SOUTHWEST AIRLINES CO
Form DEF 14A
April 05, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the

Securities Exchange Act of 1934

(Amendment No.)

Filed by the Registrant x Filed by a Party other than the Registrant ¨

Check the appropriate box:

¨ Preliminary Proxy Statement

¨ **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

x Definitive Proxy Statement

¨ Definitive Additional Materials

¨ Soliciting Material Pursuant to §240.14a-12

Southwest Airlines Co.
(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x No fee required.

¨ Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which the transaction applies:

(2) Aggregate number of securities to which the transaction applies:

(3) Per unit price or other underlying value of the transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of the transaction:

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¨ Fee paid previously with preliminary materials.

¨ Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

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SOUTHWEST AIRLINES CO.

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

WEDNESDAY, MAY 16, 2012

To the Shareholders:

The Annual Meeting of the Shareholders of Southwest Airlines Co. will be held at the Hyatt Regency Dallas located at 300 Reunion Boulevard, Dallas, Texas on Wednesday, May 16, 2012, at 10:00 a.m., Central Daylight Time, for the following purposes:

(1) to elect ten Directors;

(2) to conduct an advisory (nonbinding) vote to approve named executive officer compensation;

(3) to approve an amendment and restatement of Southwest s Articles of Incorporation to eliminate supermajority voting for certain corporate matters;

(4) to ratify the selection of Ernst & Young LLP as Southwest s independent auditors for the fiscal year ending December 31, 2012; and

(5) to transact such other business as may properly come before the meeting or any adjournment or postponement thereof.

March 20, 2012, is the date of record for determining Shareholders entitled to receive notice of and to vote at the Annual Meeting or any adjournment thereof.

The Annual Meeting will be broadcast live on the Internet. To listen to the broadcast, log on to http://southwest.investorroom.com/.

To attend the meeting in person, you will need to bring (i) a valid government-issued photo identification, such as a driver s license or passport, and (ii) either an Admission Ticket or proof of ownership of Southwest Airlines Co. common stock as of March 20, 2012 (such as an account statement from your broker showing your stock ownership as of March 20, 2012). If you have received a paper copy of your proxy materials, an Admission Ticket is included with your proxy materials. If you have received your proxy materials electronically, you will need proof of ownership to be admitted to the meeting. If you are a proxy holder for a Shareholder of Southwest who owned shares of Southwest s common stock as of March 20, 2012, you must also bring to the meeting the executed proxy naming you as the proxy holder, signed by the Shareholder who owned shares of Southwest s common stock as of March 20, 2012.

Your vote is important. Please sign and return the enclosed proxy in the enclosed envelope to ensure that your shares are represented at the meeting. You may also vote via telephone or the Internet as described in the enclosed proxy.

By Order of the Board of Directors,

Ron Ricks

Executive Vice President, Chief Legal & Regulatory Officer, & Corporate Secretary

April 5, 2012

IMPORTANT NOTICE REGARDING THE AVAILABILITY OF PROXY MATERIALS FOR THE 2012 ANNUAL MEETING OF SHAREHOLDERS TO BE HELD ON MAY 16, 2012

Southwest s Proxy Statement for the 2012 Annual Meeting of Shareholders and Annual Report to Shareholders for the fiscal year ended December 31, 2011, are available at

http://southwest.investorroom.com/

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Southwest Airlines Co.

P.O. Box 36611

Dallas, Texas 75235

(214) 792-4000

PROXY STATEMENT

FOR

ANNUAL MEETING OF SHAREHOLDERS

To be Held May 16, 2012

GENERAL INFORMATION

This proxy statement is being furnished in connection with the solicitation of proxies by and on behalf of the Board of Directors of Southwest Airlines Co. (the Company or Southwest) for use at the Annual Meeting of Shareholders of the Company to be held on May 16, 2012, at 10:00 a.m., Central Daylight Time, at the Hyatt Regency Dallas located at 300 Reunion Boulevard, Dallas, Texas, or at such other time and place to which the meeting may be adjourned. The approximate date on which this proxy statement and accompanying proxy are first being sent or given to Shareholders is April 5, 2012.

Annual Meeting Admission

To attend the meeting in person, you will need to bring (i) a valid government-issued photo identification, such as a driver s license or passport, and (ii) either an Admission Ticket or proof of ownership of Southwest Airlines Co. common stock as of March 20, 2012 (such as an account statement from your broker showing your stock ownership as of March 20, 2012). If you have received a paper copy of your proxy materials, an Admission Ticket is included with your proxy materials. If you have received your proxy materials electronically, you will need proof of ownership to be admitted to the meeting. If you are a proxy holder for a Shareholder of the Company who owned shares of the Company s common stock as of March 20, 2012, you must also bring to the meeting the executed proxy naming you as the proxy holder, signed by the Shareholder who owned shares of the Company s common stock as of March 20, 2012.

Voting Procedures

A representative of Broadridge Financial Solutions, Inc. will tabulate votes and serve as Inspector of Election for the meeting. Each Shareholder of record will be entitled to one vote for each share registered in the Shareholder s name with respect to each matter to be voted on at the meeting. A Shareholder of record is a person or entity who holds shares on the record date that are registered in such Shareholder s name on the records of the Company s transfer agent. A person or entity who holds shares through a broker, bank, or other nominee is considered a beneficial owner of the shares. You may receive more than one set of proxy materials. This means your shares are held in more than one account. Please vote all of your shares.

Voting by Shareholders of Record. If you are a Shareholder of record, you may vote by completing and returning the enclosed proxy card. You may also vote by touch-tone telephone from the United States, using the number on the proxy card, or through the Internet, using the instructions on the proxy card. Shares represented by proxy will be voted at the meeting and may be revoked at any time prior to the time at which they are voted by (i) timely submitting a valid, later-dated proxy; (ii) delivering a written notice of revocation to the Secretary of the Company; or (iii) voting in person at the meeting. If you properly complete and sign your proxy card but do not indicate how your shares should be voted on a matter, the shares represented by your proxy will be voted in accordance with the recommendation of the Company s Board of Directors.

Voting by Beneficial Owners. If you are a beneficial owner of shares, these proxy materials are being forwarded to you by your broker (or bank or other nominee) who is considered the Shareholder of record of your shares. As the beneficial owner of the shares, you are entitled to direct your broker as to how to vote your shares. You may so instruct your broker by completing the voting instruction card the broker provides to you. You may also vote by telephone or through the Internet if your broker makes these methods available, in which case your

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broker has provided applicable instructions with these proxy materials. You may change your vote by submitting new voting instructions to your broker in accordance with such broker s procedures. If you provide voting instructions to your broker, your shares will be voted as you direct. If you do not provide voting instructions, pursuant to the rules of the New York Stock Exchange (the NYSE), your broker may vote your shares only with respect to proposals as to which it has discretion to vote under the NYSE s rules. For any other proposals, the broker may not vote your shares at all, which is referred to as a broker non-vote. **Please note that, in the absence of your specific instructions as to how to vote, your broker may not vote your shares with respect to any of the proposals included in this proxy statement except for Proposal 4 (Ratification of the Selection of Independent Auditors), so please provide instructions to your broker regarding the voting of your shares.** As the beneficial owner of shares, you are invited to attend the meeting; however, you may not vote your shares in person at the meeting unless you obtain a legal proxy from the Shareholder of record of your shares.

Quorum; Effect of Abstentions and Broker Non-Votes

The presence at the meeting, in person or by proxy, of the holders of a majority of the shares of the Company s common stock entitled to vote at the meeting is necessary to constitute a quorum. Shareholders of record at the close of business on March 20, 2012, are entitled to vote at the meeting. As of that date, the Company had issued and outstanding 767,480,209 shares of common stock. Abstentions and broker non-votes are each included in the determination of the number of shares present and entitled to vote at the meeting for purposes of determining the presence or absence of a quorum for the transaction of business at the meeting; however, neither abstentions nor broker non-votes are counted as voted either for or against a proposal. If you are a beneficial owner and do not provide voting instructions to your broker, your broker will only be entitled to vote your shares in its discretion with respect to Proposal 4 (Ratification of the Selection of Independent Auditors). Your broker will not be able to vote your shares in its discretion with respect to Proposal 1 (Election of Directors), Proposal 2 (Advisory Vote on the Compensation of the Company s Named Executive Officers), or Proposal 3 (Approval of Amendment and Restatement of the Company s Articles of Incorporation), and your vote will be counted as a broker non-vote on those proposals.

PROPOSAL 1 ELECTION OF DIRECTORS

At the Annual Meeting of Shareholders, ten Directors are to be elected for one-year terms expiring in 2013. Gary C. Kelly, Laura H. Wright, and Ron Ricks have been selected as a proxy committee by the Board of Directors, and it is the intention of the proxy committee that, unless otherwise directed therein, proxies will be voted for the election of all of the nominees listed below. Although it is not contemplated that any of the nominees will be unable to serve, if such a situation arises prior to the meeting, the proxy committee will act in accordance with its best judgment. Each of the nominees has indicated his or her willingness to serve as a member of the Board of Directors, if elected.

The following sets forth certain information for each nominee for Director of the Company.

Name	Director Since	Age*
David W. Biegler	2006	65
J. Veronica Biggins	2011	65
Douglas H. Brooks	2010	59
William H. Cunningham	2000	67
John G. Denison	2008	66
Gary C. Kelly	2004	56
Nancy B. Loeffler	2003	65
John T. Montford	2002	68
Thomas M. Nealon	2010	50
Daniel D. Villanueva	2008	74

* As of January 1, 2012.

David W. Biegler has been Chairman and Chief Executive Officer of Southcross Energy, LLC since July 2009. Southcross is a midstream natural gas company engaged in the purchase and sale, pipeline transportation, gathering, and processing of natural gas. Mr. Biegler has also served as Chairman and Chief Executive Officer of Estrella Energy L.P., an investor in Southcross, since September 2003. Mr. Biegler served as interim President and Chief Executive Officer of Dynegy Inc., a provider of wholesale power, capacity, and ancillary services, from March 12, 2011 to April 11, 2011. He retired as Vice Chairman of TXU Corp. at the end of 2001, having served TXU Corp. as President and Chief Operating Officer from 1997 until 2001. He previously served as Chairman, President, and Chief Executive Officer of ENSERCH Corporation from 1993 to 1997. During the past five years, Mr. Biegler has served as a Director of the following companies that are or were publicly traded: Trinity Industries, Inc. (since 1992); Animal Health International, Inc. (2007-2011); Dynegy Inc. (2003-2011); and Guaranty Financial Group Inc. (2008-2009). Mr. Biegler also serves as a Director for Austin Industries. In November 2011, after Mr. Biegler had resigned from the Dynegy Inc. Board, certain subsidiaries of Dynegy Inc. filed for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code.

The Board has concluded that Mr. Biegler should continue to serve as a Director for the Company for the following reasons, among others: (i) Mr. Biegler s extensive experience as a Chief Executive Officer and Chief Operating Officer enable him to contribute significantly to the Board s oversight responsibilities on matters relating to operational and financial strategies and risks, particularly in his roles as a member of the Board s Audit Committee and Safety and Compliance Oversight Committee; (ii) Mr. Biegler s senior management experience, as well as his experience from serving on multiple public company boards, enable him to contribute significantly with respect to the Board s oversight of matters relating to executive compensation and compensation strategies, particularly in his role as Chair of the Board s Compensation Committee; and (iii) his broad-based knowledge in energy marketing is particularly pertinent in assisting the Board with its oversight of the Company s fuel hedging program.

J. Veronica Biggins is a Managing Director in the Atlanta office of Diversified Search LLC, an executive and board search firm. Ms. Biggins was Managing Partner of the Atlanta office of Hodge Partners from 2007 until 2011 when Hodge Partners, also an executive and board search firm, became a part of Diversified Search. Ms. Biggins served as Assistant to the President of the United States and Director of Presidential Personnel under President William Jefferson Clinton and has also served as Chair of the Czech Slovak American Enterprise Fund. Ms. Biggins background includes 20 years experience with NationsBank (now Bank of America) and its predecessor. Prior to joining the White House, Ms. Biggins was one of the highest ranking women in the banking industry. Ms. Biggins also serves on the Avnet, Inc. board (since 1997). Previously she served as a Director of Zep Inc. (2007-2012) and AirTran Holdings, Inc. (2001-2011). Ms. Biggins has served on a number of non-profit Boards.

The Board has concluded that Ms. Biggins should continue to serve as a Director for the Company for the following reasons, among others: (i) Ms. Biggins brings to the Board extensive financial expertise, knowledge of the airline industry, and institutional knowledge of AirTran s operations; (ii) Ms. Biggins has extensive knowledge of compensation and governance matters as a result of her service on the compensation and nominating and corporate governance committees for other publicly-traded companies; and (iii) Ms. Biggins knowledge of the Atlanta market, along with her community involvement and charitable work, is valuable because of the Company s significant focus in these areas.

Douglas H. Brooks has served as Chairman of the Board of Brinker International, Inc., a casual dining restaurant company, since November 2004. Mr. Brooks has also served as Brinker International s Chief Executive Officer since January 2004, and as its President since January 1999. Mr. Brooks has also served in other capacities for Brinker including as its Chief Operating Officer and as President of Chili s Grill & Bar. Mr. Brooks serves on the Board of Directors of Limbs for Life and is a member of the Professional Advisory Board for St. Jude Children s Research Hospital.

The Board has concluded that Mr. Brooks should continue to serve as a Director for the Company for the following reasons, among others: (i) Mr. Brooks adds a unique skill set to the Board because of his position as a

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standing Chief Executive Officer of a company with approximately 60,000 employees and operations in the United States and 31 other countries and two territories outside of the United States; (ii) Mr. Brooks skill set is particularly valuable to the Board and the Company in connection with AirTran s international operations and the Company s exploration of additional international opportunities; (iii) Mr. Brooks experience managing a company with a large employee base is particularly beneficial to the Board because of the importance to the Company of strong employee relations; and (iv) Mr. Brooks experience managing a company that must focus on customer service is particularly beneficial to the Board because of the importance of customer service to the Company.

William H. Cunningham, Ph.D. has been a professor at The University of Texas at Austin since 2000 and holds the James L. Bayless Chair for Free Enterprise at the University s Red McCombs School of Business. Dr. Cunningham served as Chancellor and Chief Executive Officer of The University of Texas system from 1992 to 2000 and as President of The University of Texas at Austin from 1985 to 1992. During the past five years, he has served as a Director of the following companies that are or were publicly traded: Lincoln National Corporation (since 2006); Resolute Energy Corporation (formerly Hicks Acquisition Company I, Inc., since 2007); LIN TV Corp. (since 2009 and from 2002-2008); Introgen Therapeutics, Inc. (2000-2009); and Hayes Lemmerz International, Inc. (2003-2009). He is also a disinterested Director of John Hancock Funds, III, a registered investment company.

The Board has concluded that Dr. Cunningham should continue to serve as a Director for the Company for the following reasons, among others: (i) Dr. Cunningham holds a Ph.D. and a Masters of Business Administration in Business, which, combined with his experience as an executive, brings valuable financial and strategic expertise and perspectives to the Board, particularly in his roles as Presiding Director and as a member of the Audit Committee; and (ii) Dr. Cunningham has served on over 25 corporate boards and teaches corporate governance at The University of Texas Schools of Law and Business, which enables him to bring valuable and current governance expertise to the Board, particularly in his roles as Presiding Director and Chair of the Nominating and Corporate Governance Committee.

John G. Denison served as Chairman of the Board for Global Aero Logistics Inc. (Global), a diversified passenger airline, from January 2006 until April 2008. Mr. Denison came out of retirement in January 2005 to join Global as its Co-Chief Restructuring Officer. He also served as President and Chief Executive Officer of ATA Airlines Inc. (ATA), a subsidiary of Global, from February 2005 until December 2006. In his capacities with Global and ATA, Mr. Denison s responsibilities included, among others, managing or supervising business plans, collective bargaining negotiations, restructurings, financings, and major contract negotiations. ATA filed a voluntary petition under Chapter 11 of the U.S. Bankruptcy Code in April 2008.

The Board has concluded that Mr. Denison should continue to serve as a Director for the Company for the following reasons, among others: (i) Mr. Denison holds a Masters of Business Administration in Finance and has previously served as a Chief Financial Officer; (ii) Mr. Denison s extensive experience in the airline industry, combined with his extensive experience in the area of financial reporting, brings a unique and valuable perspective to the Board with respect to the Company s operations and risks, particularly in his roles as a member of the Company s Audit Committee and Safety and Compliance Oversight Committee; and (iii) Mr. Denison s experience with business plans, collective bargaining negotiations, and major contract negotiations are extremely valuable to the Board s strategic discussions.

Gary C. Kelly has served as the Company s Chairman of the Board since May 2008, as its President since July 2008, and as its Chief Executive Officer since July 2004. Mr. Kelly also served as the Company s Executive Vice President and as its Chief Financial Officer from June 2001 to July 2004 and Vice President Finance and Chief Financial Officer from 1989 to 2001. Mr. Kelly joined the Company in 1986 as its Controller. During the past five years, Mr. Kelly has served as a Director of one publicly traded company other than Southwest: Lincoln National Corporation (since November 2009).

The Board has concluded that Mr. Kelly should continue to serve as a Director for the Company for the following reasons, among others: (i) he is the Company s Chief Executive Officer and has been with the

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Company for over 25 years; (ii) his role and his experience enable him to bring invaluable operational, financial, regulatory, governance, and cultural perspectives to the Board; and (iii) his role and his experience enable him to continually educate and advise the Board on the Company s industry and related opportunities, issues, and challenges.

Nancy B. Loeffler is a consultant for Frost Bank of San Antonio and a member of the Frost Bank Advisory Board. A long-time advocate of volunteerism, Ms. Loeffler also currently serves as Chair of The University of Texas M.D. Anderson Cancer Center Foundation, the National Cowgirl Museum and Hall of Fame Board of Directors, The University of Texas Blanton Museum of Fine Arts Board of Directors, and the Advisory Council of the San Antonio Lighthouse for the Blind. During the past five years, Ms. Loeffler also served on the Board of Trustees for the Vice President s Residence Foundation in Washington, D.C., the Board of Regents for St. Mary s University in San Antonio, Texas, and the Capitol Advisory Committee for Texas Lutheran University. Ms. Loeffler has also previously served on the Board of Trustees for the South Texas Community Foundation, the Board of Governors of the Cancer Therapy Research Foundation of South Texas and the Board of Directors of the Cancer Therapy Research Center, as President of the Junior League, and as Vice Chair of the Governor s Educational Excellence Commission.

The Board has concluded that Ms. Loeffler should continue to serve as a Director for the Company for the following reasons, among others: (i) Ms. Loeffler s background provides the Board with valuable perspectives on governmental affairs and the legislative process; and (ii) her extensive experience with community service and cultural affairs is valuable to the Board because of the Company s significant focus on these areas.

John T. Montford has been President and Chief Executive Officer of JTM Consulting, LLC since January 2010. Mr. Montford was retained by General Motors in January 2010 as a consultant and served in the capacity of Senior Advisor of Government Relations and Global Public Policy until January 2012. In his consulting role, Mr. Montford also served on the Executive Committee of General Motors. From 2001 through 2009, Mr. Montford served in a number of positions in the telecommunications industry. These included: President of Southwestern Bell and Southern New England Company, External Affairs (2001-2005); Senior Vice President for Legislative and Regulatory Affairs for SBC and AT&T (2005-2007); and President, Western Region, AT&T Services (2008-2009). Mr. Montford was Chancellor of the Texas Tech University System from 1996 to 2001 and also served in the Texas Senate from 1983 to 1996, where he served as both Chairman of the Senate Finance Committee and Chairman of the Senate State Affairs Committee. In 2002, Mr. Montford was named Chancellor Emeritus of the Texas Tech University System. He is a former active duty U.S. Marine Officer and an elected District Attorney. During the past five years, Mr. Montford has served as a Director of one publicly traded company other than Southwest: Fleetwood Enterprises, Inc. (1999-2009).

The Board has concluded that Mr. Montford should continue to serve as a Director for the Company for the following reasons, among others: (i) Mr. Montford s extensive executive experience in the areas of governmental relations, regulatory affairs, and public policy is valuable to a heavily-regulated company like Southwest; (ii) this same experience enables Mr. Montford to provide valuable perspectives and input on governance matters, particularly in his roles as a member of the Board s Nominating and Corporate Governance Committee and Compensation Committee; and (iii) his experience as Chairman of the Senate Finance Committee (for example, his role in drafting a budget of over $100 billion for the State of Texas) brings valuable perspectives to the Company in connection with its financial strategies and reporting, particularly in his role as Chair of the Board s Audit Committee.

Thomas M. Nealon served as Group Executive Vice President of J.C. Penney Company, Inc., a retail company, from August 2010 until December 2011. Mr. Nealon also served as J.C. Penney s Executive Vice President & Chief Information Officer from September 2006 until August 2010. Prior to joining J.C. Penney, Mr. Nealon was a partner with The Feld Group, a provider of information technology consulting services, where he served in a consultant capacity as Senior Vice President & Chief Information Officer for the Company from 2001 to 2006. Mr. Nealon also served as Chief Information Officer for Frito-Lay, a division of PepsiCo, Inc., from 1996 to 2000, and in various software engineering, systems engineering, and management positions, for

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Frito-Lay from 1983 to 1996. Mr. Nealon received the 2010 MIT Sloan School of Business Award for Innovation Leadership and was recognized by Information Week as a Premiere 100 CIO in 2006 and 2010.

The Board has concluded that Mr. Nealon should continue to serve as a Director for the Company for the following reasons, among others: (i) Mr. Nealon brings a technology dimension to the Board: in his roles with J.C. Penney, Mr. Nealon oversaw J.C. Penney s Internet site, jcp.com, as well as other information technology, including the design and development of systems and infrastructure to support J.C. Penney s strategic business objectives; (ii) Mr. Nealon s technology expertise is particularly significant to the Company and the Board because of the continually increasing importance of technology to the success of the Company s strategic initiatives; and (iii) in his roles with J.C. Penney, Mr. Nealon was also responsible for corporate planning and strategy, which enables him to offer practical insight with respect to the Company s strategic initiatives and long-term operating plans.

Daniel D. Villanueva has been a partner in RC Fontis, a California-based private equity firm, since 2005. Mr. Villanueva previously was Managing Partner of Bastion Capital Corporation, a private equity investment fund, from 1993 to 2005. Mr. Villanueva also has over 25 years experience as a television executive, having served as Senior Vice President, Partner, and Director at Spanish International Communications Corp. and its successor company Univision Group over the period from 1964 to 1990. Mr. Villanueva has also developed and sold numerous broadcasting properties across the United States. Mr. Villanueva s civic activities have included board memberships of the American Red Cross, the National Association of Broadcasters, National Junior Achievement, National YMCA, the National Hispanic Education Fund, the California Broadcasters Association, the California Economic Development Corporation, the Greater Los Angeles Chamber of Commerce, KCET Public Television, the United Way, Stanford Graduate School of Business, the Ventura County Community Foundation, and the Museum of Contemporary Art. Mr. Villanueva was also a Commissioner of the 1984 Summer Olympic Games in Los Angeles. During the past five years, he has served as a Director of one publicly traded company other than Southwest: Fleetwood Enterprises, Inc. (2003-2009).

The Board has concluded that Mr. Villanueva should continue to serve as a Director for the Company for the following reasons, among others: (i) Mr. Villanueva brings valuable entrepreneurial experience to the Board, particularly at a time at which the Company continues to execute many significant strategic initiatives; (ii) his expertise in the communications space is valuable to the Board as the Company addresses technological initiatives and challenges; (iii) his geographic presence on the West coast is valuable in connection with the Company s significant operations in that area; and (iv) his strong commitment to civic service is relevant in connection with the Company s similar commitment.

Vote Required

Provided a quorum is present at the meeting, the affirmative vote of a majority of the votes cast by the holders of shares entitled to vote in the election of Directors is required to elect Directors. A majority of the votes cast means the number of votes cast for a Director must exceed the number of votes cast against that Director.

Recommendation of the Board of Directors

The Board of Directors unanimously recommends a vote FOR the election of each of the nominees for Director named above. Proxies solicited by the Board of Directors will be so voted unless Shareholders specify a different choice.

CORPORATE GOVERNANCE

General

The business of the Company is managed under the direction of the Board of Directors. Pursuant to the requirements of the NYSE, a majority of the members of the Board must be independent, as defined by NYSE rules. The Board of Directors meets on a regularly scheduled basis to review significant developments affecting the Company, to act on matters requiring approval by the Board, and to otherwise fulfill its responsibilities. The

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Board of Directors has adopted Corporate Governance Guidelines, based on the recommendation of its Nominating and Corporate Governance Committee, to further its goal of providing effective governance of the Company s business for the long-term benefit of the Company s Shareholders, Employees, and Customers. These guidelines set forth policies concerning overall governance practices for the Company, including the following:

- Qualifications of Directors
- Board Meetings
- Director Responsibilities
- Independence of Directors
- Size of Board and Selection Process
- Resignation Policy
- Board Committees
- Executive Sessions; Communications with Non-Management Directors
- Board Self-Evaluation
- Ethics
- Director and Senior Management Compensation
- Direct Stock Ownership
- Access to Management
- Access to Independent Advisors
- Director Orientation and Continuing Education
- Public Communications
- Other Practices

The Company s Corporate Governance Guidelines, along with its Code of Ethics and the Charters for its Audit, Compensation, and Nominating and Corporate Governance Committees, are available on the Company s website, *www.southwest.com*. Shareholders may also obtain copies of these documents upon written request to Southwest Airlines Co., Investor Relations, HDQ-6FC, P.O. Box 36611, Dallas, Texas 75235.

Board Membership and Qualifications

General Qualification Requirements; Diversity Considerations. The Company s Nominating and Corporate Governance Committee is responsible for recommending to the Board the criteria for Board membership, as set forth in the Company s Corporate Governance Guidelines. The Corporate Governance Guidelines require that members of the Board (i) possess the highest personal and professional ethics, integrity, and values; (ii) possess practical wisdom and mature judgment; (iii) be committed to the best long-term interests of the Company s Employees, Customers, and Shareholders; (iv) be willing to devote sufficient time to fulfill their responsibilities; and (v) be willing to serve on the Board for an extended period of time. The Corporate Governance Guidelines also require the following factors to be considered in connection with the nomination or appointment of new Board members: (i) finance, marketing, government, education, and other professional experience or knowledge relevant to the success of the Company in the current business environment; (ii) independence (for non-management Directors); (iii) in the case of current Directors being considered for re-nomination, a Director s past attendance at Board and Committee meetings and participation in and contributions to such meetings; and (iv) diversity. Each individual is evaluated in the context of the Board as a whole, with the objective of recommending to Shareholders a group that collectively can best serve the long-term interests of the Company s Employees, Customers, and Shareholders. The Board does not have a formal policy with regard to Board member diversity. Rather, diversity is one of many factors considered by the Board in assessing the qualifications of Board candidates. Furthermore, in considering diversity, the Board takes into account various types of diversity, such as diversity of experience, geography, gender, ethnicity, color, and age, with the goal of obtaining diverse perspectives. The Board s primary consideration is to identify candidates with the background, experience, and skills that will best fulfill the Board s and the Company s needs at the time a search is being conducted. Therefore, the Board does not believe it is appropriate to either nominate or exclude from nomination an individual based on gender, ethnicity, color, age, or similar factors.

The Corporate Governance Guidelines prohibit non-Employee Directors from serving on more than six public company boards and prohibit Employee Directors from serving on more than three public company boards. The Corporate Governance Guidelines also require that the nature and time involved in a Director s service on other boards be considered in connection with the evaluation of the suitability of that Director. In addition, in accordance with the Corporate Governance Guidelines, Directors should advise the Chairman of the Board and the Chairman of the Nominating and Corporate Governance Committee in advance of accepting an invitation to serve on the board of directors, the audit committee, or the compensation committee of another publicly-traded company.

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Attendance at Meetings. The Board of Directors held eleven meetings during 2011 (some of which spanned two days) and otherwise acted by unanimous written consent. During 2011, each of the Company s current Directors attended at least 75 percent of the total number of Board meetings and applicable Committee meetings held during the period for which he or she served as a Director. It is the Board s policy that every Director and nominee for Director should make every effort to attend the Company s Annual Meeting of Shareholders. All of the Company s Directors at the time attended the 2011 Annual Meeting of Shareholders.

Board Leadership Structure

Gary C. Kelly, the Company s Chief Executive Officer, also serves as the Company s Chairman of the Board. The Board of Directors believes this is in the best interests of the Company and its Shareholders because Mr. Kelly is in the best position to (i) properly and timely identify matters that should be brought to the Board s attention, (ii) prioritize Board agenda items, and (iii) identify the individuals in the best position to present agenda items. The Board believes this structure is considerably more efficient and effective than (i) requiring an outside Chairman of the Board to duplicate many of the Chief Executive Officer s efforts or (ii) requiring the Chief Executive Officer to relay communications through another member of the Board. In addition, the Board believes the following practices accomplish independent oversight of management without the need to separate the roles of the Chief Executive Officer and the Chairman of the Board:

- All members of the Board, other than the Chief Executive Officer, are independent, and each member is elected annually by the Company s Shareholders.
- All members of the Board s Audit, Compensation, Nominating and Corporate Governance, and Safety and Compliance Oversight Committees are independent.
- The Board meets, at a minimum, six times per year, and at each regular meeting of the Board, the Board is apprised of the Company s operations and strategies through briefings by (i) the Chief Executive Officer, (ii) other members of senior management with key responsibilities for the Company s ongoing operations and current initiatives, and (iii) any other Employees or advisors requested by the Board.
- In addition to regularly scheduled updates, the Board and its Committees also regularly request updates from management regarding matters deemed significant at any given time.
- The independent Board members hold executive sessions outside the presence of the Chief Executive Officer and other management.
- The Board and its Committees provide regular input regarding items to be covered in future agendas.

In addition, pursuant to the Company s Corporate Governance Guidelines, the Board is required to appoint an independent member of the Board to serve as its Presiding Director. The duties of the Presiding Director, which is the Board s lead independent Director, include the following:

- presiding over executive sessions of the non-management Directors;
- consulting with the Chairman of the Board concerning the Board s agendas;
- coordinating the activities of the non-management and independent Directors and the agenda for executive sessions;

communicating feedback to the Chief Executive Officer following executive sessions;

facilitating communications between the Board and the Chief Executive Officer;

at the standing invitation of the Board s committees, attending meetings of Board committees on which the Presiding Director does not already serve;

assisting the Nominating and Corporate Governance Committee with its oversight of the annual evaluation of the Board and its Committees and communicating results of individual Director assessments to individual Board members;

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consulting with the Nominating and Corporate Governance Committee with respect to recommendations for the assignment of Board members to the Board s Committees; and

communicating (along with the Chair of the Compensation Committee) the results of the Board s evaluation of the Chief Executive Officer.

The Board believes that all of the foregoing factors provide an appropriate balance between effective and efficient Company leadership and sufficient oversight by non-Employee Directors.

Executive Sessions and Communications with Non-Management Directors

Pursuant to the Company s Corporate Governance Guidelines, the non-management members of the Board of Directors are required to meet at regularly scheduled executive sessions without the presence of management. The Board s Presiding Director, Dr. William H. Cunningham, presides over these executive sessions. Shareholders and any other interested parties may communicate directly with the Presiding Director or any or all of the non-management or other members of the Board by writing to such Director(s), c/o Southwest Airlines Co., Attn: Presiding Director, P. O. Box 36611, Dallas, Texas 75235.

Risk Oversight

Responsibility for risk oversight is primarily that of the Company s management. Pursuant to the Company s Corporate Governance Guidelines, the Board is responsible for assessing major risks facing the Company and reviewing options to mitigate such risks. The Board s oversight of major risks occurs at both the full Board level and at the Board Committee level. The Board and its Committees use the following procedures to monitor and assess risks.

The Board. The Chief Executive Officer, members of senior management, and other personnel and advisors, as requested by the Board, report on the Company s financial and operating strategies, as well as related risks, at every regular meeting of the Board. Based on these reports, the Board requests follow-up data and presentations to address any specific concerns and recommendations.

The Audit Committee. In accordance with the requirements of the NYSE, the Audit Committee assists the Board with its oversight responsibilities by discussing the Company s major financial risk exposures, its policies with respect to risk assessment and risk management, and the steps management has taken to monitor and control or mitigate financial risk exposures. The Audit Committee discusses with the Company s management, as well as the Company s Internal Audit Department (including in executive sessions), the Company s policies with respect to risk assessment and risk management and advises management on its risk assessment approach and its prioritization of risks. The Audit Committee also receives regular reports on, and assessments of, the Company s internal controls from the Company s Internal Audit Department and members of management responsible for financial controls. In addition, the Audit Committee receives the independent auditor s assessment of the Company s internal controls and financial risks, which includes the independent auditor s report on its procedures for identifying fraud and addressing any risk of management override. At each of its regular meetings, the Audit Committee also receives management reports regarding specific areas of financial risk and discusses strategies to mitigate risk.

The Safety and Compliance Oversight Committee. The Board s Safety and Compliance Oversight Committee assists the Board with overseeing the Company s activities with respect to safety and operational compliance. Pursuant to its Charter, the Safety and Compliance Oversight Committee is responsible for periodically assessing the Company s safety and operational compliance obligations and associated risks and performance relative to those standards. In fulfilling this responsibility, the Safety and Compliance Oversight Committee regularly specifies areas to be addressed at its meetings and requires that individuals from a variety of operational levels be available to discuss their areas of responsibility and respond to questions.

The Nominating and Corporate Governance Committee. The Nominating and Corporate Governance Committee receives updates and advice from management and outside advisors regarding the Company s

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procedures for complying with corporate governance regulations, as well as with respect to the Company s governance structure and protections. This Committee also reviews the Company s Corporate Governance Guidelines at least annually to further the Company s goal of providing effective governance.

The Compensation Committee. The Compensation Committee receives updates and advice on the ongoing advisability of the Company s compensation practices from both management and its independent consultant. The Compensation Committee also assists the Board with its annual review of succession planning.

The Compensation Committee is aware of the need to routinely assess the Company s compensation policies and practices as they relate to the Company s risk management and whether the structure and administration of the Company s compensation and incentive programs could influence risk-taking throughout the organization. The Compensation Committee has determined that the compensation policies and practices for the Company s Employees are not reasonably likely to have a material adverse effect on the Company for the following reasons, among others:

The Compensation Committee has historically exercised a certain amount of discretion in granting bonuses, in part to minimize the risk-taking that can result from strict application of performance-based awards. For 2011, bonus and equity awards were ultimately within the discretion of the Compensation Committee, and Employees were not formally notified of a link between performance standards and potential bonus payouts; therefore they were not incentivized to solely pursue narrowly-defined goals to achieve a particular level of bonus.

Beginning in 2010, to address regulatory and other best practice guidance, the Company moved to a more performance-oriented compensation structure whereby the Compensation Committee has awarded bonuses taking into account multiple general performance standards established by the Company to support its overall strategies and goals. This has served as a multi-dimensional tool for the Compensation Committee to use in determining bonus funding, so that factors that are deemed significant to the industry and operational performance are considered in addition to financial measures. This multi-dimensional approach reduces the risk that can be created when financial results are the only drivers of incentive payments.

Incentive compensation is used responsibly. Approximately 300 of the Company s Employees were eligible to receive bonuses for 2011.

The Company s Insider Trading Policy prohibits Employees from entering into hedging transactions with respect to the Company s securities.

Committees of the Board

The Board has established the following standing committees to assist it with fulfilling its responsibilities: (i) Audit, (ii) Compensation, (iii) Nominating and Corporate Governance, (iv) Safety and Compliance Oversight, and (v) Executive. The following table provides information on the Board s current Committee memberships.

Name	Audit Committee	Compensation Committee	Nominating and Corporate Governance Committee	Safety and Compliance Oversight Committee	Executive Committee
David W. Biegler	X	Chair		X	
J. Veronica Biggins		X			
Douglas H. Brooks			X		
William H. Cunningham	X		Chair		X
John G. Denison	X			Chair	X
Gary C. Kelly					Chair

Nancy B. Loeffler		X		
John T. Montford	Chair	X	X	
Thomas M. Nealon			X	X
Daniel D. Villanueva		X		X

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Audit Committee. The primary functions of the Audit Committee include assisting the Board in its oversight of (i) the integrity of the Company s financial statements, (ii) the Company s compliance with legal and regulatory requirements, (iii) the independent auditor s qualifications and independence, and (iv) the performance of the Company s internal audit function and independent auditors. The Audit Committee held seven meetings during 2011. The Audit Committee has been established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended, and the Board has determined that each of the members of the Audit Committee is independent under the NYSE s rules governing Board and Audit Committee membership. The Board has also determined that at least two of the members of the Audit Committee, Dr. Cunningham and Mr. Denison, satisfy the criteria adopted by the Securities and Exchange Commission (the SEC) to serve as an audit committee financial expert for the Audit Committee.

Compensation Committee.

General. The primary functions of the Compensation Committee include (i) reviewing and approving corporate goals and objectives relevant to the compensation of the Chief Executive Officer; (ii) evaluating the Chief Executive Officer s performance in light of those goals and objectives; (iii) together with the other independent members of the Board (as directed by the Board and to the extent consistent with any applicable plan documents or law), determining and approving the Chief Executive Officer s compensation level based on the Compensation Committee s evaluation; (iv) with the advice of the Chairman of the Board and the Chief Executive Officer, conducting an annual review of the compensation structure of the Company s officers and approving the salary, bonus, and other incentive and equity-related compensation for each of the Company s executive officers who are subject to Section 16(b) of the Securities Exchange Act of 1934, as amended (Reporting Officers); (v) reviewing and approving all stock-based compensation arrangements for Employees of the Company (including executive officers) and making recommendations to the Board with respect to equity-based plans that are subject to Board approval; and (vi) making recommendations to the Board with respect to non-CEO Reporting Officer compensation and incentive compensation plans that are subject to Board approval. The Compensation Committee is also responsible for reviewing non-Employee Director compensation at least annually and making any related recommendations to the full Board. To the extent permitted by applicable law and regulations, the Compensation Committee has the power to delegate any of the authority above to subcommittees or to individual members of the Compensation Committee, as it deems appropriate. The Board has determined that each of the members of the Compensation Committee is (i) independent under the NYSE s rules governing Board membership; (ii) a non-employee director under Rule 16b-3 of the Securities Exchange Act of 1934, as amended; and (iii) an outside director under Section 162(m) of the Internal Revenue Code of 1986, as amended. The Compensation Committee held six meetings during 2011.

Role of executive officers in determining or recommending the amount or form of executive and Director compensation. At the Compensation Committee s request, the Company s Chief Executive Officer and Chief People Officer provide regular input regarding compensation ideas presented to the Compensation Committee. In connection with the Compensation Committee s decisions, the Chief Executive Officer also reviews with the Compensation Committee the relative roles, scope of responsibilities, and performance of the Company s other executive officers. The roles of the Chief Executive Officer and the Chief People Officer in connection with the Compensation Committee s determinations are discussed in more detail below under Compensation of Executive Officers Compensation Discussion and Analysis.

Use of Consultants. The Compensation Committee has sole authority to retain any compensation consultant to be used to assist it in the evaluation of officer and Board compensation. During 2011, the Compensation Committee continued to engage Pay Governance LLC, an independent executive compensation advisory firm, as the Compensation Committee s independent consultant. References to the work of the independent consultant are inclusive of work performed by individual Pay Governance consultants at their predecessor firm. The Compensation Committee s executive compensation decisions during 2011 were motivated in large part by surveys provided by the independent consultant in 2009 and 2011 and the independent consultant s related assessments and recommendations with respect to form and amount of executive compensation (the Assessments). Based on the 2009 Assessment, which confirmed the Compensation Committee s concern that the Company s executive compensation was not adequate, the Compensation Committee implemented a multi-year plan to improve the adequacy of the Company s executive compensation and to add a more performance-oriented structure to the Company s executive compensation. During 2011, the Compensation Committee used the 2011 Assessment to (i) evaluate the Company s progress with respect to its multi-year plan and (ii) guide its compensation decisions during 2011.

In 2011, the independent consultant also provided an assessment of the adequacy and effectiveness of the Company s compensation program for non-Employee members of the Board. Based on the assessment, the Compensation Committee decided not to recommend any changes in non-Employee Director compensation for 2011.

The Compensation Committee has used the information provided by the independent consultant (i) for the purpose of informing, as opposed to determining, the Compensation Committee s decisions and (ii) to assist it in applying a long-term approach for the Company s compensation programs. Although the Compensation Committee considers any recommendations received from its independent consultants, its decisions are ultimately based on its own assessment of the information provided to it in the context of the totality of the Company s circumstances at any given point in time. Additional detail regarding the work performed by the independent consultant, as well as the Compensation Committee s related determinations, is included below under Compensation of Executive Officers Compensation Discussion and Analysis.

Nominating and Corporate Governance Committee. The primary functions of the Nominating and Corporate Governance Committee include (i) developing and annually reviewing and recommending to the Board a set of Corporate Governance Guidelines applicable to the Company; (ii) reviewing potential candidates for Board membership; (iii) recommending a slate of nominees to be selected by the Board for the Annual Meeting of Shareholders; (iv) recommending to the Board the composition of the Board s Committees; and (v) overseeing the evaluation of the Board and management. The Nominating and Corporate Governance Committee identifies potential candidates for first-time nomination as a Board member using a variety of sources such as recommendations from current Board members, management, and contacts in communities served by the Company. With respect to Ms. Biggins, who was appointed to the Board effective August 17, 2011, (i) Ms. Biggins was identified by Mr. Kelly and other members of the Board as a potential candidate because of her Atlanta ties and community involvement, as well as her service on the AirTran Board and related institutional knowledge; (ii) Dr. Cunningham spoke with Ms. Biggins on several occasions, and many independent members of the Board met with Ms. Biggins in person; and (iii) Dr. Cunningham requested input from other members of the Board regarding Ms. Biggins qualifications and recommended that the Nominating and Corporate Governance Committee consider Ms. Biggins as a candidate for Board membership. The Board of Directors has determined that each of the members of the Nominating and Corporate Governance Committee is independent under the NYSE s rules governing Board membership.

The Nominating and Corporate Governance Committee will also consider nominees submitted by Shareholders based on the criteria set forth in the Company s Corporate Governance Guidelines; provided that such nominations are submitted in accordance with the requirements of the Company s Bylaws. These requirements are discussed below under Other Matters Submission of Shareholder Proposals. The Nominating and Corporate Governance Committee held seven meetings during 2011.

Safety and Compliance Oversight Committee. The primary functions of the Safety and Compliance Oversight Committee include: (i) assisting the Board in overseeing the Company s activities with respect to safety and operational compliance; (ii) periodically assessing the Company s safety and operational compliance obligations and associated risks and performance relative to those standards; (iii) reviewing such policies, programs, and procedures as it shall deem necessary; (iv) meeting regularly with Company management to assess

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the Company s safety and operational compliance practices generally; and (v) periodically reporting to the Board on the adequacy and effectiveness of the Company s safety and operational compliance programs. The Safety and Compliance Oversight Committee held five meetings during 2011.

Executive Committee. The primary function of the Executive Committee is to assist the Board in fulfilling its oversight responsibilities. The Executive Committee has authority to act for the Board on most matters during the intervals between Board meetings. The Executive Committee held one meeting during 2011.

Certain Relationships and Related Transactions, and Director Independence

Review, Approval, or Ratification of Transactions with Related Persons; Director Independence Determinations. The Company does not have a formal written policy with respect to the review, approval, or ratification of transactions with related persons, but has established procedures to identify these transactions and bring them to the attention of the Board for consideration. These procedures include formal written questionnaires to Directors and executive officers and written procedures followed by the Company s Internal Audit Department to identify related person transactions.

The Company requires that all of its Directors and executive officers complete an annual questionnaire that requires them to identify and describe any transactions that they or their respective related parties may have with the Company, whether or not material. Separately, the Company s Internal Audit Department analyzes accounts payable records to search for payments involving (i) the Company s Directors and executive officers, (ii) known relatives of the Company s Directors and executive officers, (iii) companies and organizations with which the Directors and executive officers are associated, and (iv) security holders known to the Company to be the beneficial owner of more than five percent of the Company s common stock. The questionnaire for non-Employee Directors is also designed to elicit information that should be considered to determine that the Company satisfies the NYSE s requirement that a majority of its Board members be independent within the meaning of the NYSE s rules. Relevant information regarding Directors is then provided to the Nominating and Corporate Governance Committee, which is responsible for evaluating the qualifications of Board nominees, including independence, and for making recommendations to the Board regarding (i) nominations for Board membership; and (ii) individual qualifications for committee membership, taking into account various additional regulatory requirements, including independence requirements, that specifically apply to the different Board committees. In making its recommendations to the Board, the Nominating and Corporate Governance Committee considers the following regulatory guidance: (i) Item 404(a) of Regulation S-K of the Securities Act of 1933, as amended (*Transactions with Related Persons*); (ii) Accounting Standards Codification Topic 850 (*Related Party Disclosures*); and (iii) the NYSE s governance standards related to independence determinations. Based on the foregoing, the Board has determined that the following Directors are independent under applicable NYSE standards: David W. Biegler, J. Veronica Biggins, Douglas H. Brooks, William H. Cunningham, John G. Denison, Nancy B. Loeffler, John T. Montford, Thomas M. Nealon, and Daniel D. Villanueva. In addition, the Board determined that Travis C. Johnson, who retired from the Board in May 2011, was independent.

Ongoing Reporting Obligations with Respect to Related Person Transactions. In order to provide an ongoing mechanism for monitoring related person transactions and Board member independence, each Board member and executive officer of the Company is required to sign an acknowledgement that he or she will promptly inform the Company of any new information that should be considered by the Board subsequent to the Director s or executive officer s completion of his or her annual questionnaire.

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VOTING SECURITIES AND PRINCIPAL SHAREHOLDERS

At the close of business on March 20, 2012, the record date for determining Shareholders entitled to notice of and to vote at the meeting, there were outstanding 767,480,209 shares of common stock, $1.00 par value, each share of which is entitled to one vote.

Security Ownership of Certain Beneficial Owners

The following table sets forth, as of February 29, 2012, information with respect to persons who, to the Company s knowledge, beneficially own more than five percent of the Company s common stock.

	98,482,300(2)	98,482,300(2)
Name and Address of Beneficial Owner	**Amount and Nature of Beneficial Ownership**	**Percent of Class(1)**
Capital Research Global Investors 333 South Hope Street Los Angeles, CA 90071	98,482,300(2)	12.7%
PRIMECAP Management Company 225 South Lake Avenue, #400 Pasadena, CA 91101	81,047,460(3)	10.5%
T. Rowe Price Associates, Inc. 100 E. Pratt Street Baltimore, MD 21202	51,881,764(4)	6.7%
BlackRock, Inc. 40 East 52nd Street New York, NY 10022	42,487,039(5)	5.5%
The Vanguard Group, Inc. 100 Vanguard Blvd. Malvern, PA 19355	40,991,269(6)	5.3%

(1) Percentages are calculated based on the number of outstanding shares of the Company s common stock as of February 29, 2012, which was 772,936,206.

(2) Information is based on an Amendment to Schedule 13G filed with the SEC on February 8, 2012 by Capital Research Global Investors. Capital Research Global Investors reported sole voting power with respect to 92,982,300 shares, sole dispositive power with respect to 98,482,300 shares, and no shared voting or dispositive power. For purposes of the reporting requirements of the Securities Exchange Act of 1934, as amended, Capital Research Global Investors is deemed to beneficially own such securities; however, Capital Research Global Investors expressly disclaims that it is, in fact, the beneficial owner of such securities.

(3) Information is based on an Amendment to Schedule 13G filed with the SEC on February 13, 2012 by PRIMECAP Management Company. PRIMECAP Management Company reported sole voting power with respect to 23,091,156 shares, sole dispositive power with respect to 81,047,460 shares, and no shared voting or dispositive power.

(4) Information is based on an Amendment to Schedule 13G filed with the SEC on February 14, 2012 by T. Rowe Price Associates, Inc. T. Rowe Price Associates, Inc. reported sole voting power with respect to 16,176,597 shares, sole dispositive power with respect to 51,703,664 shares, and no shared voting or dispositive power. These securities are owned by various individual and institutional investors which T. Rowe Price Associates, Inc. serves as an investment adviser with power to direct investments and/or sole power to vote the securities. For purposes of the reporting requirements of the Securities Exchange Act of 1934, as amended, T. Rowe Price Associates, Inc. is deemed to be a beneficial owner of such securities; however, T. Rowe Price Associates, Inc. expressly disclaims that it is, in fact, the beneficial owner of such securities.

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(5) Information is based on an Amendment to Schedule 13G filed with the SEC on February 8, 2012 by BlackRock, Inc. BlackRock, Inc. reported sole voting power with respect to 42,487,039 shares, sole dispositive power with respect to 42,487,039 shares, and no shared voting or dispositive power.

(6) Information is based on a Schedule 13G filed with the SEC on February 8, 2012 by The Vanguard Group, Inc. The Vanguard Group, Inc. reported sole voting power with respect to 1,098,442 shares, sole dispositive power with respect to 39,892,827 shares, no shared voting power, and shared dispositive power with respect to 1,098,442 shares.

Security Ownership of Management

The following table sets forth, as of February 29, 2012, information regarding the beneficial ownership of the Company s common stock by each of the members of the Company s Board of Directors, each of the executive officers of the Company named in the Summary Compensation Table, and all executive officers and Directors as a group.

	2,520,364	2,520,364
Name of Beneficial Owner	**Amount and Nature of Beneficial Ownership(1)(2)**	**Percent of Class(2)**
David W. Biegler(3)	22,597	*
J. Veronica Biggins(4)	7,864	*
Douglas H. Brooks(5)	11,557	*
William H. Cunningham	12,890	*
John G. Denison(6)	16,390	*
Gary C. Kelly(7)	823,811	*
Nancy B. Loeffler(8)	14,718	*
John T. Montford(9)	18,590	*
Thomas M. Nealon	3,668	*
Daniel D. Villanueva(10)	14,890	*
Laura H. Wright(11)	278,599	*
Ron Ricks(12)	395,445	*
Michael G. Van de Ven(13)	334,165	*
Robert E. Jordan(14)	236,970	*
Current Executive Officers and Directors as a Group (16 persons)(15)	2,520,364	*

* Less than 1%

(1) Unless otherwise indicated, beneficial owners have sole rather than shared voting and investment power with respect to their shares, other than rights shared with spouses pursuant to joint tenancy or marital property laws.

(2) Amounts include shares subject to options that were exercisable within 60 days of February 29, 2012, whether or not such options were in-the-money.

(3) Includes 4,707 shares held by Mr. Biegler s spouse and 8,000 shares that Mr. Biegler had the right to acquire within 60 days pursuant to stock options. Of the shares reported, 5,000 shares were pledged under a line of credit.

(4) Includes 32 shares held by Ms. Biggins spouse.

(5) Includes 6,667 shares that Mr. Brooks had the right to acquire within 60 days pursuant to stock options.

(6) Includes 10,000 shares that Mr. Denison had the right to acquire within 60 days pursuant to stock options.

(7) Includes 650,120 shares that Mr. Kelly had the right to acquire within 60 days pursuant to stock options.

(8) Includes 10,000 shares that Ms. Loeffler had the right to acquire within 60 days pursuant to stock options.

(9) Includes 10,000 shares that Mr. Montford had the right to acquire within 60 days pursuant to stock options.

(10) Includes 10,000 shares that Mr. Villanueva had the right to acquire within 60 days pursuant to stock options.

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(11) Includes 8,635 shares held for Ms. Wright s account under the Company s profit sharing plan, with respect to which she has the right to direct the voting, and 239,475 shares that Ms. Wright had the right to acquire within 60 days pursuant to stock options.

(12) Includes 324,359 shares that Mr. Ricks had the right to acquire within 60 days pursuant to stock options.

(13) Includes 518 shares held for Mr. Van de Ven s account under the Company s profit sharing plan, with respect to which he has the right to direct the voting, and 290,656 shares that Mr. Van de Ven had the right to acquire within 60 days pursuant to stock options.

(14) Includes 8,103 shares held for Mr. Jordan s account under the Company s profit sharing plan, with respect to which he has the right to direct the voting, and 210,480 shares that Mr. Jordan had the right to acquire within 60 days pursuant to stock options.

(15) In addition to the amounts disclosed in footnotes (3) through (14), with respect to other executive officers of the Company, includes (i) 274,188 shares that the other executive officers had the right to acquire within 60 days pursuant to stock options, (ii) 800 shares held by an executive officer as custodian for a child; (iii) 39,000 shares held by an executive officer that were pledged as collateral for a margin loan; and (iv) 1,666 shares held for an executive officer s account under the Company s profit sharing plan, with respect to which the executive officer had the right to direct the voting.

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COMPENSATION OF EXECUTIVE OFFICERS

Compensation Discussion and Analysis

The Company is required to provide detailed compensation information in this proxy statement regarding its Chief Executive Officer, its Chief Financial Officer, and its three other most highly compensated executive officers who were serving as such at the end of fiscal 2011. For 2011, these executive officers, who will be referred to in this proxy statement as the named executive officers, were (i) Gary C. Kelly, Chairman of the Board, President, & Chief Executive Officer; (ii) Laura H. Wright, Senior Vice President Finance, Chief Financial Officer, & Treasurer; (iii) Ron Ricks, Executive Vice President, Chief Legal & Regulatory Officer, & Corporate Secretary; (iv) Michael G. Van de Ven, Executive Vice President & Chief Operating Officer; and (v) Robert E. Jordan, Executive Vice President & Chief Commercial Officer. For purposes of this Compensation Discussion and Analysis, the Compensation Committee will be referred to as the Committee.

Executive Summary

Set forth below is a summary of (i) the Company s key accomplishments during 2011; (ii) the Company s overall compensation objectives; (iii) the Committee s consideration of the Company s 2011 say-on-pay vote; (iv) the Committee s overall approach to executive compensation; and (v) the Committee s executive compensation decisions for 2011.

Company Performance

The Committee s compensation decisions for 2011 were greatly influenced and supported by the Company s performance. The airline industry is extremely volatile and is subject to various unique challenges. Among other things, it is cyclical, energy intensive, labor intensive, capital intensive, technology intensive, highly regulated, heavily taxed, and extremely competitive, with generally low barriers to entry. The airline industry is also susceptible to detrimental events such as acts of terrorism, poor weather, and natural disasters. Over the last decade, total financial losses for the U.S. airline industry have exceeded $50 billion. These losses were driven by factors such as 9/11, the worst economic recession in aviation history, and a worldwide credit crisis. In addition, in recent years the industry has been particularly negatively affected by high and volatile fuel prices. These factors have contributed to volatile and unpredictable demand for air travel and related cost and pricing challenges. Fuel costs alone have risen over 300 percent from 2000 levels, and the Company s average jet fuel cost per gallon for 2011 increased 27.1 percent compared to 2010. As a result, several U.S. airlines have ceased operations or reorganized through bankruptcy.

Despite the numerous challenges facing the Company and the airline industry, 2011 marked the Company s 39th consecutive year of profitability, an accomplishment unparalleled by any U.S. airline. In addition, in the last decade, the Company has added over 300 aircraft (net), increased available seat mile capacity more than 80 percent, more than doubled annual revenues, and added more than 30 new cities.

Specific 2011 achievements also included the following, among others:

Financial and Strategic Accomplishments

The Company set the following full year records:
- Total operating revenues: $15.7 billion
- Unit revenues (operating revenues per available seat mile): 12.99 cents
- Passenger unit revenues (Passenger revenues per available seat mile): 12.22 cents
- Passenger revenue yield per revenue passenger mile: 15.10 cents
- Revenue passenger miles (in thousands): 97,582,530
- Load factor (Revenue passenger miles divided by available seat miles): 80.9 percent
- Revenue passengers carried: 103,973,759
- Passengers enplaned: 127,551,012

On May 2, 2011, the Company acquired AirTran. The Company s 2011 results included $80 million in realized net pre-tax synergies from the acquisition, and, as of year-end 2011, the Company was

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producing over $200 million of net annualized pre-tax synergies resulting from the acquisition.
2011 operating revenues of $15.7 billion represented an increase of 29.4 percent over 2010 operating revenues of $12.1 billion.
Adjusted for stage length, the Company had lower unit costs on average than most major carriers.
Net cash provided by operations for 2011 was $1.4 billion, and the Company ended 2011 with $3.1 billion of core unrestricted cash and short-term investments.
The Company launched Southwest s All-New Rapid Rewards® program in March 2011, which already produced strong results during 2011.
The Company reached a historic agreement with The Boeing Company to become the launch customer for the Boeing 737 MAX aircraft, which is expected to enter service in 2017.

Operational Accomplishments

Based on the most recent data available from the U.S. Department of Transportation, as of September 30, 2011, Southwest was the largest domestic air carrier, as measured by the number of originating passengers boarded.
Southwest was recognized as one of the world s top ten safest airlines in the Holistic Safety Rating 2011 by the Air Transport Rating Agency.
Southwest Cargo was named Domestic Airline of the Year by the Express Delivery and Logistics Association (XLA). Southwest has placed on XLA s Airline of the Year list for ten consecutive years.
Southwest Cargo was named Domestic Carrier of the Year for 2011 by the Airforwarders Association for the second consecutive year and was recognized for excellence in *Air Cargo World s* annual Air Cargo Excellence (ACE) Survey.
Southwest was named the Greenest Airline by ClimateCounts.org.

Customer Service Accomplishments

According to the Department of Transportation s Air Travel Consumer Report, Southwest received the lowest ratio of complaints per passengers boarded of all major U.S. carriers for the fourth consecutive year in 2011.
According to the Department of Transportation s Air Travel Consumer Report, Southwest improved its ontime performance to 81.3% in 2011 from 79.5% in 2010 and improved its placement among all major U.S. carriers from tenth place to sixth place.
Southwest was named the top U.S. Airline on the University of Michigan s American Customer Satisfaction Index.
Southwest was recognized as the fourth most admired Company in the world by *FORTUNE* magazine s 2011 survey of corporate reputations, the only U.S. airline to make this list of the World s Top 50 Most Admired Companies.
Southwest was named the 2011 Customer Service Champion by J.D. Powers based on customer feedback regarding service excellence.
Southwest was ranked sixth in MSN Money s 2011 Customer Service Hall of Fame, the only airline to make the top ten.
Southwest was voted the Customer Satisfaction Leader in Consumer Reports list of airline ratings receiving the highest rankings in check-in ease, cabin crew service, cabin cleanliness, baggage handling, and seating comfort.
Southwest was named the Stevie Award Winner for the Company of the Year-Transportation by The International Business Awards for outstanding performance and Customer Service.
Southwest was named Best Low-Cost Carrier in North America by *Business Traveler Magazine* subscribers.
Southwest was named Brand of the Year in Harris Poll EquiTrend s airline category based on equity, customer connection, commitment, brand behavior, brand advocacy, and trust.
Southwest received the 2011 Quest for Quality Award for Excellence in Air Cargo from Logistics Management Magazine and ranked first in ontime performance, value, and Customer Service.

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Accomplishments as an Employer

- The Company has been profitable for 39 consecutive years and has never furloughed an Employee.
- In connection with its acquisition of AirTran, the Company reached agreements with the following employee representatives to integrate seniority lists: (i) the Southwest Airlines Pilots Association, the union representing Southwest Pilots, and the Air Line Pilots Association, the union representing the pilots of AirTran; (ii) the Transportation Workers of America, AFL-CIO, Local 556, the union representing Southwest Flight Attendants, and the Association of Flight Attendants, the union representing AirTran Flight Attendants; and (iii) the Transportation Workers of America, AFL-CIO Local 557, the union representing Southwest Flight Instructors, and the Employee Committee representing the AirTran Flight Instructors. The Company also reached new agreements with its Flight Crew Training Instructors, represented by the Transport Workers Union (TWU) 557, and its Materials Specialists, represented by the International Brotherhood of Teamsters, Local 19.
- The Company was recognized as one of the 50 best places to work by the Glassdoor.com Employees Choice Awards, the only airline to make the list.
- The Company was recognized by PR News with the 2011 PR News Corporate Responsibility Awards for Diversity Communications.
- The Company was named as one of the 100 Top Military Friendly Employers by G.I. Jobs magazine.

Company-Wide Compensation Objectives

The overall objective of the Company s compensation program is to promote and reward productivity and dedication to the overall success of the Company and to thereby also support the Company s overarching objective of attaining reasonable profits on a consistent basis and preserving job security.

Because approximately 82 percent of the Company s Employees are subject to collective bargaining agreements that govern their compensation structure (these Employees are referred to as contract Employees), these negotiated agreements also factor significantly into Company-wide compensation decisions, including executive compensation decisions. The Company s compensation program for contract Employees is generally the same in structure as its compensation program for non-contract Employees, except that the levels of compensation are determined pursuant to the terms of the collective bargaining agreements.

Compensation Committee s Consideration of 2011 Say-on-Pay Vote

At its 2011 Annual Meeting of Shareholders, votes in favor of approving the Company s named executive officer compensation constituted almost 98 percent of the shares voted either for or against the proposal. The Committee interpreted the results of the Company s 2011 say-on-pay vote as an endorsement of (i) the Committee s compensation philosophy and structure, (ii) the Company s executive pay levels generally, and (iii) the Committee s justifications for its individual executive compensation decisions.

Compensation Approach

During 2011, the Committee continued to execute a multi-year plan for addressing the adequacy and retention value of the Company s executive compensation, while at the same time (i) linking executive pay more closely to Company and individual performance than had historically been the case and (ii) providing for a significant percentage of pay at risk. The multi-year plan was implemented in connection with data provided by the Committee s independent consultant in 2009 and the independent consultant s related assessments and recommendations (collectively, the 2009 Assessment). Based on the 2009 Assessment, the Committee and its independent consultant concluded that the Company s executive compensation was inadequate to the point of presenting serious retention risks because it was not within a reasonable range of median compensation, based on available market data both within and outside of the airline industry. **For purposes of this Compensation Discussion and Analysis, references to adequacy, retention value, competitiveness, and appropriateness of compensation (and similar references), as well as comparisons to market, should be interpreted in this context.** To address the Committee s concerns regarding executive retention, as well as its desire to increase pay at risk, in 2010, the Committee significantly increased the named executive officers opportunities to increase their total compensation through short-term (annual bonus) and long-term (equity)

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incentive compensation; however, the Committee did not increase any of the named executive officer s base pay. In 2011, for the reasons discussed below, the Committee continued to provide for a significant percentage of pay at risk, but also increased base pay for each of the named executive officers.

Summary of 2011 Executive Compensation

2011 Increases in Base Pay. Prior to 2011, (i) none of the named executive officers, including the Chief Executive Officer, had received increases in base pay since at least July 2008; and (ii) four of the named executive officers, including the Chief Executive Officer, had not received base pay increases despite having received promotions and, as a result, having assumed significantly increased responsibilities. In early 2011, given the Company s financial health and other factors, the Committee decided it was the appropriate time to move named executive officer salaries closer to market. In making its decision, the Committee took into account (i) updated market data provided by the Committee s independent consultant and the independent consultant s related assessments and recommendations (collectively, the 2011 Assessment); (ii) the Committee s current evaluation of the named executive officers performance; and (iii) the current nature and scope of the named executive officers roles and responsibilities within the Company. Additional information regarding 2011 base pay is provided below under Determination of 2011 Executive Compensation; Analysis of Individual Compensation Elements Salary.

2011 Short-Term Incentive Compensation. In considering bonus awards for 2011, the Committee continued to implement its multi-year plan to apply a more structured and multi-dimensional approach for evaluating the Company s performance by referencing the Company s Management Scoreboard. The Committee also considered individual contributions and performance. Based on the Company s numerous accomplishments, each of the named executive officers received a bonus for 2011; however bonuses for 2011 were lower than 2010, reflecting, in part, the Company s decrease in earnings compared to 2010. The Management Scoreboard, which identified four broad categories of performance indicators, is discussed in more detail below under Determination of 2011 Executive Compensation; Analysis of Individual Compensation Elements Bonus.

The Committee does not believe it is advisable to limit the basis for awarding short-term incentive compensation to a single measure such as stock price performance or earnings. Rather, the Committee believes it is important to take into account multiple measures of financial and operational performance, as well as comparative pay in the market, for the following reasons, among others: (i) using a measure such as the Company s stock price performance at any specified point in time is not necessarily indicative of the Company s overall financial and operational performance, (ii) the Committee believes that rewarding Employees based solely on a measure such as stock price appreciation could create business risks by effectively encouraging Employees to focus on short-term results at the expense of the long-term financial and operational health of the Company, and (iii) the Committee believes that basing short-term incentive compensation on a single measure such as stock price performance presents serious retention risks.

2011 Long-Term Incentive Compensation. During 2011, as it did for the first time in 2010, the Committee granted restricted stock units to the named executive officers in order to diversify their plan-based equity portfolios. Two of the named executive officers, including the Chief Executive Officer, received a decrease in equity compensation. The other three named executive officers received an approximately four percent increase in equity compensation. The value of the equity grants reflects the Committee s determination, based on the 2011 Assessment and related input from the Committee s independent consultant, that the grants would provide appropriate total compensation opportunities for each of the named executive officers. Additional detail regarding the 2011 equity grants is included below under Determination of 2011 Executive Compensation; Analysis of Individual Compensation Elements Equity.

The charts below illustrate the impact of the Committee s multi-year plan on the named executive officers salary, bonus, and equity relative to each other and as a percentage of total compensation.*

Gary C. Kelly

Laura H. Wright

Ron Ricks

Michael G. Van de Ven

Robert E. Jordan

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* Amounts include compensation to the extent required to be reported in the Summary Compensation Table pursuant to the compensation disclosure rules of the SEC.

Role of Independent Compensation Consultant; Benchmarking

As discussed throughout this Compensation Discussion and Analysis, the Committee has received ongoing input from its independent consultant regarding, among other matters, market data and competitive compensation practices. The independent consultant s 2009 Assessment and 2011 Assessment included reviews of the named executive officers base salary, total cash compensation (base salary plus short-term incentives/annual incentive bonus), and total direct compensation (total cash compensation plus long-term incentives) relative to similar positions reported in multiple survey sources including (i) Towers Watson s Executive Compensation database, which provided general industry data; (ii) Towers Watson s custom survey, *The Airline Industry Compensation Survey*, which provided airline industry data; and (iii) proxy statements that included airline industry data.

The Committee did not directly target any individual named executive officer s compensation against the specific data included in the Assessments because the surveys included as part of the Assessments (i) were not necessarily comprehensive and (ii) did not always include exact matches to the Company s executive positions (which in many cases involve a unique combination of responsibilities that do not correspond directly to the roles that are included in the surveys). Nevertheless, the 2009 and 2011 Assessments provided multiple external reference points for the Committee s consideration in determining the appropriateness of its executive pay decisions. Because of the limited amount of airline industry data, the Committee believes it is important to acknowledge the broader compensation data provided by general industry surveys, which also serve as indicators of the named executive officers potential value to other organizations who might seek to hire them. Survey sources for the 2009 and 2011 Assessments are set forth below.

Survey Sources for the 2009 Assessment (based on 2007 data)

General industry

The general industry data included in the 2009 Assessment included information from participants in Towers Watson s Executive Compensation database, screened by similar revenue scope when available. The database consisted of 750 companies, and the data was adjusted by the independent consultant to take into account differences in company size.

Airline industry

The airline industry data included in the 2009 Assessment included information from the following six airlines that chose to participate in Towers Watson s custom survey, *The Airline Industry Compensation Survey*: American Airlines, Continental Airlines, Delta Air Lines, Northwest Airlines, United Airlines, and Southwest Airlines (data for this group was collected prior to the Delta-Northwest merger).

Survey Sources for the 2011 Assessment

General industry

Towers Watson Database. The general industry data included in the 2011 Assessment included information from 67 of the companies participating in Towers Watson s 2010 Executive Compensation database. The independent consultant identified industries that it considered to be representative of consumer-oriented industries (defined broadly to include hospitality, transportation, media, retail, and similar industries). The resulting group was composed of all companies in the database within these industries. The data was adjusted by the independent consultant to take into account differences in company size.

Airline industry

Towers Watson Custom Survey. The airline industry data included in the 2011 Assessment included information from Towers Watson s 2009 custom survey, *The Airline Industry Compensation Survey,* which included data for the following eight airlines that chose to participate in the survey: American

Airlines, Continental Airlines, Delta Air Lines, Frontier Airlines, JetBlue Airways, United Airlines, US Airways, and Southwest Airlines (data for this group was collected prior to the Continental-United merger).

Proxy Statement Data. The airline industry data included in the 2011 Assessment also included information from the 2010 proxy statements of the following companies: Alaska Air Group, Inc., AMR Corporation (the parent company of American Airlines, Inc.), Delta Air Lines, Inc., JetBlue Airways Corporation, United Continental Holdings, Inc., and US Airways Group, Inc.

Additional information regarding the role of the Committee s independent consultant is included throughout this Compensation Discussion and Analysis and is also included above under Corporate Governance Committees of the Board Compensation Committee.

Role of Management

At the Committee s request, the Chief Executive Officer provides regular input on compensation matters based on his day-to-day interaction with Employees at all levels of the Company, both contract and non-contract. The Chief Executive Officer, with the assistance of the Chief People Officer, also specifically reviews with the Committee the relative roles and responsibilities of the Company s other executive officers, and the Chief Executive Officer reviews with the Committee the relative performance of the Company s other executive officers and provides input with respect to their compensation. The input from the Chief Executive Officer and Chief People Officer not only assists the Committee with its compensation decisions, it serves a valuable purpose in connection with the Company s succession planning. Although the Committee is not obligated to accept any of the Chief Executive Officer s recommendations, the Committee gives considerable weight to any such recommendations because of the Chief Executive Officer s ability to directly observe on a day-to-day basis each officer s contributions and performance. In addition, the Chief Executive Officer regularly travels to visit with Employees at all levels in varying locations and is able to relay Employee concerns that he believes should be considered by the Committee as it addresses matters of internal equity. Additional information regarding management s role with respect to executive compensation determinations is included below.

Determination of 2011 Executive Compensation; Analysis of Individual Compensation Elements

Set forth below is a discussion of (i) each of the elements of the Company s compensation program for all non-contract Employees, including the Company s named executive officers; (ii) the purposes and objectives associated with each element; (iii) the manner in which each element fits within the Company s overall compensation objectives and decisions with respect to other elements; (iv) the Committee s determinations regarding the amounts paid or to be paid to each of the named executive officers for 2011; and (v) where applicable, the involvement of the Committee s independent consultant and members of management in compensation decisions. Although the Committee strongly considers the Company s overall compensation objectives disclosed above, all executive compensation decisions are ultimately within the Committee s discretion.

Salary

Approach to, and Justification of, 2011 Base Pay. The Company s objective with respect to base pay is to provide a reasonable (around the mid-range of market), as opposed to highly competitive, base level of monthly income relative to an Employee s job responsibilities and the market for the Employee s skills (both within and outside of the airline industry). Prior to 2011, Messrs. Kelly, Ricks, Van de Ven, and Jordan had not received an increase in base pay since July 2008, and Ms. Wright had not received an increase in base pay since April 2007. In addition, Mr. Kelly voluntarily reduced his base pay for a portion of 2009. Although the Committee strongly believed that all of the named executive officers should have received base pay increases prior to 2011, Mr. Kelly recommended that executive salaries remain the same, in light of the extremely negative impact that economic instability and volatile fuel prices were having on the Company s results.

In early 2011, given the Company s financial health, the moderate recovery in the U.S. economy, and the Committee s view of the performance of the named executive officers, the Committee concluded it was necessary and in the best interests of the Company to protect the Company s future health by taking action to

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retain the Company s strong leadership team. As a result, the Committee increased each of the named executive officer s base pay. In addition to addressing retention concerns, the Committee s decision was intended to recognize the named executive officers willingness to lead by example with respect to base pay during difficult economic times despite being asked to take on increasing responsibilities during these years. In particular, the Committee, along with the other independent members of the Board, deemed it advisable and in the best interests of the Company to increase the Chief Executive Officer s base pay to an amount commensurate with the additional responsibilities taken on by him in 2008 when he became Chairman of the Board and President of the Company.

To assist the Committee in gauging the appropriateness of the 2011 pay increases, the Committee considered (i) the 2011 Assessment, the comparability of the position matches in the 2011 Assessment, and related input from the independent consultant and the Chief People Officer; (ii) input from the Company s Chief Executive Officer with respect to the relative roles, responsibilities, accountability, and individual performance of the Company s other executive officers; and (iii) the potential value of the named executive officers to other organizations. The Committee, at the request of the Chief Executive Officer, does not currently contemplate an increase in the Chief Executive Officer s salary during 2012.

Bonus

Objectives of Short-Term Incentive Compensation. The Committee believes short-term incentives are necessary to attract and retain Employees at the senior leadership level and above, in particular at the officer level, given the typical use of bonuses in the market in which the Company competes for executive talent. Bonus opportunities are also provided at these levels generally to (i) reflect the additional time, responsibility, and accountability associated with senior positions; (ii) create the opportunity for total compensation to reach a level that is within a reasonable range of median in the marketplace; and (iii) further incentivize management to contribute to the Company s overall annual performance.

Approach to, and Justification of, 2011 Short-Term Incentive Compensation. The Committee believes the bonus amounts disclosed in the Summary Compensation Table for 2011 were justified based on the Company s 2011 accomplishments, as well as its long-term accomplishments relative to its competitors, each of which are discussed above under Executive Summary. As part of the Committee s multi-year plan to move towards a more structured approach towards short-term incentive compensation, the Committee considered the Company s performance within the framework of the Company s Management Scoreboard (the Scoreboard).

Since 2010, the Committee has leveraged the Scoreboard for the purpose of evaluating Company performance relative to broad categories of performance standards (which standards are prefaced with an overarching principal that Safety Matters Most). The Scoreboard standards for 2011 are set forth below along with the Company s related accomplishments.

Scoreboard Standard	Related Company Accomplishments
Every Employee Matters (Quality of Workplace)	Examples of the Company s accomplishments in this area are discussed in the Executive Summary above under the heading Accomplishments as an Employer.
Every Flight Matters (Quality of Operations)	Examples of the Company s accomplishments in this area are discussed in the Executive Summary above under the heading Operational Accomplishments.
Every Customer Matters (Quality of Customer Experience)	Examples of the Company s accomplishments in this area are discussed in the Executive Summary above under the heading Customer Service Accomplishments.
Every Dollar Matters (Financial Results and Success as Low-Cost Provider)	Examples of the Company s accomplishments in this area are discussed in the Executive Summary above under the heading Financial and Strategic Accomplishments.

The Committee has used the Scoreboard to inform its decisions because (i) there is a strong correlation between the Scoreboard and the manner in which the Company manages and measures its own performance

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generally (*i.e.*, the goals are highly relevant to the Company, its Shareholders, its Customers, and its Employees); (ii) the Scoreboard has been in existence and communicated in varying forms since the end of 2004 and therefore incorporates standards with which Employees are already familiar and to which Employees are likely to respond; (iii) the Scoreboard provides visibility to the Committee regarding what management communicates to its Employees as important and enables the Committee to take into account the Chief Executive Officer s specific views regarding the areas within the Scoreboard that require the most focus at any given point in time; (iv) the Scoreboard creates a multi-dimensional mechanism to determine overall bonus funding based on Company performance, so that factors that are deemed significant to the industry and operational performance may be considered in addition to financial measures; (v) the use of a multi-dimensional guide for determining bonus funding mitigates the risk that can be created when financial results are the only drivers of incentive payments; and (vi) individualized objectives can be customized based on applicable goals within the Scoreboard. The Committee also views the Scoreboard as a communications tool, which should be subject to adjustment to be in sync with the Company s priorities at any given time.

Throughout 2011, the Committee regularly assessed (i) if and how specific targets and metrics could be applied to the goals within the Scoreboard; (ii) how best to measure performance against the Scoreboard; (iii) to what extent bonus determinations should be based on individual performance versus Company performance; and (iv) the risks and benefits associated with performance evaluations that are based solely on mechanical or formulaic performance measures. Based on the Committee s discussions and assessments, it concluded that it would not be advisable to apply overly mechanical or formulaic methodologies to short-term incentive decisions for the following reasons.

The Committee does not believe strict performance metrics are advisable because, among other things, they may limit the Committee s ability to take into account unexpected events, both positive and negative, during any given year.

The Committee does not believe there is only one correct manner in which to weight performance metrics, in particular given the volatility of the airline industry and the numbers of factors that are out of the Company s control.

The Committee believes it is more important that the Company and its Employees be encouraged to perform based on what is most critical to the Company at any point in time, rather than to be driven by inflexible targets and metrics.

The Committee believes its approach towards short-term incentive compensation serves to mitigate the risk-taking that can result from strict application of performance-based awards.

Based on its conclusions, the Committee did not apply any specific Scoreboard metrics or weightings with respect to its bonus decisions. Rather, the Committee viewed the Scoreboard as a touch-point to which reasoned judgment could be applied taking into account other factors such as (i) the nature and extent of the Company accomplishments, (ii) input from the Committee s independent consultant, and (iii) other factors the Committee deemed significant. Based on these considerations, the Committee approved a bonus pool for 2011 of approximately $10 million for all eligible Employees, including the named executive officers.

The Committee approved individual named executive officer bonus amounts based on (i) Company performance; (ii) the named executive officers individual contributions to the Company s performance (including the factors covered by the Scoreboard and the factors discussed below under Individual Bonus Determinations for the Named Executive Officers); and (iii) the named executive officers relative levels of responsibility, accountability, and performance. In all circumstances, the Committee believed, and continues to believe, that it is appropriate and in the best interests of the Company for the Committee to ultimately retain full discretion to use its common sense in approving final bonus amounts based on its view of Company and individual named executive officer performance. The Committee believes that retaining discretion provides the Company and/or the Committee with the flexibility to:

consider a variety of factors in assessing individual contributions depending on the nature of an individual s roles and responsibilities within the Company;

adjust individual goals and payouts in response to unexpected events or changes in the industry and related changes in business strategies (as was necessary for the Company in 2008-2009 when the Company was required to react to an economic recession and extremely volatile fuel prices), thereby minimizing the risk that individuals will continue to focus on areas that become less relevant just to achieve a bonus payout;

reward individuals for the Company s superior operational and financial performance relative to its peers during periods when the Company and its peers must react to adverse events that are out of the Company s control (*e.g.*, fuel costs, economic fluctuations, competitor actions, weather events, terrorist threats, and other events that can influence the Company s business plan and strategies); and

re-focus Employee energy when an unanticipated opportunity arises that could lead to long-term benefits and reward related individual contributions (*e.g.*, the Company s acquisition of AirTran).

Individual Bonus Determinations for the Named Executive Officers. In determining the size of the named executive officers bonuses relative to other Employees of the Company, the Committee took into account the fact that these are the individuals who, because of their roles and responsibilities, have the ability to most directly impact the Company s overall results, as well as the most accountability for the Company s results. For the same reason, a significant portion of each of the named executive officer s bonus was tied to overall Company performance; however, no specific weightings were applied to Company versus individual performance. Additional factors considered by the Committee in determining the bonus amounts for the Chief Executive Officer and the other named executive officers are discussed below.

Chief Executive Officer. In assessing the Chief Executive Officer s individual performance, the Committee specifically rewarded Mr. Kelly for his strategic vision and contributions to the Company s 2011 achievements, including the following, among others: (i) the Company s record revenue results, which reflect, in part, Mr. Kelly s vision with respect to the Company s multi-year revenue and cost-control initiatives; (ii) the Company s acquisition of AirTran and related integration accomplishments during 2011; (iii) the Company s implementation of Southwest s All-New Rapid Rewards® Frequent Flyer program; (iv) the Company s agreement with Boeing to be the launch customer for the Boeing 737 MAX aircraft and related fleet modernization initiatives; (v) the Company s operational excellence and industry-leading Customer Service; and (vi) the Company s achievement of seniority list integration agreements with representatives of Southwest and AirTran Employees, which the Committee believes to be a historic accomplishment in the airline industry.

Other Named Executive Officers. In assessing the individual performance of the other named executive officers, the Committee relied heavily on the Chief Executive Officer s and Chief People Officer s input regarding the relative roles, scope of responsibilities, and performance of these officers with respect to the Company s 2011 results, as well as their respective contributions to the Company s ongoing initiatives. Specifically, the following contributions of the other named executive officers were key to the Company s achievements: (i) the contributions of Mr. Jordan and his departments with respect to the AirTran acquisition, in particular Mr. Jordan s strategic leadership and his effectiveness in taking on an increased level of responsibility and accountability as President of AirTran; (ii) the contributions of Mr. Ricks and his departments with respect to the AirTran acquisition, in particular Mr. Ricks leadership in securing Department of Justice and other regulatory approvals, as well as his successful efforts towards building strong community relationships; (iii) the contributions of Mr. Van de Ven and Mr. Ricks and their respective departments in connection with the Company s completion of Southwest labor contracts, as well as in connection with what the Committee believes to be historic seniority list integration agreements with representatives of Southwest and AirTran Employees; (iv) the contributions of Ms. Wright and her departments with respect to the AirTran acquisition, in particular Ms. Wright s financial and strategic leadership related to the transaction and related contractual, financing, benefits and integration matters; (v) the contributions of Mr. Van de Ven and Ms. Wright with respect to the Company s agreement with Boeing to be the launch customer for the Boeing 737 MAX aircraft and related fleet modernization initiatives; (vi) the contributions of Mr. Van de Ven with respect to the Company s operational excellence, including, for example, the Company s improved ontime performance and its industry-leading Customer Service; (vii) the strategic contributions of Mr. Jordan and Mr. Ricks in connection with the

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Company s new service to Charleston, South Carolina; Greenville- Spartanburg, South Carolina; and Newark, New Jersey; and (viii) the contributions of Mr. Ricks to the Love Field Modernization Program, a project that is being managed by the Company, to reconstruct Dallas Love Field Airport with modern, convenient air travel facilities. In determining individual bonus amounts, the Committee also took into account input from the Committee s independent consultant and the Chief People Officer with respect to market compensation.

Equity

Objectives of Equity Compensation. Equity awards are used by the Company (i) to attract and retain Employees; (ii) as an incentive and reward for achievement of the Company s long-term objectives; and (iii) to further align the interests of the Company s Employees with those of its Shareholders.

Because the Company is subject to limitations on the number of shares it may issue pursuant to awards under equity plans, during 2011 equity was granted at the senior management level and to members of the Board of Directors. The Committee, with the input of its independent consultant, has concluded that senior management positions are currently the positions with respect to which equity can most effectively serve as an attraction and retention mechanism. In addition, equity serves as a mechanism that can serve to further align senior management s compensation with the Company s overall business results. With respect to other Employees, the Company has decided to place more emphasis on cash compensation.

Approach to, and Justification of, 2011 Equity Compensation. The Committee believes that the value of equity grants should be considered primarily in the context of future year compensation opportunities, with some consideration of prior year performance, and that equity should be granted in amounts that provide market compensation opportunities and related retention benefits. The Company has historically granted stock options to accomplish these purposes; however, beginning in 2010, the Committee decided to grant restricted stock units to diversify the portfolio of equity held by the named executive officers and to address systemic retention concerns by providing a form of equity that, unlike stock options, is intended to retain some value over time regardless of the Company s stock price. As shown in the Outstanding Equity Awards at Fiscal 2011 Year-End table, the named executive officers all hold a significant number of stock options. Therefore, based on input from its independent consultant, the Committee has concluded that restricted stock units continue to serve as a more effective vehicle for addressing retention concerns because, unlike stock options, the value of restricted stock units are not totally dependent on stock price (*i.e.*, they allow for retention of some value to the executive even if the Company s stock price subsequently drops below the grant date stock price). At the same time, restricted stock units serve to align executive pay with Shareholder value because the compensation opportunity correlates with the Company s stock price over an extended period of time.

During 2011, the values of the named executive officers equity awards were based in part on the independent consultant s advice regarding (i) the percentage of overall compensation that should be provided in the form of equity, (ii) the values viewed as necessary for the named executive officer grants to be competitive, and (iii) the values viewed as necessary to provide for competitive total compensation opportunities. In addition, the Committee considered the level and scope of the respective roles and responsibilities of the named executive officers.

Individual Equity Determinations for the Named Executive Officers.

Chief Executive Officer. The amount of the Chief Executive Officer s 2011 equity grant was primarily driven by the Committee s desire to create a total compensation opportunity that would be competitive and that would therefore serve as a significant retention tool. The Committee took into account the advice of its independent consultant and the Chief People Officer regarding the amount that would reasonably serve these purposes.

Other Named Executive Officers. With respect to the named executive officers other than the Chief Executive Officer, the Committee took into account the advice of its independent consultant and the Chief People Officer regarding the percentage of overall compensation that should be provided in the form of equity and the number of restricted stock units that would be necessary to bring their total compensation opportunities to an adequate level. The Committee also considered the Chief Executive Officer s views regarding the relative roles and responsibilities of the other named executive officers and his related opinions regarding the independent consultant s recommendations as to the respective size of their grants.

Timing of Grants. The Committee considers regular discretionary equity grants in May of each year around the time of the Company s annual meeting of Shareholders. The Committee has chosen this timing because, based on its relationship to the timing of quarterly and full-year financial results, it is typically a time at which the Company is not in possession of material non-public information. Should the current timing of grants coincide with a time at which the Company is in possession of material non-public information, the Company will adjust the timing of grants to be in accordance with the Company s policy not to grant equity at a time at which it is in possession of material non-public information.

Qualified Retirement Benefits

Southwest offers tax-qualified 401(k) and profit sharing plans to all eligible Employees, including the named executive officers. Southwest s 401(k) and profit sharing plans are intended to be competitive in the market and include five-year vesting provisions that are designed to contribute to Employee loyalty and retention. Southwest s 401(k) plans provide for a dollar-for-dollar match on Employee contributions, subject to limits specified by the Board, applicable collective bargaining agreements, and the Internal Revenue Code and applicable Treasury Regulations. Southwest s profit sharing plan provides for an annual Company contribution to Employee accounts equal to a uniform percentage of each Employee s compensation up to an amount that is cumulatively equal to 15 percent of the Company s operating profit (as defined in the plan) for the year. The profit sharing plan is intended to serve as an incentive and reward to Employees because the plan is based on overall Company profitability. Therefore, it effectively serves as a bonus component of compensation for the Company s Employees at all levels. The numbers for 2011 in the All Other Compensation column of the Summary Compensation Table reflect fluctuations in profit sharing contributions based on fluctuations in the Company s profitability for the three years covered by the table. AirTran Employees continue to participate in the AirTran Airways, Inc. 401(k) Plan, AirTran Airways Pilot Retirement Savings and Investment Plan, and AirTran Airways Technical Operations Retirement Savings Plan, as applicable.

The Committee did not consider the value of its retirement plans when establishing other compensation elements and amounts for the named executive officers in 2011 because of the broad-based nature of these benefits and the relatively small portion of total executive compensation represented by them.

Deferred Compensation

Southwest offers nonqualified deferred compensation arrangements to Employees who are subject to certain limits established by the Internal Revenue Code with respect to qualified plan contributions. Because these arrangements by their nature are tied to the qualified plan benefits, they are not considered when establishing salary and bonus elements and amounts. The Company s excess benefit plan is available to Employees with amounts that cannot be contributed to the 401(k) or profit sharing plans due to limits under Section 415(c) of the Internal Revenue Code. Named executive officers who do not elect to participate in the Company s excess benefit plan receive payment in the form of cash equal to the contribution the executive otherwise would have been entitled to receive pursuant to the terms of the excess benefit plan. The cash payment is made at the same time as the named executive officer would have otherwise received a contribution to the excess plan.

The excess benefit plan is discussed in more detail below under Nonqualified Deferred Compensation in Fiscal 2011. Southwest also maintains two nonqualified deferred compensation plans that are available to pilots only, pursuant to the terms of their collective bargaining agreement. In addition, Mr. Kelly has an individual deferred compensation arrangement pursuant to which the Company credits to Mr. Kelly s account an amount equal to any Company contributions that would otherwise have been made on his behalf to the Company s qualified plans, but that exceed the limits under Section 415(c) and 401(a)(17) of the Internal Revenue Code for qualified plans. Mr. Kelly s deferred compensation bears interest at 10 percent, the interest rate established in 1982 when the first arrangement of this type was put into place with respect to the Company s Chairman

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Emeritus, Mr. Herbert D. Kelleher. Mr. Kelly s deferred compensation arrangement is discussed in more detail below under Nonqualified Deferred Compensation in Fiscal 2011.

Change-in-Control Arrangements

The Company has established change-in-control arrangements for all of its Employees for the purpose of offering protection in the event of a termination of employment following a change-in-control. All officers of the Company, including the Chief Executive Officer and the other named executive officers, are parties to the Company s Executive Service Recognition Plan Executive Employment Agreements. In general, in the event of termination subsequent to a change-in control, these agreements provide for a maximum incremental benefit approximately equal to (i) one year of salary and (ii) two years of bonus. In addition, the Company s equity plans provide for acceleration of any unvested equity awards at the time of a change-in-control. The terms of these arrangements are discussed in detail below under Potential Payments Upon Termination or Change-in-Control.

The remainder of the Company s Employees are provided change-in-control benefits through the Company s Change of Control Severance Pay Plan (to the extent they are not otherwise beneficiaries of an enforceable contract with the Company providing for severance payments in the event of a reduction in force or furlough).

The Company s change-in-control arrangements were all put in place in the 1980s and do not have any impact on the rest of the Company s other compensation elements because any incremental benefit from these arrangements is not triggered unless there is a termination of employment following a change-in-control. The Company believes it is appropriate to keep these arrangements in place, in particular for the Company s officers, because the Company believes they serve to (i) continue to attract and retain well-qualified executive personnel and (ii) enhance the retention of the Company s officers to carry on the Company s business as usual in the event of any real or rumored possibilities of a change-in-control of the Company. In particular, with respect to the Chief Executive Officer, a change-in-control arrangement is intended to provide some assurance that, should the Company receive proposals from third parties with respect to its future, he can, without being influenced by the uncertainties of his own situation, (i) assess such proposals, (ii) formulate an objective opinion as to whether or not such proposals would be in the best interests of the Company and its Shareholders, and (iii) take any other action regarding such proposals as the Board might determine to be appropriate.

Perquisites and Other Benefits

All of the Company s Employees and their immediate family members are eligible to fly free on Southwest Airlines and AirTran Airways on a standby basis, and the Company s officers, including the named executive officers, and their spouses and dependent children are eligible to fly free on Southwest Airlines and AirTran Airways on a reserved seat basis. In addition, the Company s officers are entitled to eight free roundtrip flight passes that they may give to anyone of their choice except for other Employees. The Company s officers also receive Company-paid physicals subject to a limit of $4,000 per year for the officers and their spouses. The Committee believes the differences in the rights of the Company s officers compared to the rights of other Employees are justified based on the additional time, responsibilities, and accountability associated with the officer positions. In addition, the difference reflects a cost/benefit analysis associated with whether or not to provide officer level flight privileges to all Employees. The named executive officers, like the Company s other contract and non-contract Employees, also participate in various Employee benefit plans, including medical and dental care plans; life, accidental death and dismemberment and disability insurance; and vacation and sick time. These elements of compensation are not taken into account when establishing salary and bonus elements and amounts.

Through January 2011, pursuant to an employment contract that expired on February 1, 2011, Mr. Kelly and members of his immediate family were entitled to reimbursement of medical and dental expenses. Mr. Kelly no longer receives this benefit.

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Accounting and Tax Considerations

Section 162(m) of the Internal Revenue Code generally limits to $1,000,000 the federal tax deductibility of compensation paid to a named executive officer, including compensation received upon exercise of stock options. Section 162(m) provides an exception to such limitation for certain performance-based compensation. The Company s Amended and Restated 2007 Equity Incentive Plan has been designed to satisfy the conditions of such exception to the extent necessary, feasible, and in the best interests of the Company. Although options granted under such plan constitute performance-based compensation, restricted stock units granted to date do not.

Overall, the Committee seeks to balance its objective of ensuring an effective compensation package for the named executive officers with the need to maximize the immediate deductibility of compensation. However, the Committee does have the discretion to design and use compensation elements that may not be deductible under Section 162(m).

The Company and the Committee have also addressed the final regulations that were enacted under Section 409A of the Internal Revenue Code. These regulations impacted Committee decisions with respect to the Company s employment and change-in-control agreements, as well as the Company s nonqualified deferred compensation arrangements.

Compensation Committee Report

The Compensation Committee has reviewed and discussed the Compensation Discussion and Analysis contained in this proxy statement with the Company s management. Based on such review and discussion and relying thereon, we have recommended to the Company s Board of Directors that the Compensation Discussion and Analysis contained in this proxy statement be included in the Company s Annual Report on Form 10-K for the year ended December 31, 2011, and in this proxy statement.

COMPENSATION COMMITTEE

David W. Biegler, Chair

J. Veronica Biggins

Nancy B. Loeffler

John T. Montford

Daniel D. Villanueva

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Summary Compensation Table

The following table provides information with respect to compensation earned by the named executive officers for the years ended December 31, 2011, 2010, and 2009.

Name and Principal Position	Year	Salary ($)	Bonus ($)(1)	Stock Awards ($)(2)	Option Awards ($)(3)	Nonqualified Deferred Compensation Earnings ($)	All Other Compensation ($)	Total ($)
Gary C. Kelly	2011	648,750	925,000	1,840,500		9,014(4)	92,937(5)	3,516,201
Chairman of the Board,	2010	465,000	930,000	1,842,000		7,902	112,668	3,357,570
	2009	441,750	590,000		462,990	6,347	58,344	1,559,431
President, & Chief								
Executive Officer								
Laura H. Wright	2011	369,550	309,000	368,100			29,998(6)	1,076,648
Senior Vice President	2010	309,000	359,000	368,400			34,624	1,071,024
	2009	309,000	275,000		216,062		19,782	819,844
Finance, Chief Financial								
Officer, & Treasurer								
Ron Ricks	2011	420,925	465,000	957,060			29,998(6)	1,872,983
Executive Vice	2010	370,000	475,000	921,000			48,896	1,814,896
	2009	370,000	375,000		277,794		22,041	1,044,835
President, Chief Legal &								
Regulatory Officer, &								
Corporate Secretary								
Michael G. Van de Ven	2011	452,500	495,000	1,141,110			29,998(6)	2,118,608
Executive Vice	2010	365,000	500,000	1,105,200			30,815	2,001,015
	2009	365,000	375,000		277,794		19,808	1,037,602
President & Chief								
Operating Officer								
Robert E. Jordan	2011	404,050	450,000	957,060			29,998(6)	1,841,108
Executive Vice	2010	340,000	470,000	921,000			49,180	1,780,180
	2009	340,000	370,000		246,928		19,792	976,720
President & Chief								
Commercial Officer								

(1) In accordance with the SEC s rules, for each particular year the noted amount reflects bonuses paid with respect to performance in that year, whether or not actually paid in such year.

(2) Awards consist of restricted stock units that are settleable in shares of common stock. The values included in this column represent the grant date fair value of these awards computed in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 718. The grant date fair value is equal to the number of shares of common stock with respect to which the restricted stock units may be settled multiplied by the closing price of the Company s common stock on the date of the grant. The closing prices of the Company s common stock on the 2011 and 2010 grant dates were $12.27 and $12.28, respectively.

(3) Awards consist of stock options. The values included in this column represent the grant date fair value of these awards computed in accordance with FASB ASC Topic 718. The assumptions used in calculating the values for fiscal 2009 are included in Note 14 to the Company s financial statements included in its Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

(4) Consists of above-market earnings on deferred compensation provided pursuant to a deferred compensation agreement between the Company and Mr. Kelly. Mr. Kelly s deferred compensation agreement is discussed in more detail above under Compensation Discussion and Analysis and below under Nonqualified Deferred Compensation in Fiscal 2011.

(5) Includes (i) Company matching contributions to the Southwest Airlines Co. 401(k) Plan of $22,000; (ii) a Company contribution of $7,998 to be made to the Company s profit sharing plan in 2012, but that was earned with respect to 2011; (iii) a Company contribution of $43,545 to be made to Mr. Kelly s individual deferred compensation arrangement in 2012, but that was earned with respect to fiscal 2011, in accordance with the terms of his February 2011 letter agreement with the Company; (iv) free travel on Southwest Airlines; (v) life insurance premiums, which were discontinued effective February 1, 2011; (vi) medical and dental reimbursements for Mr. Kelly and his spouse, which were discontinued effective February 1, 2011; (vii) home security for Mr. Kelly at the Company s request; and (viii) Company-paid physicals for Mr. Kelly and his spouse.

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(6) Includes (i) Company matching contributions to the Southwest Airlines Co. 401(k) Plan of $22,000; and (ii) a Company contribution of $7,998 to be made to the Company s profit sharing plan in 2012, but that was earned with respect to 2011.

In connection with the expiration of Mr. Kelly s employment contract in accordance with its terms in February 2011, the Company entered into a letter agreement with Mr. Kelly to continue his deferred compensation arrangement. Mr. Kelly s deferred compensation arrangement is discussed in more detail above under Compensation Discussion and Analysis and below under Nonqualified Deferred Compensation in Fiscal 2011. The Compensation Committee s determinations regarding the amount of executive salary and bonus in proportion to total compensation are discussed in detail above under Compensation Discussion and Analysis.

Grants of Plan-Based Awards in Fiscal 2011

The following table provides information with respect to grants of plan-based awards to the named executive officers in 2011.

Name	Grant Date	All Other Stock Awards: Number of Shares of Stock or Units (1)	Grant Date Fair Value of Stock Awards ($)(2)
Gary C. Kelly	5/18/2011	150,000	1,840,500
Laura H. Wright	5/18/2011	30,000	368,100
Ron Ricks	5/18/2011	78,000	957,060
Michael G. Van de Ven	5/18/2011	93,000	1,141,110
Robert E. Jordan	5/18/2011	78,000	957,060

(1) The awards consist of restricted stock units that are settleable in shares of common stock. The restricted stock units will vest with respect to one-third of the shares covered thereby annually, beginning on May 18, 2012, the first anniversary of the date of grant. The Company does not pay dividends on unvested restricted stock units.

(2) The values included in this column represent the grant date fair value of these awards computed in accordance with FASB ASC Topic 718. Each amount is equal to the number of shares of common stock with respect to which the restricted stock units may be settled multiplied by $12.27, the closing price of the Company s common stock on the date of grant.

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Outstanding Equity Awards at Fiscal 2011 Year-End

The following table provides information with respect to stock options and restricted stock units held by the named executive officers as of December 31, 2011. Stock options and restricted stock units are the only types of equity awards that have been granted to the named executive officers.

	Option Awards				Stock Awards	
Name	**Number of Securities Underlying Unexercised Options (#) Exercisable**	**Number of Securities Underlying Unexercised Options (#) Unexercisable**	**Option Exercise Price ($)**	**Option Expiration Date**	**Number of Shares or Units of Stock That Have Not Vested(#)(1)**	**Market Value of Shares or Units of Stock That Have Not Vested ($)(2)**
Gary C. Kelly	4,348		18.73	01/01/2012	250,000(3)	2,140,000
	17,250		17.78	01/18/2012		
	Nine Months Ended March 31,					
(dollars in millions)	2011	2010	2011	2010		
Net sales						
North America	$ 1,178.7	$ 958.6	$ 3,289.1	$ 2,588.9		
International	1,293.0	995.2	3,533.3	2,777.5		
Operating income						
North America	189.5	133.6	538.3	324.2		
International	$ 199.8	$ 109.3	$ 551.4	$ 253.8		
Operating income, as a percent of net sales						
North America	16.1%	13.9%	16.4%	12.5%		
International	15.5%	11.0%	15.6%	9.1%		
Backlog	$ 1,855.8	$ 1,432.7	$ 1,855.8	$ 1,432.7		

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The Industrial Segment operations experienced the following percentage changes in net sales in the current-year period compared to the equivalent prior-year period:

	Period Ending March 31	
	Three Months	Nine Months
Industrial North America as reported	23.0%	27.0%
Acquisitions	1.0%	0.5%
Currency	0.7%	0.6%
Industrial North America without acquisitions and currency	21.3%	25.9%
Industrial International as reported	29.9%	27.2%
Acquisitions	0.6%	0.3%
Currency	5.6%	0.1%
Industrial International without acquisitions and currency	23.7%	26.8%
Total Industrial Segment as reported	26.5%	27.1%
Acquisitions	0.8%	0.4%
Currency	3.2%	0.3%
Total Industrial Segment without acquisitions and currency	22.5%	26.4%

The above presentation reconciles the percentage changes in net sales of the Industrial operations reported in accordance with U.S. GAAP to percentage changes in net sales adjusted to remove the effects of acquisitions made within the prior year comparable fiscal quarters as well as the effects of currency exchange rates. The effects of acquisitions and currency exchange rates are removed to allow investors and the Company to meaningfully evaluate the percentage changes in net sales on a comparable basis from period to period.

Excluding the effects of acquisitions and changes in currency exchange rates, the increase in Industrial North American net sales for the current-year quarter and first nine months of fiscal 2011 reflects higher demand from distributors and higher end-user demand in a number of markets, particularly in the heavy-duty truck, construction equipment, mining, farm and agriculture equipment and machine tool markets. The increase in Industrial International net sales for the current-year quarter and first nine months of fiscal 2011 is primarily attributable to higher volume across most markets in all regions with the largest increase in volume experienced in Europe and Asia Pacific.

Margins in the Industrial North American and Industrial International businesses were higher for the current-year quarter and first nine months of fiscal 2011 due primarily to the higher sales volume, resulting in manufacturing efficiencies, and a lower fixed cost structure resulting from past business realignment actions.

Included in Industrial North American operating income are business realignment charges of $0.6 million and $1.6 million in the current-year quarter and prior-year quarter, respectively, and $4.1 million and $9.9 million for the first nine months of fiscal 2011 and fiscal 2010, respectively. Included in Industrial International operating income are business realignment charges of $4.7 million and $12.8 million in the current-year quarter and prior-year quarter, respectively, and $5.7 million and $27.2 million for the first nine months of fiscal 2011 and fiscal 2010, respectively. The business realignment expenses consist primarily of severance costs resulting from plant closures as well as general reductions in workforce. The Company does not anticipate that cost savings realized from the workforce reductions taken during the first nine months of fiscal 2011 will have a material impact on future operating margins. The Company expects to continue to take the actions necessary to structure appropriately the operations of the Industrial Segment. Such actions may include the necessity to record additional business realignment charges in fiscal 2011, the timing and amount of which has not been finalized.

The increase in backlog from a year ago and the June 30, 2010 amount of $1,505.0 million is primarily due to higher order rates in most markets in both the Industrial North American and Industrial International businesses, with the increase being evenly split between the two. The Company anticipates Industrial North American sales for fiscal 2011 will increase between 23.7 percent and 24.7 percent from the fiscal 2010 level and Industrial International sales for fiscal 2011 will increase between 27.0 percent and 28.0 percent from the fiscal 2010 level. Industrial North American operating margins in fiscal 2011 are expected to range from 16.3 percent to 16.5 percent and Industrial International operating margins are expected to range from 15.5 percent to 15.7 percent.

Aerospace Segment

	Three Months Ended March 31,		Nine Months Ended March 31,	
(dollars in millions)	2011	2010	2011	2010
Net sales	$ 503.8	$ 449.2	$ 1,400.1	$ 1,266.7
Operating income	$ 69.0	$ 49.8	$ 176.4	$ 144.0
Operating margin	13.7%	11.1%	12.6%	11.4%
Backlog	$ 1,755.3	$ 1,463.4	$ 1,755.3	$ 1,463.4

The increase in net sales in the Aerospace Segment for the current-year quarter is primarily due to higher volume in both the commercial original equipment manufacturer (OEM) and aftermarket businesses as well as higher volume in the military aftermarket business. The increase in net sales for the first nine months of fiscal 2011 is primarily due to higher volume in both the commercial OEM and aftermarket businesses partially offset by lower volume in both the military OEM and aftermarket businesses. The higher margins in the current-year quarter and first nine months of fiscal 2011 were primarily due to the higher sales volume, particularly in the higher margin commercial aftermarket businesses. Margins for the current-year quarter benefitted from lower engineering development costs but margins for the first nine months of fiscal 2011 were adversely affected by a higher level of engineering costs as compared to the first nine months of fiscal 2010. Margins for the first nine months of fiscal 2011 also include the favorable effect of retroactive billings and contract reserve adjustments resulting from the finalization of contract price negotiations related to certain programs.

The increase in backlog from the prior-year quarter and the June 30, 2010 amount of $1,474.4 million is primarily due to higher order rates in both the commercial OEM and aftermarket businesses as well as the military OEM business. For fiscal 2011, sales are expected to increase between 9.1 percent and 10.1 percent from the fiscal 2010 level and operating margins are expected to range from 12.9 percent to 13.1 percent. A higher concentration of commercial OEM volume in future product mix and higher than expected new product development costs could result in lower margins.

Climate & Industrial Controls Segment

	Three Months Ended March 31,		Nine Months Ended March 31,	
(dollars in millions)	2011	2010	2011	2010
Net sales	$ 264.5	$ 211.8	$ 713.6	$ 573.7
Operating income	$ 22.6	$ 16.3	$ 53.6	$ 32.9
Operating margin	8.5%	7.7%	7.5%	5.7%
Backlog	$ 189.6	$ 159.5	$ 189.6	$ 159.5

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The Climate & Industrial Controls (CIC) Segment operations experienced the following percentage changes in net sales in the current-year period compared to the equivalent prior-year period:

		Period Ending March 31	
		Three Months	Nine Months
CIC Segment	as reported	24.9%	24.4%
Acquisitions		1.7%	1.5%
Currency		1.9%	0.6%
CIC Segment	without currency	21.3%	22.3%

The above presentation reconciles the percentage changes in net sales of the Climate & Industrial Controls Segment reported in accordance with U.S. GAAP to percentage changes in net sales adjusted to remove the effects of acquisitions made within the prior year comparable fiscal quarters as well as the effects of currency exchange rates. The effects of acquisitions and currency exchange rates are removed to allow investors and the Company to meaningfully evaluate the percentage changes in net sales on a comparable basis from period to period.

Excluding the effect of acquisitions and changes in currency exchange rates, the increase in net sales in the Climate & Industrial Controls Segment for the current-year quarter and first nine months of fiscal 2011 is primarily due to higher end-user demand in the heavy-duty truck, automotive and commercial refrigeration markets. Margins for the current-year quarter and first nine months of fiscal 2011 were higher primarily due to the higher sales volume and favorable product mix. Margins in both the current-year quarter and first nine months of fiscal 2011 were adversely affected by higher material costs as well as operating inefficiencies, which primarily include overtime and premium freight. Included in operating income for the prior-year quarter and first nine months of fiscal 2010 were business realignment charges of $0.5 million and $3.7 million, respectively. The Company may take further actions to structure appropriately the operations of the Climate & Industrial Controls Segment. Such actions may include the necessity to record business realignment charges in fiscal 2011.

The increase in backlog from the prior-year quarter and the June 30, 2010 amount of $161.9 million is primarily due to higher order rates in the heavy-duty truck, automotive and commercial refrigeration markets. For fiscal 2011, sales are expected to increase between 19.5 percent and 20.5 percent from the fiscal 2010 level and operating margins are expected to range from 7.9 percent to 8.1 percent.

Corporate and Other

Corporate general and administrative expenses were $41.7 million in the current-year quarter compared to $41.3 million in the prior-year quarter and were $112.7 million for the first nine months of fiscal 2011 compared to $99.1 million for the first nine months of fiscal 2010. As a percent of sales, corporate general and administrative expenses for the current-year quarter were 1.3 percent compared to 1.6 percent for the prior-year quarter and were 1.3 percent and 1.4 percent for the first nine months of fiscal 2011 and fiscal 2010, respectively. The higher expense for the first nine months of fiscal 2011 is primarily due to higher incentive compensation expenses.

Other expense (in the Business Segment Results) included the following:

(in millions) Expense (income)	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010	Nine Months Ended March 31, 2011	Nine Months Ended March 31, 2010
Currency transaction	$ (3.1)	$ 7.9	$ (0.9)	$ 15.9
Stock-based compensation	9.2	6.9	42.4	37.4
Pensions	17.6	9.9	54.6	34.9
Asset sales and writedowns	1.1	3.2	(2.0)	8.8
Other items, net		7.5	5.7	19.5
	$ 24.8	$ 35.4	$ 99.8	$ 116.5

CONSOLIDATED BALANCE SHEET

(dollars in millions)	March 31, 2011	June 30, 2010
Accounts receivable, net	$ 1,951.0	$ 1,599.9
Inventories	1,390.9	1,171.7
Plant and equipment, less accumulated depreciation	1,788.4	1,697.9
Goodwill	2,976.2	2,786.3
Intangible assets, net	1,191.1	1,150.1
Notes payable	173.2	363.3
Accounts payable, trade	1,085.1	888.7
Accrued domestic and foreign taxes	237.2	176.3
Other liabilities	267.3	196.2
Shareholders equity	5,481.9	4,368.0
Working capital	$ 2,350.9	$ 1,383.9
Current ratio	2.00	1.63

Accounts receivable, net are primarily receivables due from customers for sales of product ($1,746 million at March 31, 2011 and $1,443 million at June 30, 2010). Days sales outstanding relating to trade accounts receivable was 49 days at March 31, 2011 and 48 days at June 30, 2010. The Company believes that its receivables are collectible and appropriate allowances for doubtful accounts have been recorded.

Inventories increased $219 million, primarily in the Industrial Segment, in response to positive order trends. Days supply of inventory was 57 days at March 31, 2011 and 58 days at June 30, 2010.

Notes payable decreased due to the $257 million payment of the 3.5 percent Euro Bonds that were due in November 2010.

Accounts payable, trade increased from June 30, 2010 primarily due to increased production levels and the timing of payments.

Accrued domestic and foreign taxes increased primarily due to higher income taxes and unemployment tax rates.

Other liabilities increased primarily due to the effect of cross-currency swap contracts the Company entered into during fiscal 2011.

Shareholders equity included an increase of $413 million related to foreign currency translation adjustments that primarily affected Accounts receivable, Inventories, Plant and equipment, Goodwill, Intangible assets, Accounts payable, trade and Long-term debt.

CONSOLIDATED STATEMENT OF CASH FLOWS

(in millions)	Nine months ended March 31, 2011	2010
Cash provided by (used in):		
Operating activities	$ 799.9	$ 841.4
Investing activities	(203.1)	(104.4)
Financing activities	(123.7)	(534.3)
Effect of exchange rates	59.3	(9.7)
Net increase in cash and cash equivalents	$ 532.4	$ 193.0

Cash flows from operating activities decreased compared to the first nine months of fiscal 2010 primarily due to a higher amount of cash used for working capital needs, especially Accounts receivable and Inventory partially offset by an increase in Net income. The Company continues to focus on managing its inventory and other working capital requirements. The Company made a $200 million and a $100 million voluntary contribution to its domestic qualified defined benefit pension plan during the first nine months of fiscal 2011 and fiscal 2010, respectively. The Company made an additional $200 million voluntary contribution to its domestic qualified defined benefit pension plan in April 2011.

Cash flows used in investing activities increased from the first nine months of fiscal 2010 as economic uncertainties in the prior year resulted in the Company reducing its acquisition activity and closely managing capital expenditures during such year. The Company completed three acquisitions in fiscal 2011. Also, capital expenditures, as a percent of sales, increased to 1.8 percent for the first nine months of fiscal 2011 as compared to 1.3 percent in the first nine months of fiscal 2010.

Cash flows used in financing activities in fiscal 2011 included the issuance of $300 million aggregate principal amount of Medium-Term Notes and payments of approximately $257 million related to the Euro Bonds which matured in November 2010. In the prior year, the Company used cash to repay its commercial paper borrowings.

The Company s goal is to maintain no less than an A rating on senior debt to ensure availability and reasonable cost of external funds. As a means of achieving this objective, the Company has established a financial goal of maintaining a ratio of debt to debt-shareholders equity of no more than 37 percent.

(in millions) Debt to Debt-Shareholders Equity Ratio	March 31, 2011	June 30, 2010
Debt	$ 1,857	$ 1,777
Debt & Shareholders equity	$ 7,339	$ 6,145
Ratio	25.3%	28.9%

The Company has a line of credit totaling $1,500 million through a multi-currency revolving credit agreement with a group of banks, all of which was available as of March 31, 2011. The credit agreement expires in March 2016; however, the Company has the right to request a one-year extension of the expiration date on an annual basis, which request may result in changes to the current terms and conditions of the credit agreement. A portion of the credit agreement supports the Company s commercial paper note program, which is rated A-1 by Standard & Poor s, P-1 by Moody s and F-1 by Fitch Ratings. These ratings are considered investment grade. The revolving credit agreement requires the payment of an annual facility fee, the amount of which would increase in the event the Company s credit ratings are lowered. A lowering of the Company s credit ratings would not limit the Company s ability to use the credit agreement nor would it accelerate the repayment of any outstanding borrowings.

The Company is currently authorized to sell up to $1,350 million of short-term commercial paper notes. No commercial paper notes were outstanding as of March 31, 2011 and the largest amount of commercial paper notes outstanding during the third quarter of fiscal 2011 was $2 million.

The Company s credit agreements and indentures governing certain debt agreements contain various covenants, the violation of which would limit or preclude the use of the credit agreements for future borrowings, or might accelerate the maturity of the related outstanding borrowings covered by the indentures. At the Company s present rating level, the most restrictive financial covenants provide that the ratio of secured debt to net tangible assets be less than 10 percent. However, the Company currently does not have secured debt in its debt portfolio. The Company is in compliance with all covenants and expects to remain in compliance during the term of the credit agreements and indentures.

The Company s principal sources of liquidity are its cash flows provided from operating activities and borrowings either from or directly supported by its line of credit. The Company s ability to borrow has not been affected by a lack of general credit availability and the Company does not foresee any impediments to borrow funds at affordable interest rates in the near future. The Company expects that its ability to generate cash from its operations and ability to borrow directly from its line of credit or sources directly supported by its line of credit should be sufficient to support working capital needs, planned growth, benefit plan funding, dividend payments and share repurchases in the near term.

CRITICAL ACCOUNTING POLICIES

Impairment of Goodwill and Long-Lived Assets - Goodwill is tested for impairment at the reporting unit level on an annual basis and between annual tests whenever events or circumstances indicate that the carrying value of a reporting unit may exceed its fair value. For the Company, a reporting unit is one level below the operating segment level. Determining whether an impairment has occurred requires the valuation of the respective reporting unit, which the Company has consistently estimated using a discounted cash flow model. The Company believes that the use of a discounted cash flow model results in the most accurate calculation of a reporting unit s fair value because the market value for a reporting unit is not readily available. The discounted cash flow analysis requires several assumptions, including future sales growth and operating margin levels, as well as assumptions regarding future industry specific market conditions. Each reporting unit regularly prepares discrete operating forecasts and uses these forecasts as the basis for the assumptions used in the discounted cash flow analyses. The Company has consistently used a discount rate commensurate with its cost of capital, adjusted for inherent business risks and has consistently used a terminal growth factor of 2.5 percent. The Company also reconciles the estimated aggregate fair value of its reporting units as derived from the discounted cash flow analyses to the Company s overall market capitalization.

The results of the Company s fiscal 2011 annual goodwill impairment test performed as of December 31, 2010 indicated that no goodwill impairment existed. However, the following reporting units had an estimated fair value that the Company has determined, from a quantitative or qualitative perspective, was not significantly in excess of their carrying value:

Reporting Unit	Goodwill Balance	Fair Value In Excess of Carrying Value
Medical Systems	$ 103.7 million	109.3%
Worldwide Energy Products	$ 182.6 million	113.8%

Both of these reporting units are part of the Industrial Segment. For both of these reporting units, the sales growth assumption had the most significant influence on the estimation of fair value.

The sales growth assumption for Medical Systems was primarily based on market data specific to the products that this reporting unit currently manufactures as well as securing business with new customers. The key uncertainty in the sales growth assumption used in the estimation of the fair value of this reporting unit is the ability to secure business with new customers.

The sales growth assumption for Worldwide Energy Products was based on future business already secured or highly likely to be secured with existing customers based on current quoting activity and forecasted market demand for the oil and gas industry as well as the expanded applicability of the Company s products based on market trends. The key uncertainty in the sales growth assumption used in the estimation of the fair value of this reporting unit is the growth of the oil and gas market and the level of investments customers will make to improve the productivity and efficiency of their capital equipment.

The Company continually monitors its reporting units for impairment indicators and updates assumptions used in the most recent calculation of the fair value of a reporting unit as appropriate. The Company is unaware of any current market trends that are contrary to the assumptions made in the estimation of its reporting unit s fair value. If the recovery of the current economic environment is not consistent with the Company s current expectations, it is possible that the estimated fair value of certain reporting units could fall below their carrying value resulting in the necessity to conduct additional goodwill impairment tests.

Long-lived assets held for use, which primarily includes finite lived intangible assets and property, plant and equipment, are evaluated for impairment whenever events or circumstances indicate that the undiscounted net cash flows to be generated by their use over their expected useful lives and eventual disposition are less than their net carrying value. The long-term nature of these assets requires the estimation of their cash inflows and outflows several years into the future and only takes into consideration technological advances known at the time of the impairment test. During the first nine months of fiscal 2011, there were no events or circumstances that indicated that the net carrying value of the Company s long-lived assets held for use was not recoverable.

FORWARD-LOOKING STATEMENTS

Forward-looking statements contained in this and other written and oral reports are made based on known events and circumstances at the time of release, and as such, are subject in the future to unforeseen uncertainties and risks. All statements regarding future performance, earnings projections, events or developments are forward-looking statements. It is possible that the future performance and earnings projections of the Company, including its individual segments, may differ materially from current expectations, depending on economic conditions within its mobile, industrial and aerospace markets, and the Company s ability to maintain and achieve anticipated benefits associated with announced realignment activities, strategic initiatives to improve operating margins, actions taken to combat the effects of the current economic environment, and growth, innovation and global diversification initiatives. A change in the economic conditions in individual markets may have a particularly volatile effect on segment performance.

Among the other factors which may affect future performance are:

- changes in business relationships with and purchases by or from major customers, suppliers or distributors, including delays or cancellations in shipments, disputes regarding contract terms or significant changes in financial condition, changes in contract cost and revenue estimates for new development programs and changes in product mix,

- uncertainties surrounding timing, successful completion or integration of acquisitions,

- ability to realize anticipated costs savings from business realignment activities,

- threats associated with and efforts to combat terrorism,

- uncertainties surrounding the ultimate resolution of outstanding legal proceedings, including the outcome of any appeals,

- competitive market conditions and resulting effects on sales and pricing,

- increases in raw material costs that cannot be recovered in product pricing,

- the Company s ability to manage costs related to insurance and employee retirement and health care benefits, and

- global economic factors, including manufacturing activity, air travel trends, currency exchange rates, difficulties entering new markets and general economic conditions such as inflation, deflation, interest rates and credit availability.

The Company makes these statements as of the date of this disclosure, and undertakes no obligation to update them unless otherwise required by law.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company manages foreign currency transaction and translation risk by utilizing derivative and non-derivative financial instruments, including forward exchange contracts, costless collar contracts and cross-currency swap contracts and certain foreign denominated debt designated as net investment hedges. The derivative financial instrument contracts are with major investment grade financial institutions and the Company does not anticipate any material non-performance by any of the counterparties. The Company does not hold or issue derivative financial instruments for trading purposes.

Derivative financial instruments are recognized on the balance sheet as either assets or liabilities and are measured at fair value. Further information on the fair value of these contracts is provided in Notes 12 and 13 to the Consolidated Financial Statements. Gains or losses on derivatives that are not hedges are adjusted to fair value through the Consolidated Statement of Income. Gains or losses on derivatives that are hedges are adjusted to fair value through accumulated other comprehensive income (loss) in the Consolidated Balance Sheet until the hedged item is recognized in earnings. The translation of the foreign denominated debt that has been designated as a net investment hedge is recorded in accumulated other comprehensive income (loss) and remains there until the underlying net investment is sold or substantially liquidated.

The Company s debt portfolio contains variable rate debt, inherently exposing the Company to interest rate risk. The Company s objective is to maintain a 60/40 mix between fixed rate and variable rate debt thereby limiting its exposure to changes in near-term interest rates.

ITEM 4. CONTROLS AND PROCEDURES

The Company carried out an evaluation, under the supervision and with the participation of the Company s management, including the Company s principal executive officer and principal financial officer, of the effectiveness of the Company s disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the third quarter of fiscal 2011. Based on this evaluation, the principal executive officer and principal financial officer have concluded that the Company s disclosure controls and procedures are effective.

There has been no change in the Company s internal control over financial reporting during the quarter ended March 31, 2011 that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

PARKER-HANNIFIN CORPORATION

PART II - OTHER INFORMATION

ITEM 1. Legal Proceedings. Parker ITR S.r.l. (Parker ITR), a subsidiary acquired on January 31, 2002, has been the subject of a number of lawsuits and regulatory investigations. The lawsuits and investigations relate to allegations that for a period of up to 21 years, the Parker ITR business unit that manufactures and sells marine hose, typically used in oil transfer, conspired with competitors in unreasonable restraint of trade to artificially raise, fix, maintain or stabilize prices, rig bids and allocate markets and customers for marine oil and gas hose in the United States and in other jurisdictions. Parker ITR and the Company have cooperated with all of the regulatory authorities investigating the activities of the Parker ITR business unit that manufactures and sells marine hose and continue to cooperate with the investigations that remain ongoing. Several of the investigations and all but one of the lawsuits have concluded. The following investigations and lawsuit remain pending.

Brazilian competition authorities commenced their investigations on November 14, 2007. Parker ITR filed a procedural defense in January 2008. The Brazilian competition authorities have not yet responded to Parker ITR s filing. The Brazilian competition authorities investigation is ongoing and the Company and Parker ITR continue to cooperate. The Brazilian authorities appear to be investigating the period from 1999 through May 2007. Because the Brazilian competition authorities have not yet responded to Parker ITR s initial filing, the potential outcome of this investigation is uncertain and will depend on the resolution of numerous issues not yet addressed at the current preliminary stage of the investigation.

On May 15, 2007, the European Commission issued its initial Request for Information to the Company and Parker ITR. On January 28, 2009, the European Commission announced the results of its investigation of the alleged cartel activities. As part of its decision, the European Commission found that Parker ITR infringed Article 81 of the European Commission treaty from April 1986 to May 2, 2007 and fined Parker ITR 25.61 million euros. The European Commission also determined that the Company was jointly and severally responsible for 8.32 million euros of the total fine which related to the period from January 2002, when the Company acquired Parker ITR, to May 2, 2007, when the cartel activities ceased. Parker ITR and the Company filed an appeal to the Court of First Instance of the European Communities on April 10, 2009.

A lawsuit was filed against the Company and Parker ITR on May 25, 2010 under the False Claims Act in the Central District of California: The United States of America ex rel. Douglas Farrow v. Trelleborg, AB et al. The United States declined to intervene against the Company or Parker ITR in the case. Plaintiff generally seeks treble damages, penalties for each false claim and attorneys fees. The court dismissed the complaint with prejudice as to the Company, but it remains pending against Parker ITR.

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

(a) ***Unregistered Sales of Equity Securities.*** Not applicable.
(b) ***Use of Proceeds.*** Not applicable.
(c) ***Issuer Purchases of Equity Securities.***

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid Per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	(d) Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
January 1, 2011 through January 31, 2011	74,700	$ 87.57	74,700	8,738,020
February 1, 2011 through February 28, 2011	67,000	$ 90.56	67,000	8,671,020
March 1, 2011 through March 31, 2011	158,201	$ 86.09	158,201	8,512,819
Total:	299,901	$ 87.46	299,901	8,512,819

(1) On August 16, 1990, the Company publicly announced that its Board of Directors authorized the repurchase by the Company of up to 3.0 million shares of its common stock. From time to time, the Board of Directors has adjusted the number of shares authorized for repurchase under this program. On January 28, 2009, the Finance Committee of the Board of Directors of the Company approved an increase in the number of shares authorized for repurchase under this program so that, beginning on such date, the aggregate number of shares authorized for repurchase was equal to 10 million. Subject to this overall limitation, each fiscal year the Company is authorized to repurchase an amount of common shares equal to the greater of 7.5 million shares or five percent of the shares outstanding as of the end of the prior fiscal year. There is no expiration date for this program.

ITEM 6. Exhibits.
The following documents are furnished as exhibits and are numbered pursuant to Item 601 of Regulation S-K:

Exhibit No.	Description of Exhibit
10(a)	Amendment to Parker-Hannifin Corporation Amended and Restated Supplemental Executive Retirement Benefits Program effective January 27, 2011.*
10(b)	Amendment to Parker-Hannifin Corporation Amended and Restated Pension Restoration Plan effective January 27, 2011.*
10(c)	Parker-Hannifin Corporation Long-Term Incentive Performance Plan Under the Performance Bonus Plan incorporated by reference to Exhibit 10.1 to the Company s Report on Form 8-K filed with the Securities and Exchange Commission (the Commission) on February 1, 2011 (Commission File No. 1-4982).

10(d)	Parker-Hannifin Corporation Long-Term Incentive Performance Award Under the Performance Bonus Plan incorporated by reference to Exhibit 10.2 to the Company s Report on Form 8-K filed with the Commission on February 1, 2011 (Commission File No. 1- 4982).
12	Computation of Ratio of Earnings to Fixed Charges as of March 31, 2011.*
31(i)(a)	Certification of the Principal Executive Officer Pursuant to 17 CFR 240.13a-14(a), as Adopted Pursuant to §302 of the Sarbanes-Oxley Act of 2002.*
31(i)(b)	Certification of the Principal Financial Officer Pursuant to 17 CFR 240.13a-14(a), as Adopted Pursuant to §302 of the Sarbanes-Oxley Act of 2002.*
32	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to §906 of the Sarbanes-Oxley Act of 2002. *
101.INS	XBRL Instance Document.*
101.SCH	XBRL Taxonomy Extension Schema Document.*
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.*
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document. *
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.*
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.*

* Submitted electronically herewith.
Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Statement of Income for the three months ended March 31, 2011 and 2010, (ii) Consolidated Statement of Income for the nine months ended March 31, 2011 and 2010, (iii) Consolidated Balance Sheet at March 31, 2011 and June 30, 2010, (iv) Consolidated Statement of Cash Flows for the nine months ended March 31, 2011 and 2010 and (v) Notes to Consolidated Financial Statements for the nine months ended March 31, 2011.

In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be filed for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be part of any registration or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PARKER-HANNIFIN CORPORATION
(Registrant)
/s/ Jon P. Marten
Jon P. Marten
Executive Vice President - Finance and Administration

and Chief Financial Officer

Date: May 10, 2011

EXHIBIT INDEX

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