020, the Company issued \$500 million senior unsecured notes due 2030. The notes bear interest at 2.625 percent. Interest is payable semi-annually in arrears on February 10 and August 10, beginning in 2020.

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 was set to mature on October 31, 2026, and was repayable via semi-annual installments of principal that began on April 30, 2018. The loan bore interest at the LIBO Rate (as defined in the term loan agreement) plus 1.10 percent, and interest was payable semi-annually in installments. The Company prepaid the loan in full on November 1, 2021, utilizing available cash on hand.

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 \$124 million at December 31, 2021.

The net book value of the assets pledged as collateral for the Company's secured borrowings, primarily aircraft, was \$2.2 billion at December 31, 2021.

As of December 31, 2021, aggregate annual principal maturities of debt and finance leases (not including amounts associated with interest on finance leases) for the five-year period ending December 31, 2026, and thereafter, were \$453 million in 2022, \$1.3 billion in 2023, \$81 million in 2024, \$3.7 billion in 2025, \$350 million in 2026, and \$5.1 billion thereafter.

8. 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 ASC 842, Leases.

As of December 31, 2021, the Company held aircraft leases with remaining terms ranging from one month to 12 years. The aircraft leases generally can be renewed for three months to three years at rates based on the 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. The Company's future sublease income associated with the 14 remaining B717s on operating lease as of December 31, 2021, was as follows: \$17 million in 2022, \$7 million in 2023, and \$1 million in 2024. There are no contingent payments and no significant residual value conditions associated with the transaction.

In second quarter 2020, the Company entered into transactions with third parties, involving ten of the Company's Boeing 737-800 aircraft and ten of the Company's Boeing 737 MAX 8 aircraft that qualified as sale-leaseback arrangements under applicable accounting guidance. The Company sold the ten 737-800 aircraft to a third party for \$405 million, then immediately leased the aircraft back for approximately ten years. The Company sold the ten 737 MAX 8 aircraft to a third party for \$410 million, then immediately leased the aircraft back for approximately 13 years. As such, the aircraft were de-recognized from Property and equipment at their remaining net book values. All of the leases from the sale-leasebacks are accounted for as operating leases, and thus are now reflected as part of the Company's Operating lease right-of-use assets and operating lease liabilities in the accompanying Consolidated Balance Sheet. For 2020, the 737-800 and 737 MAX 8 sale-leaseback transactions resulted in a recognized gain of \$153 million and \$69 million, respectively, reflected within Other operating expenses, net in the accompanying Consolidated Statement of Income (Loss).

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 39 years. Certain leases can be renewed from 1 year 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 applicable accounting guidance. The remaining lease terms range from three months to five years. Certain leases can be renewed from six months to three years.

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

(in millions)	Balance Sheet location	December 31, 2021	December 31, 2020
Assets			
Operating	Operating lease right-of-use assets (net)	\$ 1,590	\$ 1,892
Finance	Property and equipment (net of allowance for depreciation and amortization of \$679 million and \$567 million)	556	667
Total lease assets		<u>\$ 2,146</u>	<u>\$ 2,559</u>
Liabilities			
Current			
Operating	Current operating lease liabilities	\$ 239	\$ 306
Finance	Current maturities of long-term debt	82	83
Noncurrent			
Operating	Noncurrent operating lease liabilities	1,315	1,562
Finance	Long-term debt less current maturities	377	459
Total lease liabilities		<u>\$ 2,013</u>	<u>\$ 2,410</u>

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

(in millions)	Statement of Comprehensive Income (Loss) location	Year ended December 31, 2021	Year ended December 31, 2020	Year ended December 31, 2019
Operating lease cost - aircraft (a)	Other operating expenses	\$ 204	\$ 216	\$ 182
	Landing fees and airport rentals, and Other operating expenses	81	89	89
Operating lease cost - other				
Short-term lease cost	Other operating expenses	1	1	4
	Landing fees and airport rentals, and Other operating expenses			
Variable lease cost		1,406	1,260	1,377
Finance lease cost:				
Amortization of lease liabilities	Depreciation and amortization	112	113	116
Interest on lease liabilities	Interest expense	19	22	26
Total net finance lease cost		<u>\$ 131</u>	<u>\$ 135</u>	<u>\$ 142</u>

(a) Net of sublease income of \$41 million, \$78 million, and \$97 million for the years ended December 31, 2021, 2020, and 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, 2021	Year ended December 31, 2020	Year ended December 31, 2019
Cash paid for amounts included in the measurement of lease liabilities:			
Operating cash flows for operating leases	\$ 346	\$ 398	\$ 379
Operating cash flows for finance leases	19	22	26
Financing cash flows for finance leases	83	85	85
Right-of-use assets obtained in exchange for lease obligations:			
Operating leases	327	915	230
Finance leases	—	—	1

As of December 31, 2021, maturities of lease liabilities were as follows:

(in millions)	Operating leases	Finance leases
2022	\$ 285	\$ 98
2023	249	94
2024	221	90
2025	184	74
2026	176	54
Thereafter	680	102
Total lease payments	\$ 1,795	\$ 512
Less imputed interest	(241)	(53)
Total lease obligations	1,554	459
Less current obligations	(239)	(82)
Long-term lease obligations	\$ 1,315	\$ 377

The table below presents additional information related to the Company's leases:

Weighted average remaining lease term	December 31, 2021	December 31, 2020
Operating leases	8 years	10 years
Finance leases	6 years	7 years
Weighted average discount rate		
Operating leases (a)	3.5 %	3.8 %
Finance leases	3.8 %	3.8 %

(a) Upon adoption of ASU No. 2016-02, Leases, codified in ASC 842, the incremental borrowing rate used for existing leases was established as of January 1, 2019.

9. COMMON STOCK

The Company has one class of capital stock, its common stock. On May 1, 2020, the Company completed the public offering of 80.5 million shares of \$1.00 par value common stock of the Company, which included the full exercise of the underwriters' option to purchase an additional 10.5 million shares of common stock, at a public offering price of \$28.50 per share. As discussed further in Note 2, in connection with funding that the Company has received under the PSP1 Payroll Support Program, PSP2 Payroll Support Program, and PSP3 Payroll Support Program, the Company issued Warrants to acquire up to 4.8 million shares of the Company's common stock to Treasury.

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. In connection with the receipt of Payroll Support, the Company is prohibited from paying dividends with respect to its common stock through September 30, 2022. See Note 2 for further information on the Payroll Support programs. At December 31,

2021, the Company had 60 million shares of common stock reserved for issuance pursuant to Employee equity plans (of which 22 million shares had not been granted) through various share-based compensation arrangements. See Note 10 to the Consolidated Financial Statements for information regarding the Company's equity plans.

10. 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 (Loss) for the years ended December 31, 2021, 2020, and 2019, reflects share-based compensation expense of \$58 million, \$17 million, and \$55 million, respectively. The total tax impact recognized in earnings from share-based compensation arrangements for the years ended December 31, 2021, 2020, and 2019, was not material. As of December 31, 2021, there was \$36 million of total unrecognized compensation cost related to share-based compensation arrangements, which is expected to be recognized over a weighted-average period of 1.7 years. The Company expects substantially all unvested shares associated with time-based restricted stock unit 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 2021, 2020, and 2019.

The RSUs are scheduled to vest with respect to one-third of the shares covered thereby annually. Other than in connection with death or disability, vesting is subject to the individual's continued service as an Employee, Board member, or advisor through the vesting date. However, with respect to the RSUs granted in 2021, provided that the individual's service has terminated no earlier than 12 months after the date of grant, in the event of a "qualified retirement," any outstanding unvested RSUs will remain outstanding as if the individual's service has not terminated and will continue to vest in accordance with the schedule set forth in the notice of the grant. An individual's termination of service will be considered a "qualified retirement" if (a) the individual has completed at least 10 years of continuous service; (b) the individual's age plus completed years of continuous service equal at least 65 at the time of the individual's termination of service; and (c) the individual has not been terminated for cause.

With respect to PBRsUs granted in 2021, the number of PBRsUs vesting on the vesting date will be interpolated based on the Company's cumulative Adjusted Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA) for the years 2022 and 2023 and ranges from 10 percent of granted PBRsUs to 300 percent of granted PBRsUs, only after a minimum performance level has been achieved. However, in the event the Company's pre-tax return on invested capital exceeds the median (i.e., 50th percentile) return on invested capital of certain of the Company's peer group of domestic mainline carriers subject to the Securities and Exchange Commission's reporting requirements, the minimum number of PBRsUs that will vest, as of the vesting date, will be equal to the grant amount times 50 percent. With respect to PBRsUs granted in 2021, provided that the individual's service has terminated no earlier than 12 months after the date of grant, in the event of a "qualified retirement," such individual's PBRsUs will remain outstanding as if the individual's service has not terminated and will otherwise be settleable in accordance with the notice of grant and applicable terms and conditions; however, the number of shares received upon settlement will be prorated based on the individual's number of days of service between the date of grant and the end of the performance period.

Under the 2019 and 2020 grants, PBRsUs granted 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. Under the 2019 and 2020 grants, 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, 2018	1,342	\$ 52.56
Granted	994 (a)	57.49
Vested	(744)	42.42
Surrendered	(47)	57.72
Outstanding December 31, 2019	1,545	57.65
Granted	1,235 (b)	56.89
Vested	(715)	54.70
Surrendered	(103)	58.04
Outstanding December 31, 2020, Unvested	1,962	57.81
Granted	1,463 (c)	46.58
Vested	(790)	59.48
Surrendered	(74)	51.36
Outstanding December 31, 2021, Unvested	2,561	51.81

(a) Includes 387 thousand PBRsUs

(b) Includes 519 thousand PBRsUs

(c) Includes 466 thousand PBRsUs

In addition, the Company granted approximately 27 thousand shares of unrestricted stock at a weighted average grant price of \$60.39 in 2021, approximately 54 thousand shares at a weighted average grant price of \$29.60 in 2020, and approximately 31 thousand shares at a weighted average grant price of \$52.01 in 2019, to members of its Board of Directors.

A remaining balance of up to 17 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 5 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 2021, 2020, and 2019:

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, 2019	821	\$ 47.60	\$	5.29
December 31, 2020	1,386	\$ 34.39	\$	3.82
December 31, 2021	1,083	\$ 47.31	\$	5.19

(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.

11. 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.

As of December 31, 2021, the Company had fuel derivative instruments in place to provide coverage at varying price levels. 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 December 31, 2021	Derivative underlying commodity type as of December 31, 2021
	(gallons in millions) (a)	
2022	1,220	WTI crude oil and Brent crude oil
2023	769	WTI crude oil and Brent crude oil
2024	358	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 and the Company's flight schedule fluctuate.

Upon proper qualification, the Company accounts for its fuel derivative instruments as cash flow hedges. Qualification is re-evaluated quarterly, and 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 13.

If a derivative ceases to qualify for hedge accounting, 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 (Loss) 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.

During 2020 and 2021, as a result of the drastic drop in demand for air travel due to the COVID-19 pandemic, the Company's forecast for 2020 and 2021 fuel purchases and consumption was significantly reduced, causing the Company to be in an estimated "over-hedged" position for second, third, and fourth quarter 2020, and full year 2021. Therefore, the Company de-designated a portion of its fuel hedges related to these periods, and has reclassified approximately \$39 million and \$6 million in losses from AOCI into Other (gains) losses, net, during 2020 and 2021, respectively. The Company did not have any such situations occur during 2019.

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 12/31/2021	Fair value at 12/31/2020	Fair value at 12/31/2021	Fair value at 12/31/2020
Derivatives designated as hedges (a)					
Fuel derivative contracts (gross)	Prepaid expenses and other current assets	\$ 409	\$ 9	\$ —	\$ —
Fuel derivative contracts (gross)	Other assets	287	121	—	—
Interest rate derivative contracts	Other noncurrent liabilities	—	—	4	6
Total derivatives designated as hedges		\$ 696	\$ 130	\$ 4	\$ 6
Derivatives not designated as hedges (a)					
Fuel derivative contracts (gross)	Prepaid expenses and other current assets	\$ —	\$ 4	\$ —	\$ —
Total derivatives		\$ 696	\$ 134	\$ 4	\$ 6

(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.

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, 2021	December 31, 2020
Cash collateral deposits held from counterparties for fuel contracts - current	Offset against Prepaid expenses and other current assets	\$ 80	\$ 3
Cash collateral deposits held from counterparties for fuel contracts - noncurrent	Offset against Other assets	95	31
Receivable from third parties for fuel contracts	Accounts and other receivables	8	—

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. As of December 31, 2021, 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, 2021			December 31, 2020		
		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	\$ 409	\$ (80)	\$ 329	\$ 13	\$ (3)	\$ 10
Fuel derivative contracts	Other assets	\$ 287	\$ (95)	\$ 192 (a)	\$ 121	\$ (31)	\$ 90 (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 16.

Offsetting of derivative liabilities

(in millions)

Description	Balance Sheet location	(i)	(ii)	(iii) = (i) + (ii)	(i)	(ii)	(iii) = (i) + (ii)
		December 31, 2021			December 31, 2020		
		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	\$ 80	\$ (80)	\$ —	\$ 3	\$ (3)	\$ —
Fuel derivative contracts	Other assets	\$ 95	\$ (95)	\$ — (a)	\$ 31	\$ (31)	\$ — (a)
Interest rate derivative contracts	Other noncurrent liabilities	\$ 4	\$ —	\$ 4	\$ 6	\$ —	\$ 6

(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 16.

The following tables present the impact of derivative instruments and their location within the Consolidated Statement of Income (Loss) for the years ended December 31, 2021 and 2020:

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

(in millions)	Year ended December 31, 2021			Year ended December 31, 2020		
	Fuel and oil	Other (gains)/losses, net	Other operating expenses	Fuel and oil	Other (gains)/losses, net	Interest expense
Total	\$ 4	\$ 6	\$ 6	\$ 70	\$ 39	\$ 6
Loss on cash flow hedging relationships						
Commodity contracts:						
Amount of loss reclassified from AOCI into income	4	6	—	70	39	—
Interest contracts:						
Amount of loss reclassified from AOCI into income	—	—	6	—	—	1
Impact of fair value hedging relationships:						
Interest contracts:						
Hedged items	—	—	—	—	—	11
Derivatives designated as hedging instruments	—	—	—	—	—	(6)

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,	
	2021	2020
Fuel derivative contracts	\$ (461)	\$ 80
Interest rate derivatives	(2)	26
Total	\$ (463)	\$ 106

Derivatives not designated as hedges

	(Gain) Loss recognized in income on derivatives		
	Year ended		
	December 31,		
(in millions)	2021	2020	Location of (gain) loss recognized in income on derivatives
Fuel derivative contracts	\$ (13)	\$ 1	Other (gains) losses, net
Interest rate derivatives	—	28	Other (gains) losses, net
Total	\$ (13)	\$ 29	

The Company also recorded expense associated with premiums paid for fuel derivative contracts that settled/expired during 2021, 2020, and 2019. Gains and/or losses associated with fuel derivatives that qualify for hedge accounting are ultimately recorded to Fuel and oil expense. Gains and/or losses associated with fuel derivatives that do not qualify for hedge accounting are recorded to Other (gains) and losses, net. The following table presents the impact

of premiums paid for fuel derivative contracts and their location within the Consolidated Statement of Income (Loss) during the period the contract settles:

(in millions)	Premium expense recognized in income on derivatives			Location of premium expense recognized in income on derivatives
	Year ended December 31,			
	2021	2020	2019	
Fuel derivative contracts designated as hedges	\$ 57	\$ 64	\$ 95	Fuel and oil
Fuel derivative contracts not designated as hedges	\$ 43	\$ 34	\$ —	Other (gains) losses, net

The fair values of the derivative instruments, depending on the type of instrument, were determined by the use of present value methods or option value models with assumptions about commodity prices based on those observed in underlying markets or provided by third parties. Included in the Company's cumulative net unrealized gains from fuel hedges as of December 31, 2021, recorded in AOCI, were approximately \$234 million in unrealized gains, net of taxes, which are expected to be realized in earnings during the twelve months subsequent to December 31, 2021.

Interest Rate Swaps

The Company is party to certain interest rate swap agreements that are accounted for as cash flow hedges, and has in the past held interest rate swap agreements that have qualified as fair value 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" or "critical terms match" methods of accounting for hedges, which dictate that the hedges were assumed to be perfectly effective at origination, and, thus, there was no ineffectiveness to be recorded in earnings.

During 2019, the Company had entered into forward-starting interest rate swap agreements related to a series of 12 -8 aircraft leases for aircraft originally scheduled to be received between July 2019 and February 2020. These lease contracts exposed the Company to interest rate risk as the rental payments were subject to adjustment and would become fixed based on the 9-year swap rate at the time of delivery. As a result of the grounding of the MAX aircraft, those deliveries were significantly delayed. These original agreements were subsequently terminated in third quarter 2019, and the Company entered into new interest rate swap agreements based on revised expected aircraft delivery dates. As the revised delivery dates were also not met, these subsequent agreements were subsequently de-designated as hedges and the agreements terminated. All of the associated aircraft had been delivered to the Company as of September 30, 2021. As a result of the discontinued hedges, the Company had cumulative losses "frozen" in AOCI as of December 31, 2021, of \$57 million, which will be recognized in earnings over the 9-year lease terms of each aircraft.

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 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 liability of \$4 million are cash flow hedges and are classified as components of Other noncurrent liabilities. The corresponding offsetting adjustment related to the liability associated with the Company's cash flow hedges is to AOCI. See Note 13.

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, 2021, 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 and letters of credit were 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 at 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, 2021, at which such postings are triggered:

(in millions)	Counterparty (CP)									Total
	A	B	C	D	E	F	G	Other (a)		
Fair value of fuel derivatives	\$ 160	\$ 90	\$ 162	\$ 78	\$ 77	\$ 55	\$ 59	\$ 15	\$ 696	
Cash collateral held from CP	175	—	—	—	—	—	—	—	175	
Letters of credit (LC)	—	—	—	—	—	—		—	—	
Option to substitute LC for cash	N/A	N/A	(b)	(b)	(b)	N/A	(b)			
If credit rating is investment grade, fair value of fuel derivative level at which:										
Cash is provided to CP	>(100)	>(50)	>(75)	>(125)	>(40)	>(65)	>(100)			
Cash is received from CP	>0(c)	>150(c)	>250(c)	>125(c)	>100(c)	>70(c)	>100(c)			
If credit rating is non-investment grade, fair value of fuel derivative level at which:										
Cash is received from CP	(d)	(d)	(d)	(d)	(d)	(d)	(d)			

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

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

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

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

12. 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, 2021, 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. Equity securities primarily consist of investments with readily determinable market values 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 11 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 a similar 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 plan obligations and plan assets, which net to zero, within the Salaries, wages, and benefits line and Other (gains) losses line, respectively, of the Consolidated Statement of Income (Loss).

The following tables present the Company's assets and liabilities that are measured at fair value on a recurring basis at December 31, 2021, and December 31, 2020:

Description	December 31, 2021	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)	\$ 12,340	\$ 12,340	\$ —	\$ —
Commercial paper	90	—	90	—
Time deposits	50	—	50	—
Short-term investments:				
Treasury bills	2,399	2,399	—	—
Time deposits	625	—	625	—
Fuel derivatives:				
Option contracts (b)	696	—	—	696
Equity Securities	288	288	—	—
Total assets	\$ 16,488	\$ 15,027	\$ 765	\$ 696
Liabilities				
Interest rate derivatives (see Note 11)	\$ (4)	\$ —	\$ (4)	\$ —

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

(b) In the Consolidated Balance Sheet amounts are presented as an asset. See Note 11.

Description	December 31, 2020	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)	\$ 10,663	\$ 10,663	\$ —	\$ —
Commercial paper	90	—	90	—
Certificates of deposit	10	—	10	—
Time deposits	300	—	300	—
Short-term investments:				
Treasury bills	1,800	1,800	—	—
Certificates of deposit	46	—	46	—
Time deposits	425	—	425	—
Fuel derivatives:				
Option contracts (b)	134	—	—	134
Equity Securities	259	259	—	—
Total assets	\$ 13,727	\$ 12,722	\$ 871	\$ 134
Liabilities				
Interest rate derivatives (see Note 11)	\$ (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 11.

The Company did not have any material assets or liabilities measured at fair value on a nonrecurring basis as of December 31, 2021 or 2020. 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 2021 and 2020:

Fair value measurements using significant unobservable inputs (Level 3)		
(in millions)	Fuel derivatives	
Balance at December 31, 2020	\$	134
Total gains for the period		
Included in earnings		7 (a)
Included in other comprehensive income		609
Purchases		41 (b)
Sales		(7) (b)
Settlements		(88)
Balance at December 31, 2021	\$	696
The amount of total gains for the period included in other comprehensive income attributable to the change in unrealized gains or losses relating to assets still held at December 31, 2021	\$	541

(a) Included in Other (gains) losses, net, within the Consolidated Statement of Income (Loss).

(b) The purchase and sale of fuel derivatives is 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)		
(in millions)	Fuel derivatives	
Balance at December 31, 2019	\$	110
Total losses for the period		
Included in earnings		(40) (a)
Included in other comprehensive loss		(65)
Purchases		129 (b)
Balance at December 31, 2020	\$	134
The amount of total losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at December 31, 2020	\$	(15) (a)
The amount of total losses for the period included in other comprehensive loss attributable to the change in unrealized gains or losses relating to assets still held at December 31, 2020	\$	(41)

(a) Included in Other (gains) losses, net, within the Consolidated Statement of Income (Loss).

(b) The purchase of fuel derivatives is 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 have resulted in a higher (lower) fair value measurement, respectively, for the Company's derivative option contracts.

The following table presents a range and weighted average of the unobservable inputs utilized in the fair value measurements of the Company's fuel derivatives classified as Level 3 at December 31, 2021:

Quantitative information about Level 3 fair value measurements					Weighted Average (a)
	Valuation technique	Unobservable input	Period (by year)	Range	
Fuel derivatives	Option model	Implied volatility	2022	21-53%	41 %
			2023	29-40%	34 %
			2024	26-33%	28 %

(a) Implied volatility weighted by the notional amount (barrels of fuel) that will settle in respective period.

The carrying amounts and estimated fair values of the Company's short-term and long-term debt (including current maturities), as well as the applicable fair value hierarchy tier, at December 31, 2021, 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. All privately held debt agreements are categorized as Level 3. The Company has determined the estimated fair value of this debt to be Level 3, as certain inputs used to determine the fair value of these agreements are unobservable. The Company utilizes indicative pricing from counterparties and a discounted cash flow method to estimate the fair value of the Level 3 items.

(in millions)	Carrying value	Estimated fair value	Fair value level hierarchy
2.75% Notes due 2022	\$ 300	\$ 305	Level 2
Pass Through Certificates due 2022 - 6.24%	71	73	Level 2
4.75% Notes due 2023	1,250	1,311	Level 2
1.25% Convertible Notes due 2025	1,842	2,802	Level 2
5.25% Notes due 2025	1,550	1,724	Level 2
3.00% Notes due 2026	300	314	Level 2
3.45% Notes due 2027	300	321	Level 2
5.125% Notes due 2027	2,000	2,294	Level 2
7.375% Debentures due 2027	116	140	Level 2
2.625% Notes due 2030	500	499	Level 2
1.000% Payroll Support Program Loan due April 2030	976	958	Level 3
1.000% Payroll Support Program Loan due January 2031	566	548	Level 3
1.000% Payroll Support Program Loan due April 2031	526	507	Level 3

13. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) 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 2021 and 2020:

(in millions)	Fuel derivatives	Interest rate derivatives	Defined benefit plan items	Other	Deferred tax impact	Accumulated other comprehensive income (loss)
Balance at December 31, 2019	\$ (125)	\$ (33)	\$ 20	\$ 59	\$ 18	\$ (61)
Changes in fair value	(103)	(34)	(63)	32	39	(129)
Reclassification to earnings	109	1	—	—	(25)	85
Balance at December 31, 2020	\$ (119)	\$ (66)	\$ (43)	\$ 91	\$ 32	\$ (105)
Cumulative effect of adopting ASU 2016-01 as of January 1, 2018	—	—	—	(31)	11	(20)
Changes in fair value	601	3	109	—	(166)	547
Reclassification to earnings	10	6	—	(60)	(a) 10	(34)
Balance at December 31, 2021	<u>\$ 492</u>	<u>\$ (57)</u>	<u>\$ 66</u>	<u>\$ —</u>	<u>\$ (113)</u>	<u>\$ 388</u>

(a) Investment gains related to prior periods that were reclassified from AOCI into Other (gains) losses, net. See Note 1.

The following table illustrates the significant amounts reclassified out of each component of AOCI for the year ended December 31, 2021:

Year ended December 31, 2021		
(in millions)	Amounts reclassified from AOCI	Affected line item in the Consolidated Statement of Income (Loss)
AOCI components		
Unrealized loss on fuel derivative instruments	\$	4 Fuel and oil expense
		6 Other (gains) losses, net
		2 Less: Tax expense
	\$	8 Net of tax
Unrealized loss on interest rate derivative instruments		6 Other operating expenses
		1 Less: Tax expense
	\$	5 Net of tax
Unrealized gain on deferred compensation plan investment	\$	(60) Other (gains) losses, net
		(13) Less: Tax expense
	\$	(47) Net of tax
Total reclassifications for the period	<u>\$</u>	<u>(34)</u> Net of tax

14. 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 2021, 2020, and 2019, reflected as a component of Salaries, wages, and benefits, were \$749 million, \$561 million, and \$1.2 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, 2021 and 2020:

(in millions)	2021	2020
APBO at beginning of period	\$ 428	\$ 288
Service cost	25	22
Interest cost	10	10
Benefits paid	(24)	(10)
Actuarial (gain)/loss	(109)	63
Curtailment	—	53
Special termination benefits	—	2
APBO at end of period	<u>\$ 330</u>	<u>\$ 428</u>

During 2021, the Company recorded a \$109 million actuarial gain as a decrease to the APBO with an offset to AOCI. This actuarial gain is reflected above and resulted from changes in certain key assumptions used to determine the Company's year-end obligation. The assumption changes that resulted in the largest portion of the actuarial gain were the expected participation and retirement rates in the Plan for future qualifying retirees, which reflect lower expectations as to utilization of benefits based on recent history, combined with census data and other demographic changes.

All plans are unfunded, and benefits are paid as they become due. Estimated future benefit payments expected to be paid are \$21 million in 2022, \$20 million in 2023, \$19 million in 2024, \$20 million in 2025, \$21 million in 2026, and \$115 million for the next five years thereafter.

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, 2021 and 2020.

(in millions)	2021	2020
Funded status	\$ (330)	\$ (428)
Unrecognized net actuarial (gain) loss	(69)	40
Unrecognized prior service cost	3	3
Accumulated other comprehensive income (loss)	66	(43)
Consolidated Balance Sheet liability	<u>\$ (330)</u>	<u>\$ (428)</u>

The consolidated periodic postretirement benefit cost for the years ended December 31, 2021, 2020, and 2019, included the following:

(in millions)	2021	2020	2019
Service cost	\$ 25	\$ 22	\$ 17
Interest cost	10	10	10
Amortization of prior service cost	—	1	1
Amortization of net gain	—	—	(2)
Curtailment	—	53	—
Special termination benefits	—	2	—
Net periodic postretirement benefit cost	\$ 35	\$ 88	\$ 26

Service cost and Special termination benefits are recognized within Salaries, wages, and benefits expense, and all other costs are recognized in Other (gains) losses, net in the Consolidated Statement of Income (Loss). 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, 2021, 2020, and 2019:

	2021	2020	2019
Weighted-average discount rate	2.90 %	2.45 %	3.30 %
Assumed healthcare cost trend rate (a)	6.25 %	6.75 %	7.13 %

(a) The assumed healthcare cost trend rate is expected to be 6.25% for 2022, then decline gradually to 4.75% by 2028 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 increased during 2021 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.

15. INCOME TAXES

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The components of deferred tax assets and liabilities at December 31, 2021 and 2020, are as follows:

(in millions)	2021	2020
DEFERRED TAX LIABILITIES:		
Accelerated depreciation	\$ 2,883	\$ 2,939
Prepaid insurance	189	190
Operating lease right-of-use assets	356	423
Other	188	67
Total deferred tax liabilities	3,616	3,619
DEFERRED TAX ASSETS:		
Accrued employee benefits	341	491
Rapid rewards loyalty liability	636	632
Operating lease liabilities	371	443
Customer travel credits	305	117
Construction obligation	—	72
Net operating losses and tax credits	36 (a)	60
Other	157	170
Total deferred tax assets	1,846	1,985
Net deferred tax liability	\$ 1,770	\$ 1,634

(a) At December 31, 2021 and 2020, the Company had approximately \$44 million and \$65 million, respectively, of state net operating loss carryforwards (tax effected) to reduce future state taxable income. These state net operating loss carryforwards will expire in years 2025 - 2040 if unused.

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

(in millions)	2021	2020	2019
CURRENT:			
Federal (a)	\$ 337	\$ (273)	\$ 610
State	33	(5)	102
Change in federal statutory rate (b)	(2)	(188)	—
Total current	368	(466)	712
DEFERRED:			
Federal (a)	(43)	(589)	(18)
State	2	(76)	(6)
State net operating losses	21	(51)	—
Change in federal statutory tax rate (c)	—	—	(31)
Total deferred	(20)	(716)	(55)
	\$ 348	\$ (1,182)	\$ 657

(a) The CARES Act allows entities to carry back 2020 losses to prior periods of up to five years, and claim refunds of federal taxes paid. The Company has filed the refund claim with the IRS, and expects a refund of \$472 million in the first six months of 2022.

(b) The benefit is representative of the excess refund generated as the result of carrying the 2020 losses back to a period when the federal statutory tax rate was 35 percent as opposed to the current tax rate of 21 percent.

(c) 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 (loss) before income taxes differed from the federal income tax statutory rate for the following reasons:

(in millions)	2021	2020	2019
Tax at statutory U.S. tax rates	\$ 278	\$ (894)	\$ 621
State income taxes, net of federal benefit	45	(115)	76
Change in federal statutory tax rate	(2)	(188)	(31) (a) (b)
Other, net	27	15	(9)
Total income tax provision (benefit)	<u>\$ 348</u>	<u>\$ (1,182)</u>	<u>\$ 657</u>

(a) The benefit is representative of the excess refund generated as the result of carrying the 2020 losses back to a period when the federal statutory tax rate was 35 percent as opposed to the current tax rate of 21 percent.

(b) 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 2020 and 2021 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.

16. SUPPLEMENTAL FINANCIAL INFORMATION

(in millions)	December 31, 2021	December 31, 2020
Trade receivables	\$ 58	\$ 46
Credit card receivables	83	35
Business partners and other suppliers	432	274
Taxes receivable (a)	699	740
Other	85	35
Accounts and other receivables (b)	<u>\$ 1,357</u>	<u>\$ 1,130</u>

(in millions)	December 31, 2021	December 31, 2020
Derivative contracts	\$ 192	\$ 90
Intangible assets, net	295	295
Other	395	337
Other assets	<u>\$ 882</u>	<u>\$ 722</u>

(in millions)	December 31, 2021	December 31, 2020
Accounts payable trade	\$ 156	\$ 111
Salaries payable	287	201
Taxes payable excluding income taxes	200	49
Aircraft maintenance payable	42	95
Fuel payable	170	66
Other payable	427	409
Accounts payable	<u>\$ 1,282</u>	<u>\$ 931</u>

(in millions)	December 31, 2021	December 31, 2020
Extended Emergency Time Off	\$ 3	\$ 393
Voluntary Separation Program	92	143
Profitsharing and savings plans	262	25
Vendor prepayment (b)	—	600
Vacation pay	451	436
Health	152	111
Workers compensation	141	161
Property and income taxes	65	84
Interest	46	49
Deferred supplier payments (c)	80	—
Other	332	257
Accrued liabilities	\$ 1,624	\$ 2,259

(in millions)	December 31, 2021	December 31, 2020
Extended Emergency Time Off	\$ —	\$ 57
Voluntary Separation Program	233	321
Postretirement obligation	330	428
Other deferred compensation	369	353
Other	292	88
Other noncurrent liabilities	\$ 1,224	\$ 1,247

(a) This amount includes approximately \$472 million and \$470 million, as of December 31, 2021 and 2020, respectively, associated with a significant cash tax refund expected as a result of the CARES Act allowing entities to carry back 2020 losses to prior periods of up to five years, and claim refunds of federal taxes paid. These amounts also includes excise taxes remitted to taxing authorities for which the subsequent flights were canceled by Customers, resulting in amounts due back to the Company. See Note 15 for further information.

(b) In fourth quarter 2020, the Company received a \$600 million prepayment from Chase for Rapid Rewards points that were subsequently issued to Members during the first half of 2021, based on cardholder activity on the Visa credit card associated with its loyalty program. This resulted in a reduction in cash receipts from Chase during 2021, which were classified within Accounts and other receivables in the Consolidated Statement of Cash Flows.

(c) Represents amounts owed for aircraft deliveries received that will be relieved via future payments to supplier. See Note 17 for further information.

For further information on fuel derivative and interest rate derivative contracts, see Note 11.

Other Operating Expenses

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

17. BOEING 737 MAX AIRCRAFT GROUNDING AND RETURN TO SERVICE

On March 13, 2019, the FAA issued an emergency order for all U.S. airlines to ground all MAX aircraft. The Company immediately complied with the order and grounded all 34 MAX aircraft in its fleet. On November 18, 2020, the FAA rescinded the emergency order and issued official requirements to enable U.S. airlines to return the

MAX to service. The Company returned the MAX to revenue service on March 11, 2021, after the Company met all FAA requirements and Pilots received updated, MAX-related training.

The most significant financial impacts of the grounding resulting from the FAA's emergency order were the lost revenues, operating income, and operating cash flows, and delayed capital expenditures, directly associated with the Company's grounded MAX fleet and other new aircraft that were not able to be delivered.

During 2019, the Company entered into a Memorandum of Understanding with Boeing to compensate Southwest for estimated financial damages incurred during 2019 related to the grounding of the MAX. The terms of the agreement are confidential, but were 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 at the time, and the Company's future firm aircraft deliveries as of the date of the agreement. A total of \$428 million in proceeds received in cash from Boeing are reflected within Investing Activities in the Consolidated Statement of Cash Flows for the year ended December 31, 2020. No material financial impacts of the agreement were realized in the Company's earnings during the years ended December 31, 2019, 2020, or 2021.

During December 2020, the Company entered into an agreement with Boeing to compensate the Company for estimated financial damages incurred during 2020 related to the grounding of the MAX. The terms of the agreement are confidential, but the compensation is in the form of credit memos taken against future payments due to Boeing as aircraft have been and are delivered in accordance with the amended delivery schedule, or as future progress payments are due. In accordance with applicable accounting principles, the Company has accounted for substantially all of the compensation received from Boeing as a reduction in cost basis spread across both the existing owned MAX in the Company's fleet, and the Company's future firm aircraft deliveries from Boeing as of the date of the agreement. No material financial impacts of the agreement were realized in the Company's earnings for the year ended December 31, 2021.

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, 2021 and 2020, the related consolidated statements of income (loss), comprehensive income (loss), stockholders' equity and cash flows for each of the three years in the period ended December 31, 2021, 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, 2021 and 2020, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2021, 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, 2021, 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 4, 2022 expressed an unqualified opinion thereon.

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 error or fraud, 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.

Valuation of financial derivative instruments

Description of the Matter As explained in Notes 1, 11, and 12 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 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 and limited observable market data. 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 reasonableness of 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.

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.

Air traffic liability breakage

Description of the Matter As explained in Notes 1 and 6, tickets sold, but not yet used, are initially deferred as Air traffic liability, and are recognized in passenger revenue when transportation is provided. The Company estimates the amount of tickets that expire unused and recognizes such amounts in Passenger revenue once the scheduled flight date passes in proportion to the pattern of flights taken by the customers. During 2020, the Company experienced a significantly higher number of customer-driven flight cancellations related to the COVID-19 pandemic, and extended the expiration date for certain travel funds to September 7, 2022. At December 31, 2021, \$1.3 billion of these extended funds remained available for customers to use on future travel.

Auditing the Company's breakage estimates on these extended funds requires judgment, as the Company has limited historical data available to predict both the amount of these funds estimated to expire and the expected pattern of flights to be taken by customers holding extended travel funds, since historically travel funds expired within 12 months of the original date of sale. In making its estimates, the Company considers historical customer travel behavior, as well as assumptions about customers' future travel behavior, which can be impacted by many factors including ticketing and other policies, fares, seat availability, and other economic factors.

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 breakage estimate, including controls over management's review of the estimation of breakage and the completeness and accuracy of the historical data analyzed as part of the breakage estimate.

We evaluated management's assumptions used in the breakage calculation by comparing current and historical actual expirations to the Company's estimates. Additionally, among other procedures, we assessed the reasonableness of other assumptions made by the Company as part of the breakage estimate, including the consideration of the constraint on variable consideration on cumulative revenue recognized.

/s/ Ernst & Young LLP

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

Dallas, Texas

February 4, 2022

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, 2021, 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, 2021, 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, 2021 and 2020, the related consolidated statements of income (loss), comprehensive income (loss), stockholders' equity and cash flows for each of the three years in the period ended December 31, 2021, and the related notes (collectively referred to as the "financial statements") of the Company and our report dated February 4, 2022 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 the 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.