

SOUTHWEST AIRLINES CO  
Form 10-Q/A  
October 22, 2009

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q/A  
Amendment No. 1

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2009

or

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 1-7259

Southwest Airlines Co.  
(Exact name of registrant as specified in its charter)

TEXAS  
(State or other jurisdiction of  
incorporation or organization)

74-1563240  
(IRS Employer  
Identification No.)

P.O. Box 36611, Dallas, Texas  
(Address of principal executive offices)

75235-1611  
(Zip Code)

Registrant's telephone number, including area code: (214) 792-4000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒

Accelerated filer ☐

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Non-accelerated filer " (Do not check if a smaller reporting  
company) Smaller reporting company "

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

Number of shares of Common Stock outstanding as of the close of business on July 20, 2009: 741,447,409

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## EXPLANATORY NOTE

This Amendment No. 1 on Form 10-Q/A (Amendment) amends and restates Southwest Airlines Co.'s (Company or Southwest) Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2009, originally filed on July 23, 2009 (Original Filing).

As disclosed in the Company's Form 8-K dated October 15, 2009, on October 14, 2009, the Company determined that its previously issued unaudited interim condensed consolidated financial statements for the three and six month periods ended June 30, 2009, contained an error with respect to one rule within Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133), as amended. Specifically, to facilitate the implementation of new hedge accounting software, in April 2009, existing hedging instruments were de-designated and re-designated as new hedges. Included in the re-designation, however, were certain derivative instruments that were in a net written option position that did not qualify as hedges according to SFAS 133.

The result of this error was that a portion of the increase in fair value of these derivatives was deferred as part of Accumulated Other Comprehensive Income/Loss (AOCI), when in fact those increases should have been recognized in earnings in the second quarter 2009. Recognizing these increases in earnings results in an increase in GAAP Net income of \$37 million for second quarter 2009. The net increase in fair value related to these instruments, totaling \$57 million, before taxes, during second quarter 2009, relates entirely to unrealized changes in fair value as substantially all of the instruments will not settle until periods subsequent to 2009. Since the Company classifies these unrealized noncash changes in fair value as a component of Other (gains) losses, net in the unaudited Condensed Consolidated Statement of Operations, this error had no impact on the Company's operating income for the three or six month periods ended June 30, 2009, nor did it impact the Company's net cash flows for the same periods of 2009. The impact on the Company's unaudited Condensed Consolidated Balance Sheet is a decrease (debit) to AOCI of \$35 million, an increase to Retained earnings of \$37 million, a decrease to Accrued liabilities of \$5 million, and an increase to Deferred income taxes of \$3 million as of June 30, 2009. This error had no impact on any financial statements prior to those issued for second quarter 2009. In light of this error, the Company's financial statements and other financial information included in the Original Filing for second quarter 2009 are being restated in this Amendment.

The information contained in the Original Filing has been updated in this Amendment to give effect to the restatement. This Amendment continues to speak as of the dates described herein, and with the exception of Note 13, the disclosures have not been updated to reflect any events that occurred subsequent to such dates. With the exception of Note 13, information not affected by the restatement is unchanged and reflects the disclosures at the time of the Original Filing. Therefore, this Amendment should be read in conjunction with the Company's other filings made with the Securities and Exchange Commission subsequent to the Original Filing.



SOUTHWEST AIRLINES CO.

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SOUTHWEST AIRLINES CO.  
FORM 10-Q/A  
Part I - FINANCIAL INFORMATION

## Item 1. Financial Statements

Southwest Airlines Co.  
Condensed Consolidated Balance Sheet  
(in millions)  
(unaudited)

	June 30, 2009 (As restated)	December 31, 2008
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$946	\$1,368
Short-term investments	1,252	435
Accounts and other receivables	237	209
Inventories of parts and supplies, at cost	200	203
Deferred income taxes	365	365
Prepaid expenses and other current assets	94	73
Total current assets	3,094	2,653
Property and equipment, at cost:		
Flight equipment	13,690	13,722
Ground property and equipment	1,849	1,769
Deposits on flight equipment purchase contracts	204	380
	15,743	15,871
Less allowance for depreciation and amortization	5,082	4,831
	10,661	11,040
Other assets	272	375
	\$14,027	\$14,068
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$732	\$668
Accrued liabilities	1,024	1,012
Air traffic liability	1,207	963
Current maturities of long-term debt	105	163
Total current liabilities	3,068	2,806
Long-term debt less current maturities	3,278	3,498
Deferred income taxes	1,924	1,904
Deferred gains from sale and leaseback of aircraft	128	105
Other deferred liabilities	481	802
Stockholders' equity:		
Common stock	808	808
Capital in excess of par value	1,223	1,215
Retained earnings	4,900	4,919

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Accumulated other comprehensive loss	(797 )	(984 )
Treasury stock, at cost	(986 )	(1,005 )
Total stockholders' equity	5,148	4,953
	\$14,027	\$14,068

See accompanying notes.

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

	Three months ended June 30,		Six months ended June 30,	
	2009 (As restated)	2008	2009 (As restated)	2008
<b>OPERATING REVENUES:</b>				
Passenger	\$2,506	\$2,747	\$4,758	\$5,161
Freight	29	37	58	71
Other	81	85	156	167
Total operating revenues	2,616	2,869	4,972	5,399
<b>OPERATING EXPENSES:</b>				
Salaries, wages, and benefits	863	839	1,699	1,639
Fuel and oil	726	945	1,423	1,745
Maintenance materials and repairs	190	191	373	333
Aircraft rentals	47	38	93	76
Landing fees and other rentals	179	159	345	330
Depreciation and amortization	150	148	300	293
Other operating expenses	338	344	666	690
Total operating expenses	2,493	2,664	4,899	5,106
OPERATING INCOME	123	205	73	293
<b>OTHER EXPENSES (INCOME):</b>				
Interest expense	47	32	92	60
Capitalized interest	(5 )	(6 )	(11 )	(14 )
Interest income	(3 )	(5 )	(8 )	(12 )
Other (gains) losses, net	(23 )	(345 )	-	(307 )
Total other expenses (income)	16	(324 )	73	(273 )
INCOME BEFORE INCOME TAXES	107	529	-	566
PROVISION FOR INCOME TAXES	16	208	-	211
NET INCOME	\$91	\$321	\$-	\$355
<b>NET INCOME PER SHARE, BASIC</b>				
	\$ .12	\$ .44	\$-	\$ .48
<b>NET INCOME PER SHARE, DILUTED</b>				
	\$ .12	\$ .44	\$-	\$ .48
<b>WEIGHTED AVERAGE SHARES OUTSTANDING:</b>				
Basic	741	732	741	733
Diluted	741	737	741	736

See accompanying notes.





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

	Three months ended June 30, 2009		Six months ended June 30, 2009	
	(As restated)	2008	(As restated)	2008
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net income (loss)	\$91	\$321	\$-	\$355
Adjustments to reconcile net income (loss) to cash provided by operating activities:				
Depreciation and amortization	150	148	300	293
Unrealized loss (gain) on fuel derivative instruments	(3 )	(324 )	67	(290 )
Deferred income taxes	16	135	(5 )	129
Amortization of deferred gains on sale and leaseback of aircraft				
	(4 )	(3 )	(7 )	(6 )
Share-based compensation expense	3	5	6	9
Excess tax benefits from share-based compensation arrangements				
	(5 )	3	(1 )	3
Changes in certain assets and liabilities:				
Accounts and other receivables	(6 )	(97 )	(28 )	(167 )
Other current assets	(28 )	(37 )	(18 )	(50 )
Accounts payable and accrued liabilities	104	286	104	333
Air traffic liability	(43 )	105	244	372
Cash collateral received from (provided to) fuel derivative counterparties				
	(125 )	1,865	(185 )	2,435
Other, net	(15 )	(71 )	(57 )	(116 )
Net cash provided by operating activities	135	2,336	420	3,300
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchases of property and equipment, net	(187 )	(223 )	(272 )	(587 )
Purchases of short-term investments	(1,394 )	(2,226 )	(3,090 )	(3,447 )
Proceeds from sales of short-term investments	1,203	1,185	2,347	2,645
Other, net	1	-	1	-
Net cash used in investing activities	(377 )	(1,264 )	(1,014 )	(1,389 )
CASH FLOWS FROM FINANCING ACTIVITIES:				
Proceeds from sale and leaseback transactions	208	-	381	-
Issuance of Long-term debt	332	600	332	600
Proceeds from Employee stock plans	4	17	8	27
Payments of long-term debt and capital lease obligations	(7 )	(6 )	(41 )	(25 )
Payment of revolving credit facility	(400 )	-	(400 )	-
Payment of credit line borrowing	(91 )	-	(91 )	-
Payments of cash dividends	(3 )	(3 )	(10 )	(10 )
Repurchase of common stock	-	-	-	(54 )
Excess tax benefits from share-based				

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compensation arrangements	5	(3	)	1	(3	)
Other, net	(5	)	(6	)	(8	)
Net cash provided by financing activities	43	599	172	529		

NET CHANGE IN CASH AND

CASH EQUIVALENTS (199 ) 1,671 (422 ) 2,440

CASH AND CASH EQUIVALENTS AT

BEGINNING OF PERIOD 1,145 2,982 1,368 2,213

CASH AND CASH EQUIVALENTS

AT END OF PERIOD \$946 \$4,653 \$946 \$4,653

CASH PAYMENTS FOR:

Interest, net of amount capitalized \$42 \$16 \$78 \$41

Income taxes \$3 \$7 \$4 \$13

See accompanying notes.

Southwest Airlines Co.  
Notes to Condensed Consolidated Financial Statements  
(unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of Southwest Airlines Co. (Company or Southwest) have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. The unaudited condensed consolidated financial statements for the interim periods ended June 30, 2009 and 2008, include all adjustments which are, in the opinion of management, necessary for a fair presentation of the results for the interim periods. This includes all normal and recurring adjustments, but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. Financial results for the Company, and airlines in general, are seasonal in nature. Historically, the Company's revenues, as well as its overall financial performance, are better in its second and third fiscal quarters than in its first and fourth fiscal quarters. However, as a result of significant fluctuations in revenues and the price of jet fuel in some periods, the nature of the Company's fuel hedging program, the periodic volatility of commodities used by the Company for hedging jet fuel, and the accounting requirements of Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended (SFAS 133), the Company has experienced, and may continue to experience significant volatility in its results in certain fiscal periods. See Note 5 for further information. Operating results for the three months and six months ended June 30, 2009, are not necessarily indicative of the results that may be expected for the year ended December 31, 2009. For further information, refer to the consolidated financial statements and footnotes thereto included in the Southwest Airlines Co. Annual Report on Form 10-K for the year ended December 31, 2008.

Certain prior period amounts have been reclassified to conform to the current presentation. In the unaudited Condensed Consolidated Balance Sheet as of December 31, 2008, the Company's cash collateral deposits related to fuel derivatives that have been provided to a counterparty have been adjusted to show a "net" presentation against the fair value of the Company's fuel derivative instruments. The entire portion of cash collateral deposits as of December 31, 2008, \$240 million, has been reclassified to reduce "Other deferred liabilities." In the Company's 2008 Form 10-K filing, these cash collateral deposits were presented "gross" and all were included as an increase to "Prepaid expenses and other current assets." This change in presentation was made in order to comply with the requirements of Financial Accounting Standards Board (FASB) Staff Position FIN 39-1 (FIN 39-1), which was required to be adopted by the Company effective January 1, 2008. Following the Company's 2008 Form 10-K filing on February 2, 2009, the Company became aware that the requirements of FIN 39-1 had not been properly applied to its financial derivative instruments within the financial statements. The Company determined that the effect of this error was not material to its financial statements and disclosures taken as a whole, and decided to apply FIN 39-1 prospectively beginning with its first quarter 2009 Form 10-Q. Also, in the unaudited Condensed Consolidated Statement of Cash Flows for the three and six months ended June 30, 2008, the Company has reclassified certain unrealized noncash gains recorded on fuel derivative instruments and the cash collateral received from counterparties to its fuel hedging program, in order to conform to the current year presentation. These reclassifications had no impact on net cash flows provided by operations.

In preparation of the unaudited condensed consolidated financial statements, the Company reviewed, as determined necessary by the Company's management, events that occurred after June 30, 2009, up until the original issuance of the financial statements, which occurred on July 23, 2009. In connection with the reissuance of these financial statements on Form 10-Q/A, the Company reviewed, as determined necessary by the Company's management, events

that occurred up until the reissuance of the financial statements, which occurred on October 22, 2009.

## 2. RESTATEMENT OF PREVIOUSLY ISSUED FINANCIAL STATEMENTS

The Company has determined that its previously issued unaudited interim condensed consolidated financial statements for the three and six month periods ended June 30, 2009, contained an error with respect to one rule within SFAS 133. Specifically, to facilitate the implementation of new hedge accounting software, in April 2009, existing hedging instruments were de-designated and re-designated as new hedges. Included in the re-designation, however, were certain derivative instruments that were in a net written option position that did not qualify as hedges according to SFAS 133. As a result, the Company is restating its financial statements for the three and six month periods ended June 30, 2009. The following table illustrates the correction as it is associated with certain line items in the financial statements (in millions, except per share amounts):

### Condensed Consolidated Balance Sheet (unaudited)

	June 30, 2009		
	As reported	Adjustment	Restated
Accrued liabilities	1,029	(5 )	1,024
Total current liabilities	3,073	(5 )	3,068
Deferred income taxes	1,921	3	1,924
Retained earnings	4,863	37	4,900
Accumulated other comprehensive loss	(762 )	(35 )	(797 )
Total stockholders' equity	5,146	2	5,148

### Condensed Consolidated Statement of Operations (unaudited)

	Three months ended June 30, 2009		
	As reported	Adjustment	Restated
Other (gains) losses, net	34	(57 )	(23 )
Total other expenses (income)	73	(57 )	16
INCOME (LOSS) BEFORE INCOME TAXES	50	57	107
PROVISION (BENEFIT) FOR INCOME TAXES	(4 )	20	16
NET INCOME (LOSS)	54	37	91
NET INCOME (LOSS) PER SHARE, BASIC	0.07	0.05	0.12
NET INCOME (LOSS) PER SHARE, DILUTED	0.07	0.05	0.12

## Condensed Consolidated Statement of Operations (unaudited)

	Six months ended June 30, 2009		
	As reported	Adjustment	Restated
Other (gains) losses, net	57	(57 )	-
Total other expenses (income)	130	(57 )	73
INCOME (LOSS) BEFORE INCOME TAXES	(57 )	57	-
PROVISION (BENEFIT) FOR INCOME TAXES	(20 )	20	-
NET INCOME (LOSS)	(37 )	37	-
NET INCOME (LOSS) PER SHARE, BASIC	(0.05 )	0.05	-
NET INCOME (LOSS) PER SHARE, DILUTED	(0.05 )	0.05	-

## 3. NEW ACCOUNTING PRONOUNCEMENTS

On April 9, 2009, the Financial Accounting Standards Board (FASB) issued Staff Position SFAS 107-1 and Accounting Principles Board (APB) Opinion No. 28-1, "Interim Disclosures about Fair Value of Financial Instruments" (FSP 107-1 and APB 28-1). FSP 107-1 amends FASB Statement No. 107, "Disclosures about Fair Values of Financial Instruments," to require disclosures about fair value of financial instruments in interim financial statements as well as in annual financial statements. APB 28-1 amends APB Opinion No. 28, "Interim Financial Reporting," to require those disclosures in all interim financial statements. FSP 107-1 and APB 28-1 are effective for interim periods ending after June 15, 2009 and the Company has adopted them in second quarter 2009. See Note 11.

On April 9, 2009, the FASB issued Staff Position SFAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly" (FSP 157-4). FSP 157-4 provides additional guidance in estimating fair value under statement No. 157, "Fair Value Measurements" (SFAS 157), when the volume and level of transaction activity for an asset or liability have significantly decreased in relation to normal market activity for the asset or liability. FSP 157-4 also provides additional guidance on circumstances that may indicate a transaction is not orderly. FSP 157-4 is effective for interim periods ending after June 15, 2009, and the Company has adopted its provisions during second quarter 2009. FSP 157-4 did not have a significant impact on the Company's financial position, results of operations, cash flows, or disclosures for second quarter 2009.

On April 9, 2009, the FASB issued Staff Position SFAS 115-2 and SFAS 124-2, “Recognition and Presentation of Other-Than-Temporary Impairments” (FSP 115-2). FSP 115-2 provides guidance in determining whether impairments in debt securities are other than temporary, and modifies the presentation and disclosures surrounding such instruments. FSP 115-2 is effective for interim periods ending after June 15, 2009, and the Company has adopted its provisions for second quarter 2009. FSP 115-2 did not have a significant impact on the Company’s financial position, results of operations, cash flows, or disclosures for second quarter 2009.

In May 2009, the FASB issued statement No. 165, “Subsequent Events” (SFAS 165). SFAS 165 modifies the definition of what qualifies as a subsequent event—those events or transactions that occur following the balance sheet date, but before the financial statements are issued, or are available to be issued—and requires companies to disclose the date through which it has evaluated subsequent events and the basis for determining that date. The Company adopted the provisions of SFAS 165 for second quarter 2009, in accordance with the effective date. See Note 1.

In June 2009, the FASB issued statement No. 167, “Amendments to FASB Interpretation No. 46(R)” (SFAS 167). Among other items, SFAS 167 responds to concerns about the application of certain key provisions of FIN 46(R), including those regarding the transparency of the involvement with variable interest entities. SFAS 167 is effective for calendar year companies beginning on January 1, 2010. The Company has not yet determined the impact that adoption of SFAS 167 will have on its financial position, results of operations, cash flows, or disclosures.

#### 4. NET INCOME (LOSS) PER SHARE-RESTATED

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

	Three months ended June 30, 2009 (As restated)		Six months ended June 30, 2009 (As restated)	
	2009	2008	2009	2008
<b>NUMERATOR:</b>				
Net income (loss)	\$91	\$321	\$-	\$355
<b>DENOMINATOR:</b>				
Weighted-average shares outstanding, basic	741	732	741	733
Dilutive effect of Employee stock options	-	5	-	3
Adjusted weighted-average shares outstanding, diluted	741	737	741	736
<b>NET INCOME (LOSS) PER SHARE:</b>				
Basic	\$.12	\$.44	\$-	\$.48
Diluted	\$.12	\$.44	\$-	\$.48

The Company has excluded 79 million and 56 million shares, respectively, from its calculations of net income per share, diluted, for the three months ended June 30, 2009 and 2008, and has excluded 79 million and 72 million shares, respectively, from its calculations of net income per share, diluted, for the six months ended June 30, 2009 and 2008,

as they represent antidilutive stock options for the respective periods presented.

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## 5. FINANCIAL DERIVATIVE INSTRUMENTS-RESTATED

## Fuel Contracts

Airline operators are inherently dependent upon energy to operate and, therefore, are impacted by changes in jet fuel prices. Jet fuel and oil (including related taxes) consumed during the three months ended June 30, 2009 and 2008, represented approximately 29 percent and 35 percent of the Company's operating expenses, respectively. The Company's operating expenses have been extremely volatile in recent years due to dramatic increases and declines in energy prices. The Company endeavors to acquire jet fuel at the lowest possible cost and to reduce volatility in operating expenses. Because jet fuel is not traded on an organized futures exchange, there are limited opportunities to hedge directly in jet fuel. However, the Company has found that financial derivative instruments in other commodities, such as crude oil, and refined products such as heating oil and unleaded gasoline, can be useful in decreasing its exposure to jet fuel price volatility. The Company does not purchase or hold any derivative financial instruments for trading purposes.

The Company has used financial derivative instruments for both short-term and long-term time frames, and typically uses a mixture of purchased call options, collar structures (which include both a purchased call option and a sold put option), and fixed price swap agreements in its portfolio. Generally, when prices are lower, the Company prefers to use fixed price swap agreements and purchased call options. However, when prices are higher, the Company uses more collar structures due to the high cost of purchased call options and the increased risk associated with fixed price swaps. Although the use of collar structures 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 settles. With the use of purchased call options, the Company cannot be in a liability position at settlement.

The following table provides information about the Company's volume of fuel hedging for the first half of 2009, and its portfolio as of June 30, 2009, for future periods. These hedge volumes are presented strictly from an "economic" standpoint and thus do not reflect whether the hedges qualified or will qualify for special hedge accounting as defined in SFAS 133. The Company defines its "economic" hedge as the total volume of fuel derivative contracts held, including the net impact of positions that have been effectively "settled" through offsetting positions, regardless of whether those contracts qualify for hedge accounting as defined in SFAS 133.

Period (by year)	Fuel hedged as of June 30, 2009 (gallons in millions)	Approximate % of jet fuel consumption	
2009	518	37	% *
2010	653	47	% *
2011	211	15	% *
2012	93	7	% *
2013	98	7	% *
Period (by quarter for 2009)			
First quarter 2009	15	4	%
Second quarter 2009	185	50	%
Third quarter 2009	144	40	% *
Fourth quarter 2009	174	52	% *

\* Forecasted



Upon proper qualification, the Company accounts for its fuel derivative instruments as cash flow hedges, as defined in SFAS 133. Under SFAS 133, all derivatives designated as hedges that meet certain requirements are granted special hedge accounting treatment. Generally, utilizing the special hedge accounting, all periodic changes in fair value of the derivatives designated as hedges that are considered to be effective, as defined, are recorded in "Accumulated other comprehensive income (loss)" ("AOCI") until the underlying jet fuel is consumed. See Note 6 for further information on "AOCI." The Company is exposed to the risk that periodic changes will not be effective, as defined, or that the derivatives will no longer qualify for special hedge accounting. Ineffectiveness, as defined, results when the change in the fair value of the derivative instrument exceeds the change in the value of the Company's expected future cash outlay to purchase and consume jet fuel. To the extent that the periodic changes in the fair value of the derivatives are not effective, that ineffectiveness is recorded to "Other (gains) losses, net" in the statement of operations. Likewise, if a hedge ceases to qualify for hedge accounting, any change in the fair value of derivative instruments since the last period is recorded to "Other (gains) losses, net" in the statement of operations in the period of the change; however, in accordance with SFAS 133, 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. In a situation where it becomes probable that a hedged forecasted transaction will not occur, any gains and/or losses that have been recorded to "AOCI" would be required to be immediately reclassified into earnings. The Company did not have any such situations occur for the three or six months ended June 30, 2009 or 2008.

Ineffectiveness is inherent in hedging jet fuel with derivative positions based in other crude oil related commodities. Due to the volatility in markets for crude oil and related products, the Company is unable to predict the amount of ineffectiveness each period, including the loss of hedge accounting, which could be determined on a derivative by derivative basis or in the aggregate for a specific commodity. This may result, and has resulted, in increased volatility in the Company's financial results. Factors that have and may continue to lead to ineffectiveness and unrealized gains and losses on derivative contracts include: significant fluctuation in energy prices, the number of derivative positions the Company holds, significant weather events affecting refinery capacity and the production of refined products, and the volatility of the different types of products the Company uses in hedging. The number of instances in which the Company has discontinued hedge accounting for specific hedges and for specific refined products, such as unleaded gasoline, has increased recently, primarily due to the foregoing factors. However, even though these derivatives may not qualify for SFAS 133 special hedge accounting, the Company continues to hold the instruments as it believes they continue to afford the Company the opportunity to minimize jet fuel costs.

SFAS 133 is a complex accounting standard with stringent requirements, including the documentation of a Company hedging strategy, statistical analysis to qualify a commodity for hedge accounting both on a historical and a prospective basis, and strict contemporaneous documentation that is required at the time each hedge is designated by the Company. As required by SFAS 133, the Company assesses the effectiveness of each of its individual hedges on a quarterly basis. The Company also examines the effectiveness of its entire hedging program on a quarterly basis utilizing statistical analysis. This analysis involves utilizing regression and other statistical analyses that compare changes in the price of jet fuel to changes in the prices of the commodities used for hedging purposes.

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

Derivatives designated as hedging instruments under SFAS 133		Asset Derivatives		Liability Derivatives	
		Fair Value at 6/30/09	Fair Value at 12/31/08	Fair Value at 6/30/09 (As restated)	Fair Value at 12/31/08
	Balance Sheet Location				

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Fuel derivative contracts (gross)*	Accrued liabilities	\$ 92	\$ 94	\$ 16	\$ 19
Fuel derivative contracts (gross)*	Other deferred liabilities	112	40	36	522
Interest rate derivative contracts	Other assets	50	83	-	-
Interest rate derivative contracts	Other deferred liabilities	-	-	-	3
Total derivatives designated as hedging instruments under SFAS 133					
		\$ 254	\$ 217	\$ 52	\$ 544
Derivatives not designated as hedging instruments under SFAS 133					
Fuel derivative contracts (gross)*	Accrued liabilities	\$ 403	\$ 387	\$ 651	\$ 708
Fuel derivative contracts (gross)*	Other deferred liabilities	308	266	970	530
Total derivatives not designated as hedging instruments under SFAS 133					
		\$ 711	\$ 653	\$ 1,621	\$ 1,238
Total derivatives		\$ 965	\$ 870	\$ 1,673	\$ 1,782

\* Does not include the impact of cash collateral deposits provided to counterparties. See discussion of credit risk and collateral following in this Note.

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

Balance Sheet Location		June 30, 2009 (As restated)	December 31, 2008
Cash collateral deposits provided to counterparty - noncurrent	Offset against Other deferred liabilities	374	240
Cash collateral deposits provided to counterparty - current	Offset against Accrued liabilities	51	-
Due to third parties for settled fuel contracts	Accrued liabilities	18	16
Net unrealized losses from fuel hedges, net of tax	Accumulated other comprehensive loss	785	946

The following tables present the impact of derivative instruments and their location within the unaudited Condensed Consolidated Statement of Operations for the three and six months ended June 30, 2009 and 2008 (in millions):

#### Derivatives in SFAS 133 Cash Flow Hedging Relationships

	Amount of (Gain) Loss Recognized in AOCI on Derivative (Effective Portion)		Amount of (Gain) Loss Reclassified from AOCI into Income (Effective Portion)(a)		Amount of (Gain) Loss Recognized in Income on Derivatives (ineffective portion) (b)	
	Three months ended June 30, 2009	Three months ended June 30, 2008	Three months ended June 30, 2009	Three months ended June 30, 2008	Three months ended June 30, 2009	Three months ended June 30, 2008
	2009	2008	2009	2008	2009	2008
	(As restated)					
Fuel derivative contracts	\$(7 ) *	\$(1,493 ) *	\$96 *	\$(284 ) *	\$(25 )	\$20
Interest rate derivatives	(20 ) *	-	-	-	-	-
Total	\$(27 )	\$(1,493 )	\$96	\$(284 )	\$(25 )	\$20

\* Net of tax

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

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

## Derivatives in SFAS 133 Cash Flow Hedging Relationships

	Amount of (Gain) Loss Recognized in AOCI on Derivative (Effective Portion)		Amount of (Gain) Loss Reclassified from AOCI into Income (Effective Portion)(a)		Amount of (Gain) Loss Recognized in Income on Derivatives (ineffective portion) (b)	
	Six months ended June 30, 2009 (As restated)	2008	Six months ended June 30, 2009	2008	Six months ended June 30, 2009	2008
Fuel derivative						
contracts	\$45	* \$(1,923)	* \$206	* \$(454)	* \$(9)	\$26
Interest rate						
derivatives	(25)	)* -	-	-	-	-
Total	\$20	\$(1,923)	\$206	\$(454)	\$(9)	\$26

\* Net of tax

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

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

## Derivatives not in SFAS 133 Cash Flow Hedging Relationships

	Amount of (Gain) Loss Recognized in Income on Derivatives		Location of (Gain) Loss Recognized in Income on Derivatives
	Three months ended June 30, 2009 (As restated)	2008	
Fuel			
derivative			
contracts	\$ (38)	\$ (381)	Other (gains) losses, net

## Derivatives not in SFAS 133 Cash Flow Hedging Relationships

	Amount of (Gain) Loss Recognized in Income on Derivatives		Location of (Gain) Loss Recognized in Income on Derivatives
	Six months ended June 30, 2009 (As restated)	2008	

Fuel derivative contracts	\$	(65)	\$	(365)	Other (gains) losses, net
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The Company also recorded expense associated with premiums paid for fuel derivative contracts that settled/expired during the three months ended June 30, 2009 and 2008, respectively, of \$37 million and \$14 million, and during the six months ended June 30, 2009 and 2008, respectively, of \$69 million and \$27 million. These amounts are excluded from the Company's measurement of effectiveness for related hedges.

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The fair value of the derivative instruments, depending on the type of instrument, was determined by the use of present value methods or standard option value models with assumptions about commodity prices based on those observed in underlying markets. Included in the Company's total net unrealized losses from fuel hedges as of June 30, 2009, are approximately \$288 million in unrealized losses, net of taxes, that are expected to be realized in earnings during the twelve months following June 30, 2009. In addition, as of June 30, 2009, the Company had already recognized cumulative net losses due to ineffectiveness and derivatives that do not qualify for hedge accounting totaling \$6 million, net of taxes. These losses were recognized in the three months ended June 30, 2009, and prior periods, and are reflected in "Retained earnings" as of June 30, 2009, but the underlying derivative instruments will not expire/settle until subsequent periods of 2009 or future periods.

#### Interest rate swaps

The Company is party to interest rate swap agreements related to its \$385 million 6.5% senior unsecured notes due 2012, its \$350 million 5.25% senior unsecured notes due 2014, its \$300 million 5.125% senior unsecured notes due 2017, and its \$100 million 7.375% senior unsecured debentures due 2027. The primary objective for the Company's use of these interest rate hedges is to better match the repricing of its assets and liabilities. Under each of these interest rate swap agreements, the Company pays the London InterBank Offered Rate (LIBOR) plus a margin every six months on the notional amount of the debt, and receives payments based on the fixed stated rate of the notes every six months until the date the notes become due. These interest rate swap agreements qualify as fair value hedges, as defined by SFAS 133. In addition, these interest rate swap agreements qualify for the "shortcut" method of accounting for hedges, as defined by SFAS 133. Under the "shortcut" method, the hedges are assumed to be perfectly effective, and, thus, there is no ineffectiveness to be recorded in earnings.

The Company also entered into interest rate swap agreements concurrent with its entry into a twelve-year, \$600 million floating-rate term loan agreement during 2008, and a ten-year, \$332 million floating-rate term loan agreement during May 2009. Under these swap agreements, which are accounted for as cash flow hedges, the interest rates on the term loans are effectively fixed for their entire term at 5.223 percent and 6.64 percent, respectively, and ineffectiveness is required to be measured each reporting period. The fair values of the interest rate swap agreements, which are adjusted regularly, have been aggregated by counterparty for classification in the unaudited Condensed Consolidated Balance Sheet.

#### Credit risk and collateral

The Company's credit exposure related to fuel derivative instruments is represented by the fair value of contracts with a net positive fair value to the Company at the reporting date. 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 will periodically review counterparties based on credit ratings, limits its exposure to a single counterparty, and monitors the market position of the fuel hedging program and its relative market position with each counterparty. At June 30, 2009, the Company had agreements with all of its 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. Based on the Company's current agreements with two of these counterparties, cash deposits are required to be posted whenever the net fair value of derivatives associated with those counterparties exceed specific thresholds. If the threshold is exceeded, cash is either posted by the counterparty if the value of derivatives is an asset to the Company, or posted by the Company if the value of derivatives is a liability to the Company.

Under one of the Company's counterparty agreements, as amended, until January 1, 2010, if the Company becomes obligated to post collateral for obligations in amounts of up to \$300 million and in excess of \$700 million, the Company is required to post cash collateral; however, if the Company becomes obligated to post collateral for



obligations in amounts between \$300 million and \$700 million, the Company has pledged 20 of its Boeing 737-700 aircraft as collateral in lieu of cash. At June 30, 2009, the fair value of fuel derivative instruments with this counterparty was a net liability of \$302 million, and the Company had posted \$300 million in cash collateral deposits with the counterparty, with the remaining \$2 million secured by pledged aircraft. If the fair value of fuel derivative instruments with this counterparty were in a net asset position, the counterparty would be required to post cash collateral to the Company on a dollar-for-dollar basis for amounts in excess of \$40 million. This agreement does not contain any triggers that would require additional cash to be posted by the Company outside of further changes in the fair value of the fuel derivative instruments held with the counterparty. However, if the fair value of fuel derivative instruments with this counterparty were in a net asset position, and the counterparty's credit rating were to be lowered to specified levels, the counterparty could be required to post cash collateral to the Company on a dollar-for-dollar basis related to the first \$40 million of assets held.

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Under another of the Company's counterparty agreements, the Company is obligated to post collateral related to fuel derivative liabilities as follows: (i) if the obligation is up to \$125 million, the Company posts cash collateral, (ii) if the obligation is between \$125 million and \$625 million, the Company has pledged 29 Boeing 737-700 aircraft as collateral in lieu of cash, and (iii) if the obligation exceeds \$625 million, the Company must post cash or letters of credit as collateral. The Company pledged 29 of its Boeing 737-700 aircraft to cover the collateral posting band in clause (ii). As of June 30, 2009, the fair value of fuel derivative instruments with this counterparty was a net liability of \$399 million, and the Company had posted \$125 million in cash collateral deposits to this counterparty, with the remaining \$274 million secured by pledged aircraft. This agreement also provides for the counterparty to post cash collateral to the Company on a dollar-for-dollar basis for any net positive fair value of fuel derivative instruments in excess of \$150 million held by the Company from that counterparty. This agreement does not contain any triggers that would require additional cash to be posted by the Company outside of further changes in the fair value of the fuel derivative instruments held with the counterparty. However, if the fair value of fuel derivative instruments with this counterparty were in a net asset position, and the counterparty's credit rating were to be lowered to specified levels, the counterparty would be required to post cash collateral to the Company on a dollar-for-dollar basis related to the first \$150 million of assets held.

As of June 30, 2009, other than as described above, the Company did not have any fuel hedging agreements with counterparties in which cash collateral is required to be posted based on the Company's current investment grade credit rating. However, additional fuel hedging agreements contain a provision whereby each party has the right to terminate and settle all outstanding fuel contracts if the other party's credit rating falls below investment grade. Upon this occurrence, the party in a net liability position could subsequently be required to post cash collateral if a mutual alternative agreement could not be reached. At June 30, 2009, the Company's estimated fair value of fuel derivative contracts with one counterparty containing this provision was a liability of \$101 million, including \$29 million that will settle by the end of 2009.

Due to the Company's current fuel hedging agreements with counterparties, in the Company's judgment, it does not have significant exposure to future cash collateral requirements. As an example, even if market prices for the commodities used in the Company's fuel hedging activities were to decrease by 50 percent from market prices as of June 30, 2009, given the Company's current fuel hedge portfolio and its investment grade credit rating, it would not have had to provide additional cash collateral to its current counterparties.

The Company classifies its cash collateral provided to counterparties in accordance with the provisions of FIN 39-1. FIN 39-1 requires an entity to select a policy of how it records the offset rights to reclaim cash collateral associated with the related derivative fair value of the assets or liabilities of such derivative instruments. Entities may either select a "net" or a "gross" presentation. The Company has elected to present its cash collateral utilizing a net presentation, in which cash collateral amounts held or provided have been netted against the fair value of outstanding derivative instruments. The Company's policy differs depending on whether its derivative instruments are in a net asset position or a net liability position. If its fuel derivative instruments are in a net asset position with a counterparty, cash collateral amounts held are first netted against current derivative amounts (those that will settle during the twelve months following the balance sheet date) associated with that counterparty until that balance is zero, and then any remainder would be applied against the fair value of noncurrent outstanding derivative instruments (those that will settle beyond one year following the balance sheet date.) If its fuel derivative instruments are in a net liability position with a counterparty, cash collateral amounts provided are first netted against noncurrent derivative amounts associated with that counterparty until that balance is zero, and then any remainder would be applied against the fair value of current outstanding derivative instruments. At June 30, 2009, of the \$425 million in cash collateral deposits posted with counterparties under its bilateral collateral provisions, \$374 million has been netted against noncurrent fuel derivative instruments within "Other deferred liabilities" and \$51 million has been netted against current fuel derivative instruments within "Accrued liabilities" in the unaudited Condensed Consolidated Balance Sheet.

## 6. COMPREHENSIVE INCOME (LOSS)-RESTATED

Comprehensive income (loss) includes changes in the fair value of certain financial derivative instruments, which qualify for hedge accounting, and unrealized gains and losses on certain investments. The differences between net income (loss) and comprehensive income (loss) for the three and six months ended June 30, 2009 and 2008, were as follows:

(In millions)	Three months ended June 30,	
	2009	2008
	(As restated)	
Net income	\$ 91	\$ 321
Unrealized gain on derivative instruments, net of deferred taxes of \$64 and \$753	103	1,209
Other, net of deferred taxes of \$14 and (\$1)	22	(2 )
Total other comprehensive income	125	1,207
Comprehensive income	\$ 216	\$ 1,528

(In millions)	Six months ended June 30,	
	2009	2008
	(As restated)	
Net income	\$ -	\$ 355
Unrealized gain on derivative instruments, net of deferred taxes of \$100 and \$904	161	1,469
Other, net of deferred taxes of \$16 and (\$7)	26	(11 )
Total other comprehensive income (loss)	187	1,458
Comprehensive income	\$ 187	\$ 1,813

A rollforward of the amounts included in “AOCI,” net of taxes, is shown below for the three and six months ended June 30, 2009:

(In millions)	Fuel hedge derivatives (As restated)	Other	Accumulated other comprehensive income (loss) (As restated)
Balance at March 31, 2009	\$ (888 )	\$ (34 )	\$ (922 )
Second quarter 2009 changes in value	7	22	29
Reclassification to earnings	96		96
Balance at June 30, 2009	\$ (785 )	\$ (12 )	\$ (797 )

(In millions)	Fuel hedge derivatives (As restated)	Other	Accumulated other comprehensive income (loss) (As restated)
Balance at December 31, 2008	\$ (946 )	\$ (38 )	\$ (984 )
2009 changes in value	(45 )	26	(19 )
Reclassification to earnings	206	-	206
Balance at June 30, 2009	\$ (785 )	\$ (12 )	\$ (797 )

## 7. ACCRUED LIABILITIES-RESTATED

(In millions)	June 30, 2009 (As restated)	December 31, 2008
Retirement plans	\$ 97	\$ 86
Aircraft rentals	109	118
Vacation pay	181	175
Advances and deposits	14	23
Fuel derivative contracts	120	246
Deferred income taxes	133	36
Workers compensation	124	122
Other	246	206
Accrued liabilities	\$ 1,024	\$ 1,012



## 8. POSTRETIREMENT BENEFITS

The following table sets forth the Company's periodic postretirement benefit cost for each of the interim periods identified:

(In millions)	Three months ended June 30,	
	2009	2008
Service cost	\$ 4	\$ 4
Interest cost	1	1
Amortization of prior service cost	1	1
Recognized actuarial gain	(1 )	(1 )
Net periodic postretirement benefit cost	\$ 5	\$ 5

(In millions)	Six months ended June 30,	
	2009	2008
Service cost	\$ 7	\$ 7