

SOUTHWEST AIRLINES CO
Form 10-Q
April 25, 2011

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2011

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 ☐

Smaller reporting company ☐

Non-accelerated filer ☐ (Do not check if a 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 ☒

Number of shares of Common Stock outstanding as of the close of business on April 20, 2011: 747,958,666

TABLE OF CONTENTS TO FORM 10-Q

Part I- FINANCIAL INFORMATION

Item 1. Financial Statements

Condensed Consolidated Balance Sheet as of March 31, 2011 and December 31, 2010

Condensed Consolidated Statement of Operations for the three months ended March 31, 2011 and 2010

Condensed Consolidated Statement of Cash Flows for the three months ended March 31, 2011 and 2010

Notes to Condensed Consolidated Financial Statements

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Item 4. Controls and Procedures

Part II – OTHER INFORMATION

Item 1. Legal Proceedings

Item 1A. Risk Factors

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Item 3. Defaults Upon Senior Securities

Item 4. (Removed and Reserved)

Item 5. Other Information

Item 6. Exhibits

SIGNATURES

EXHIBIT INDEX

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

Item 1. Financial Statements

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

	March 31, 2011	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 2,039	\$ 1,261
Short-term investments	2,426	2,277
Accounts and other receivables	282	195
Inventories of parts and supplies, at cost	320	243
Deferred income taxes	-	214
Prepaid expenses and other current assets	262	89
Total current assets	5,329	4,279
Property and equipment, at cost:		
Flight equipment	14,090	13,991
Ground property and equipment	2,153	2,122
Deposits on flight equipment purchase contracts	172	230
	16,415	16,343
Less allowance for depreciation and amortization	5,919	5,765
	10,496	10,578
Other assets	589	606
	\$ 16,414	\$ 15,463
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 916	\$ 739
Accrued liabilities	827	863
Air traffic liability	1,710	1,198
Current maturities of long-term debt	905	505
Total current liabilities	4,358	3,305
Long-term debt less current maturities	2,428	2,875
Deferred income taxes	2,496	2,493
Deferred gains from sale and leaseback of aircraft	85	88
Other non-current liabilities	460	465
Stockholders' equity:		
Common stock	808	808

Edgar Filing: SOUTHWEST AIRLINES CO - Form 10-Q

Capital in excess of par value	1,186	1,183
Retained earnings	5,399	5,399
Accumulated other comprehensive income (loss)	79	(262)
Treasury stock, at cost	(885)	(891)
Total stockholders' equity	6,587	6,237
	\$ 16,414	\$ 15,463

See accompanying notes.

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

	Three months ended March 31,	
	2011	2010
OPERATING REVENUES:		
Passenger	\$ 2,939	\$ 2,495
Freight	31	30
Other	133	105
Total operating revenues	3,103	2,630
OPERATING EXPENSES:		
Salaries, wages, and benefits	954	864
Fuel and oil	1,038	821
Maintenance materials and repairs	199	166
Aircraft rentals	46	47
Landing fees and other rentals	201	190
Depreciation and amortization	155	154
Other operating expenses	396	334
Total operating expenses	2,989	2,576
OPERATING INCOME	114	54
OTHER EXPENSES (INCOME):		
Interest expense	43	41
Capitalized interest	(3)	(5)
Interest income	(3)	(3)
Other (gains) losses, net	59	4
Total other expenses	96	37
INCOME BEFORE INCOME TAXES	18	17
PROVISION FOR INCOME TAXES	13	6
NET INCOME	\$ 5	\$ 11
NET INCOME PER SHARE, BASIC	\$ 0.01	\$ 0.01
NET INCOME PER SHARE, DILUTED	\$ 0.01	\$ 0.01
WEIGHTED AVERAGE SHARES		

OUTSTANDING:

Basic	748	743
Diluted	749	744
Cash dividends declared per common share	\$ 0.0045	\$ 0.0045

See accompanying notes.

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

	Three months ended March 31,	
	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 5	\$ 11
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	155	154
Unrealized loss on fuel derivative instruments	10	21
Deferred income taxes	28	12
Amortization of deferred gains on sale and leaseback of aircraft	(3)	(3)
Changes in certain assets and liabilities:		
Accounts and other receivables	(87)	(67)
Other current assets	(92)	(18)
Accounts payable and accrued liabilities	238	(85)
Air traffic liability	512	356
Cash collateral received from fuel derivative counterparties	29	5
Other, net	170	(13)
Net cash provided by operating activities	965	373
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment, net	(57)	(139)
Purchases of short-term investments	(1,484)	(1,380)
Proceeds from sales of short-term investments	1,310	1,197
Net cash used in investing activities	(231)	(322)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from Employee stock plans	4	12
Proceeds from termination of interest rate derivatives	76	-
Payments of long-term debt and capital lease obligations	(30)	(60)
Payments of cash dividends	(7)	(7)
Other, net	1	-
Net cash provided by (used in) financing activities	44	(55)
NET CHANGE IN CASH AND CASH EQUIVALENTS	778	(4)
CASH AND CASH EQUIVALENTS AT		

BEGINNING OF PERIOD	1,261	1,114
---------------------	-------	-------

CASH AND CASH EQUIVALENTS

AT END OF PERIOD	\$ 2,039	\$ 1,110
------------------	----------	----------

CASH PAYMENTS FOR:

Interest, net of amount capitalized	\$ 34	\$ 34
-------------------------------------	-------	-------

Income taxes	\$ -	\$ -
--------------	------	------

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. (the "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 March 31, 2011 and 2010 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 ("GAAP") for complete financial statements. Financial results for the Company and airlines in general can be seasonal in nature. In many years, the Company's revenues, as well as its operating income and net income, have been better in its second and third fiscal quarters than in its first and fourth fiscal quarters. Air travel is also significantly impacted by general economic conditions, the amount of disposable income available to consumers, unemployment levels, and corporate travel budgets. These and other factors, such as 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 requirements related to hedge accounting, have created, and may continue to create, significant volatility in the Company's results in certain fiscal periods. See Note 5 for further information on fuel and the Company's hedging program. Operating results for the three months ended March 31, 2011 are not necessarily indicative of the results that may be expected for the year ended December 31, 2011. 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, 2010.

2. MERGER AND RELATED MATTERS

On September 26, 2010, the Company, AirTran Holdings, Inc. ("AirTran"), and Guadalupe Holdings Corp. ("Merger Sub") entered into an Agreement and Plan of Merger (the "Merger Agreement"), providing for the acquisition of AirTran by the Company. The Merger Agreement provides that, upon the terms and subject to the conditions set forth in the Merger Agreement, Merger Sub, a wholly owned subsidiary of the Company formed for the sole purpose of effecting the merger, will be merged with and into AirTran, with AirTran continuing as the surviving corporation and as a wholly owned subsidiary of the Company (the "Merger"). Immediately following the effective time of the Merger, AirTran will merge with and into a wholly owned limited liability company subsidiary of the Company. The Company has announced that it expects the closing date of the merger to be May 2, 2011.

Subject to the terms and conditions of the Merger Agreement, which has been approved by the AirTran stockholders, if the Merger is completed, each outstanding share of AirTran common stock will be converted into the right to receive 0.321 shares of Southwest Airlines Co. common stock, which exchange ratio may be adjusted as discussed below, and \$3.75 in cash, without interest. If the average closing price of Southwest common stock for the 20 consecutive trading day period ending on (and including) the third trading day prior to the closing of the Merger (the "Southwest Average Share Price") is greater than \$12.46, then the exchange ratio will be adjusted to equal \$4.00 divided by the Southwest Average Share Price, rounded to the nearest thousandth. If the Southwest Average Share Price is less than \$10.90, then, subject to the next sentence, the exchange ratio will be adjusted to equal \$3.50 divided

by the Southwest Average Share Price, rounded to the nearest thousandth. If the Southwest Average Share Price is less than \$10.90, the Company must deliver, at its election, an additional amount of cash, an additional number (or fraction) of shares of Southwest common stock, or a combination of both, such that, after giving effect to such election, the aggregate value of the Merger consideration is equal to \$7.25. The exchange ratio adjustment mechanism provides at least \$7.25 in value and up to \$7.75 in value (based on the Southwest Average Share Price) per share of AirTran common stock.

Completion of the Merger is subject to certain conditions, including, among others: (i) the expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, (ii) receipt of any other material governmental consents and approvals required to consummate the Merger, (iii) the absence of any governmental order, law, or legal restraint prohibiting the consummation of the Merger, and (iv) authorization of the listing on the New York Stock Exchange of the shares of Southwest common stock to be issued to AirTran stockholders pursuant to the Merger. The obligation of each party to consummate the Merger is also conditioned upon the accuracy of the other party's representations and warranties and the other party having performed in all material respects its obligations under the Merger Agreement.

The Company and AirTran may mutually agree to terminate the Merger Agreement at any time prior to the effectiveness of the Merger. In addition, either party may terminate the Merger Agreement (i) if the Merger is not consummated on or before September 26, 2011 (subject to extension by mutual agreement of the parties) or (ii) for certain other reasons, as set forth in the Merger Agreement.

The foregoing description of the Merger Agreement is only a summary, does not purport to be complete and is qualified in its entirety by reference to the Merger Agreement, which is attached as Exhibit 2.1 to the Company's Current Report on Form 8-K as filed with the Securities and Exchange Commission (the "SEC") on September 27, 2010.

The Company is expected to incur substantial integration and transition expenses in connection with the Merger, including the necessary costs associated with integrating the operations of the two companies. While the Company has assumed that a certain level of expenses would be incurred, there are many factors that could affect the total amount or the timing of the expenses, and many of the expenses that will be incurred are, by their nature, difficult to estimate. These expenses could, particularly in the near term, result in the Company taking significant charges against earnings following the completion of the Merger. The amount and timing of such charges are currently uncertain.

3. ACCOUNTING CHANGES AND NEW ACCOUNTING PRONOUNCEMENTS

On September 23, 2009, the Financial Accounting Standards Board ("FASB") ratified Accounting Standards Update ("ASU") No. 2009-13 (formerly referred to as Emerging Issues Task Force Issue No. 08-1), "Revenue Arrangements with Multiple Deliverables." ASU No. 2009-13 requires the allocation of consideration among separately identified deliverables contained within an arrangement, based on their relative selling prices. The Company utilizes current accounting guidance, also titled "Revenue Arrangements with Multiple Deliverables," in the timing of recognition of revenue associated with the sale of frequent flyer credits to business partners. The Company applies the residual method, which is allowed with respect to the Company's revenue arrangements in their current form, but which will be prohibited under ASU No. 2009-13 with respect to new and modified revenue arrangements. ASU No. 2009-13 is effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after January 1, 2011. Subsequent to adoption of ASU No. 2009-13, the Company has not entered into or materially modified any of its revenue arrangements, thus ASU No. 2009-13 currently has no impact on the Company. However, ASU No. 2009-13 could have a significant impact on future results as new or materially modified revenue arrangements with certain partners are established in the normal course of business.

In January 2010, the FASB issued ASU No. 2010-06, "Improving Disclosures about Fair Value Measurements" an amendment to Accounting Standards Codification Topic 820, "Fair Value Measurements and Disclosures." This amendment requires an entity to: (i) disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers, and (ii) present separate information for Level 3 activity pertaining to gross purchases, sales, issuances, and settlements. ASU No. 2010-06 is effective for the

Company for interim and annual reporting periods beginning after December 15, 2009, with one new disclosure effective after December 15, 2010. The Company early adopted this ASU in full at the interim period ended March 31, 2010. See Note 10.

4. NET INCOME PER SHARE

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

	Three months ended March 31,	
	2011	2010
NUMERATOR:		
Net income	\$ 5	\$ 11
DENOMINATOR:		
Weighted-average shares outstanding, basic	748	743
Dilutive effect of Employee stock options	1	1
Adjusted weighted-average shares outstanding, diluted	749	744
NET INCOME PER SHARE:		
Basic	\$ 0.01	\$ 0.01
Diluted	\$ 0.01	\$ 0.01
Antidilutive stock options excluded from calculations	47	75

5. FINANCIAL DERIVATIVE INSTRUMENTS

Fuel Contracts

Airline operators are inherently dependent upon energy to operate and, therefore, are impacted by changes in jet fuel prices. Furthermore, jet fuel and oil typically represent one of the largest operating expenses for airlines. The Company endeavors to acquire jet fuel at the lowest possible cost and to reduce volatility in operating expenses through its fuel hedging program. Because jet fuel is not widely 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 financial derivative 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), call spreads (which include a purchased call option and a sold call option), and fixed price swap agreements in its portfolio.

The Company evaluates its hedge volumes strictly from an “economic” standpoint and thus does not consider whether the hedges 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. For first quarter 2011, the Company had fuel derivatives in place related to approximately 40 percent of its fuel consumption. As of March 31, 2011, the Company had fuel derivative instruments in place to provide coverage on a large portion of its remaining 2011 estimated fuel consumption at varying price levels. The following table provides information about the Company’s volume of fuel hedging for 2011 (including first quarter actuals), as well as the years 2012 through 2014.

	Fuel hedged as of March 31, 2011
Period (by year)	(gallons in millions)
2011	626
2012	470
2013	554
2014	458

Upon proper qualification, the Company accounts for its fuel derivative instruments as cash flow hedges. All derivatives designated as hedges that meet certain requirements are granted hedge accounting treatment. Generally, utilizing hedge accounting, all periodic changes in fair value of the derivatives designated as hedges that are considered to be effective are recorded in Accumulated other comprehensive income (loss) ("AOCI") until the underlying jet fuel is consumed. See Note 6. 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 hedge accounting. Ineffectiveness results when the change in the fair value of the derivative instrument exceeds the change in the value of the Company's expected future cash outlay to purchase and consume jet fuel. To the extent that the periodic changes in the fair value of the derivatives are ineffective, the ineffective portion is recorded to Other (gains) losses, net in the 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, any amounts previously recorded to AOCI would remain there until such time as the original forecasted transaction occurs, at which time these amounts would be reclassified to Fuel and oil expense. When the Company has sold derivative positions in order to effectively "close" or offset a derivative already held as part of its fuel derivative instrument portfolio, any subsequent changes in fair value of those positions are marked to market through earnings. Likewise, any changes in fair value of those positions that were offset by entering into the sold positions 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 hedged forecasted transaction will not occur, any gains and/or losses that have been recorded to AOCI would be required to be immediately reclassified into earnings. The Company did not have any such situations occur during 2010 or first quarter 2011.

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. However, even though derivatives may not qualify for hedge accounting, the Company continues to hold the instruments as management believes derivative instruments continue to afford the Company the opportunity to stabilize jet fuel costs.

Accounting pronouncements pertaining to derivative instruments and hedging are complex with stringent requirements, including the documentation of a Company hedging strategy, statistical analysis to qualify a commodity for hedge accounting both on a historical and a prospective basis, and strict contemporaneous documentation that is required at the time each hedge is designated by the Company. As required, 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 fuel derivatives are classified as Other operating cash flows in the unaudited Condensed Consolidated Statement of Cash Flows. See Note 5 for additional information. 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:

		Asset Derivatives		Liability Derivatives	
	Balance Sheet Location	Fair Value at 03/31/11	Fair Value at 12/31/10	Fair Value at 03/31/11	Fair Value at 12/31/10
(in millions)					
Derivatives designated as hedges					
Fuel derivative contracts (gross)*	Other current assets	\$ 352	\$ 151	\$ 59	\$ 16
Fuel derivative contracts (gross)*	Other Assets	868	547	128	88
Fuel derivative contracts (gross)*	Accrued liabilities	105	122	-	18
Fuel derivative contracts (gross)*	Other noncurrent liabilities	30	71	2	9
Interest rate derivative contracts	Other assets	23	73	-	-
Interest rate derivative contracts	Other noncurrent liabilities	12	-	45	4
Total derivatives designated as hedges		\$ 1,390	\$ 964	\$ 234	\$ 135
Derivatives not designated as hedges					
Fuel derivative contracts (gross)*	Other current assets	\$ 432	\$ 164	\$ 505	\$ 284
Fuel derivative contracts (gross)*	Other assets	332	212	619	304
		16	40	233	222

Fuel derivative contracts (gross)*	Accrued liabilities				
Fuel derivative contracts (gross)*	Other noncurrent liabilities	9	33	142	257
Total derivatives not designated as hedges		\$ 789	\$ 449	\$ 1,499	\$ 1,067
Total derivatives		\$ 2,179	\$ 1,413	\$ 1,733	\$ 1,202

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

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

(in millions)	Balance Sheet Location	March 31, 2011	December 31, 2010
Cash collateral deposits provided	Offset against Other		
to counterparty - noncurrent	noncurrent liabilities	\$ 105	\$ 125
Cash collateral deposits provided	Offset against Accrued		
to counterparty - current	liabilities	119	-
Cash collateral deposits held from	Offset against Other		
counterparty - noncurrent	Assets	141	60
Cash collateral deposits held from	Offset against Other		
counterparty - current	Current Assets	47	-
Due to third parties for settled fuel contracts	Accrued liabilities	3	-
Receivable from third parties for settled fuel contracts	Accounts and other receivables	-	1
Net unrealized (gains) losses from fuel hedges, net of tax	Accumulated other comprehensive (gain) loss	(81)	250

The following tables present the impact of derivative instruments and their location within the unaudited Condensed Consolidated Statement of Operations for the three months ended March 31, 2011 and 2010:

Derivatives in Cash Flow Hedging Relationships						
(in millions)	(Gain) Loss Recognized in AOCI on		(Gain) Loss Reclassified from AOCI into Income		(Gain) Loss Recognized in Income	
	Derivatives (effective portion)		Derivatives (effective portion)(a)		on Derivatives (ineffective portion) (b)	
	Three months ended March 31,		Three months ended March 31,		Three months ended March 31,	
	2011	2010	2011	2010	2011	2010
Fuel derivative						
contracts	\$ (315) *	\$ (16) *	\$ 16 *	\$ 75 *	\$ 34	\$ (4)
Interest rate derivatives	(7) *	1 *	-	-	-	-

Total	\$	(322)	\$	(15)	\$	16	\$	75	\$	34	\$	(4)
-------	----	-------	----	------	----	----	----	----	----	----	----	-----

* Net of tax

Amounts related to fuel derivative contracts and interest rate derivatives are included

(a) in Fuel and oil and Interest expense, respectively.

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

Derivatives not in Cash Flow Hedging Relationships				Location of (Gain) Loss Recognized in Income on Derivatives Other (gains) losses, net
(Gain) Loss				
Recognized in Income on				
Derivatives				
	Three months ended			
	March 31,			
(in millions)	2011		2010	
Fuel derivative contracts	\$ (5)		\$ (23)	

The Company also recorded expense associated with premiums paid for fuel derivative contracts that settled/expired during first quarter 2011 and first quarter 2010 of \$31 million in each period. These amounts are excluded from the Company's measurement of effectiveness for related hedges and are included as a component of Other (gains) losses, net, in the unaudited Condensed Consolidated Statement of Operations.

The fair values of the derivative instruments, depending on the type of instrument, were 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 gains from fuel hedges as of March 31, 2011, were approximately \$19 million in unrealized gains, net of taxes, which are expected to be realized in earnings during the twelve months subsequent to March 31, 2011. In addition, as of March 31, 2011, the Company had already recognized cumulative net losses due to ineffectiveness and derivatives that do not qualify for hedge accounting treatment totaling \$67 million, net of taxes. These net losses were recognized in first quarter 2011 and prior periods, and are reflected in Retained earnings as of March 31, 2011, but the underlying derivative instruments will not expire/settle until second quarter 2011 or future periods.

Interest rate swaps

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

In January 2011, the Company terminated the fixed-to-floating interest rate swap agreements related to its \$350 million 5.25% senior unsecured notes due 2014 and its \$300 million 5.125% senior unsecured notes due 2017. The effect of these terminations is basically that the interest associated with these debts prospectively revert back to their original fixed rates. As a result of the gains realized on these transactions, which will be amortized over the remaining term of the corresponding notes, and based on projected interest rates at the date of termination, the Company does not believe its future interest expense associated with these notes will significantly differ from the expense it would have recorded had the notes remained at floating rates.

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 periodically reviews 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 March 31, 2011, 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 or credit ratings fall below certain levels. The Company also had agreements with counterparties in which cash deposits and/or pledged aircraft are required to be posted whenever the net fair value of derivatives associated with those counterparties exceeds specific thresholds. The following table provides the fair values of fuel derivatives, amounts posted as collateral, and applicable collateral posting threshold amounts as of March 31, 2011, at which such postings are triggered:

(in millions)	Counterparty (CP)						Total
	A	B	C	D	E	Other(a)	
Fair value of fuel derivatives	\$258	\$(215)	\$35	\$134	\$245	\$(1)	\$456
Cash collateral held from (by) CP	185	(224)	-	3	-	-	(36)
If credit rating is investment grade, fair value of fuel derivative level at which:							