ACE AVIATION

Consolidated Financial Statements and Notes
2008

These audited consolidated financial statements, which are prepared on a going concern basis, replace ACE Aviation's annual audited financial statements filed on February 13, 2009. The annual audited financial statements filed on February 13, 2009 were prepared on a liquidation basis of presentation.

August 7, 2009

PRICEWATERHOUSECOOPERS

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August 6, 2009

Auditors' Report

To the Shareholders of
ACE Aviation Holdings Inc.

We have audited the consolidated statements of financial position of **ACE Aviation Holdings Inc.** as at December 31, 2008 and December 31, 2007 and the consolidated statements of operations, changes in shareholders' equity, comprehensive income (loss) and cash flow for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Corporation as at December 31, 2008 and December 31, 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP[1]

[1] Chartered accountant auditor permit No. 18144

Consolidated Statement of Operations

For the year ended December 31 (Canadian dollars in millions except per share figures)		2008	2007*
Operating revenues			
Passenger		$ 9,713	$ 9,344
Cargo		515	548
Other		852	934
		11,080	10,826
Operating expenses			
Aircraft fuel		3,419	2,553
Wages, salaries and benefits		1,908	2,383
Airport and navigation fees		1,001	1,021
Capacity purchase with Jazz	Note 2D)	948	537
Depreciation, amortization and obsolescence	Notes 6,7,16	686	582
Aircraft maintenance		659	515
Food, beverages and supplies		314	318
Communications and information technology		286	281
Aircraft rent		279	323
Commissions		194	201
Special charge for labour restructuring		-	15
Other		1,460	1,644
		11,154	10,373
Operating income (loss) before under-noted item		**(74)**	**453**
Provision for cargo investigations	Note 20	(125)	-
Operating income (loss)		**(199)**	**453**
Non-operating income (expense)			
Interest income		84	126
Interest expense		(373)	(420)
Interest capitalized		37	108
Gain on assets	Note 1	946	1,366
Gain on financial instruments recorded at fair value	Note 18	92	26
Equity and other investment income (loss)	Notes 3,4,5	(64)	71
Other		(2)	(12)
		720	1,265
Income before the following items		**521**	**1,718**
Non-controlling interest		238	(157)
Foreign exchange gain (loss)		(655)	313
Provision for income taxes	Note 10		
Current		(3)	(15)
Future		(221)	(461)
Income (loss) for the year		**$ (120)**	**$ 1,398**
Income (loss) per share	Note 15		
Basic		$ (2.59)	$ 13.51
Diluted		$ (2.59)	$ 11.44

**Effective March 14, 2007, May 24, 2007, and October 16, 2007, the results and financial position of Aeroplan, Jazz and ACTS Aero, respectively, are not consolidated with ACE (Refer to Notes 3, 4 and 5, respectively).*

The accompanying notes are an integral part of these financial statements.

Consolidated Statement of Financial Position

As at December 31 (Canadian dollars in millions)		2008	2007*
ASSETS			
Current			
Cash and cash equivalents	Note 2O)	$ 1,307	$ 2,300
Short-term investments	Note 2P)	506	839
		1,813	3,139
Restricted cash	Note 2Q)	45	124
Accounts receivable	Note 21	700	793
Aircraft fuel inventory		97	98
Fuel derivatives	Note 18	-	68
Collateral deposits for fuel derivatives	Note 18	328	-
Prepaid expenses and other current assets	Note 21	226	182
Future income taxes	Note 10	-	200
		3,209	4,604
Property and equipment	Note 6	7,469	7,925
Intangible assets	Note 7	698	647
Deposits and other assets	Note 8	495	578
		$ 11,871	**$ 13,754**
LIABILITIES			
Current			
Accounts payable and accrued liabilities	Note 21	$ 1,466	$ 1,249
Fuel derivatives	Note 18	420	-
Advance ticket sales		1,333	1,300
Current portion of long-term debt and capital leases	Note 9	663	686
		3,882	3,235
Long-term debt and capital leases	Note 9	4,980	4,006
Convertible preferred shares	Note 14	206	182
Future income taxes	Note 10	50	50
Pension and other benefit liabilities	Note 11	1,407	1,824
Other long-term liabilities	Note 12	370	483
		10,895	9,780
Non-controlling interest		512	757
SHAREHOLDERS' EQUITY	Note 14		
Share capital and other equity		307	450
Contributed surplus		163	504
Retained earnings		600	2,209
Accumulated other comprehensive income (loss)		(606)	54
		464	3,217
		$ 11,871	**$ 13,754**

**Effective March 14, 2007, May 24, 2007, and October 16, 2007, the results and financial position of Aeroplan, Jazz and ACTS Aero, respectively, are not consolidated with ACE (Refer to Notes 3, 4 and 5, respectively).*
The accompanying notes are an integral part of these financial statements.
Commitments (Note 17); Contingencies, Guarantees, and Indemnities (Note 20).

On behalf of the Board of Directors:

(signed) Robert A. Milton
Robert A. Milton
Chairman, President and Chief Executive Officer

(signed) David I. Richardson
David I. Richardson
Chair of the Audit, Finance and Risk Committee

Consolidated Statement of Changes in Shareholders' Equity

For the year ended December 31 (Canadian dollars in millions)		2008	2007*
Share capital			
Common shares, beginning of year		$ 243	$ 533
Repurchase and cancellation of common shares	Note 14	(180)	-
Distributions of Aeroplan units	Note 3	-	(306)
Distributions of Jazz units	Note 4	-	(70)
Issue of shares through stock options exercised		37	86
Total share capital		100	243
Other equity			
Convertible preferred shares	Note 14	117	117
Convertible senior notes	Note 9	90	90
Total share capital and other equity		307	450
Contributed surplus			
Balance, beginning of year		504	25
Repurchase and cancellation of common shares	Note 14	(329)	-
Fair value of stock options recognized as compensation expense (recovery)	Note 13	(5)	25
Fair value of exercised stock options to share capital		(7)	(29)
Aeroplan negative investment	Note 3	-	483
Total contributed surplus		163	504
Retained earnings			
Balance, beginning of year		2,209	810
Repurchase and cancellation of common shares	Note 14	(1,489)	-
Cumulative effect of adopting new accounting policies		-	5
Repair schemes and Non-compete agreement	Note 21	-	(4)
		720	811
Income (loss) for the year		(120)	1,398
Total retained earnings		600	2,209
Accumulated other comprehensive income (loss)	Note 14		
Balance, beginning of year		54	-
Cumulative effect of adopting new accounting policies		-	(7)
Other comprehensive income (loss)		(660)	61
Total accumulated other comprehensive income (loss)		(606)	54
Total retained earnings and accumulated other comprehensive income (loss)		(6)	2,263
Total shareholders' equity		**$ 464**	**$ 3,217**

**Effective March 14, 2007, May 24, 2007, and October 16, 2007, the results and financial position of Aeroplan, Jazz and ACTS Aero, respectively, are not consolidated with ACE (Refer to Notes 3, 4 and 5, respectively).*

The accompanying notes are an integral part of these financial statements.

Consolidated Statement of Comprehensive Income (Loss)

For the year ended December 31 (Canadian dollars in millions)		2008	2007*
Comprehensive income (loss)			
Income (loss) for the year		$ (120)	$ 1,398
Other comprehensive income (loss), net of taxes:			
Net change in unrealized loss on US Airways securities		-	(13)
Reclassification of realized gain on US Airways securities to income		-	(6)
Net change in unrealized gain on Jazz Air Income Fund	Note 4	65	-
Reclassification of net realized gain on Jazz Air Income Fund to income	Note 4	(65)	-
Net change in unrealized gain on Aeroplan Income Fund	Note 3	331	-
Reclassification of net realized gain on Aeroplan Income Fund to income	Note 3	(331)	-
Net gains (losses) on fuel derivatives under hedge accounting (net of taxes of 2008 - nil and 2007 - ($39))	Note 18	(605)	107
Reclassification of net realized gains on fuel derivatives to income (net of taxes of 2008 - $22 and 2007 - $11)	Note 18	(57)	(25)
Unrealized gain (loss) on translation of self-sustaining operation operation (net of nil tax)		2	(9)
Proportional reclassification adjustment from foreign currency translation to income related to disposal of ACTS (net of nil tax)		-	7
		(660)	61
Total comprehensive income (loss)		**$ (780)**	**$ 1,459**

**Effective March 14, 2007, May 24, 2007, and October 16, 2007, the results and financial position of Aeroplan, Jazz and ACTS Aero, respectively, are not consolidated with ACE (Refer to Notes 3, 4 and 5, respectively).*

The accompanying notes are an integral part of these financial statements.

Consolidated Statement of Cash Flow

For the year ended December 31 (Canadian dollars in millions)		2008	2007*
Cash flows from (used for)			
Operating			
Income (loss) for the year		$ (120)	$ 1,398
Adjustments to reconcile to net cash from operations			
Depreciation, amortization and obsolescence		686	582
Gain on assets	Note 1	(946)	(1,366)
Foreign exchange loss (gain)		822	(387)
Future income taxes		221	461
Excess of employee future benefit funding over expense		(316)	(205)
Provision for cargo investigations	Note 20	125	-
Non-controlling interest		(238)	146
Fuel and other derivative instruments	Note 18	(208)	(3)
Fuel hedge collateral deposits, net	Note 18	(322)	-
Equity investment (income) loss		69	(71)
Other		(3)	124
Changes in non-cash working capital balances		120	(42)
		(110)	**637**
Financing			
Issue of common shares		30	56
Repurchase and cancellation of common shares	Note 14	(1,998)	-
Borrowings	Note 9	871	1,914
Distributions paid to non-controlling interest		-	(25)
Reduction of long-term debt and capital lease obligations		(993)	(504)
Other	Notes 9,18	(5)	(38)
		(2,095)	**1,403**
Investing			
Short-term investments		334	83
Proceeds from sale of Aeroplan units	Note 3	692	463
Proceeds from sale of Jazz units	Note 4	182	263
Proceeds from sale of ACTS to ACE	Note 5	-	723
Proceeds from sale of ACTS to Air Canada	Note 5	-	65
Exercise of ACTS Aero put option	Note 5	(19)	-
Proceeds from escrow related to sale of ACTS	Note 5	40	-
Proceeds from sale of other assets	Note 6	38	106
Proceeds from sale lease-back transactions	Note 6	708	-
Additions to capital assets		(883)	(2,730)
Deconsolidation of Aeroplan cash	Note 3	-	(231)
Deconsolidation of Jazz cash	Note 4	-	(138)
Deconsolidation of ACTS cash	Note 5	-	(7)
Acquisition of Aeroman, net of cash		-	(53)
Funding of ACTS Aero letter of credit		59	(101)
Other	Note 18	61	(37)
		1,212	**(1,594)**
Increase (decrease) in cash and cash equivalents		**(993)**	**446**
Cash and cash equivalents, beginning of year		2,300	1,854
Cash and cash equivalents, end of year		**$ 1,307**	**$ 2,300**
Cash payments of interest		$ 307	$ 281
Cash payments of income taxes		$ 2	$ 13

**Effective March 14, 2007, May 24, 2007, and October 16, 2007, the results and financial position of Aeroplan, Jazz and ACTS Aero, respectively, are not consolidated with ACE (Refer to Notes 3, 4 and 5, respectively). Cash and cash equivalents exclude Short-term investments of $506 as at December 31, 2008 ($839 as at December 31, 2007). The accompanying notes are an integral part of these financial statements.*

For the years ended December 31, 2008 and 2007
(currencies in millions – Canadian dollars)

1. BASIS OF PRESENTATION, NATURE OF OPERATIONS, AND LIQUIDITY RISK

A) BASIS OF PRESENTATION

ACE Aviation Holdings Inc. ("ACE") which was incorporated on June 29, 2004, is a holding company of aviation interests. Reference to the "Corporation" in the following notes to the financial statements refers to, as the context may require, ACE and its aviation interests collectively, ACE and one or more of its aviation interests, one or more of ACE's aviation interests, or ACE itself.

ACE has two reportable segments: Air Canada and Corporate Items and Eliminations ("CIE"). During 2007 ACE had the following reportable segments: Air Canada, Aeroplan Limited Partnership ("Aeroplan") up to March 14, 2007, Jazz Air LP ("Jazz") up to May 24, 2007, ACTS LP ("ACTS") up to October 16, 2007, and CIE.

As at December 31, 2008, ACE holds:

- a 75.0% direct ownership interest in Air Canada; and
- a 27.8% direct interest in Aero Technical Support & Services Holdings sarl ("ACTS Aero"), which owns 100% of Aveos Fleet Performance Inc.. ACTS Aero Technical Support and Services Inc. changed its legal name to Aveos Fleet Performance Inc. ("Aveos") on September 23, 2008.

On December 10, 2008, ACE announced its intention to seek court and shareholder approvals for a plan of arrangement pursuant to which it will proceed with a liquidation and its net assets will be distributed, in an orderly fashion, after providing for outstanding liabilities and costs of the transaction.

In accordance with Section 1400 of the Canadian Institute of Chartered Accountants Handbook, General standards of financial statement presentation ("CICA 1400"), effective December 31, 2008, the Corporation changed the basis of preparing its financial statements from going concern to liquidation.

On July 29, 2009, ACE announced that its participation in the Air Canada credit facility of up to $700, announced on the same day by Air Canada, amounts to $150. Given ACE's participation in the facility, it is not management's intention to liquidate at this time.

Therefore, these financial statements have been prepared on a going concern basis of presentation and replace the previously issued financial statements for the year ended December 31, 2008 prepared on a liquidation basis. Under a going concern basis of presentation, Air Canada is consolidated within ACE's financial statements under accounting policies applicable to a going concern which previously existed. The going concern basis of presentation assumes continuity of operations, realization of assets and satisfaction of liabilities in the ordinary course of business. For the year ended December 31, 2008, the Corporation assumed the effective date of application of the liquidation basis was December 31, 2008 and the consolidated statement of operations, shareholders' equity, comprehensive loss and cash flow for the year ended December 31, 2008 were presented on a going concern basis whereas the statement of financial position was presented on a liquidation basis.

These consolidated financial statements are expressed in millions of Canadian dollars and are prepared in accordance with generally accepted accounting principles ("GAAP") in Canada.

Certain comparative figures have been reclassified to conform to the financial statement presentation adopted in the current year.

B) NATURE OF OPERATIONS

Air Canada includes the Corporation's principal passenger and cargo transportation services business operated by Air Canada and related ancillary services.

These services are provided through Air Canada, Air Canada Cargo Limited Partnership ("Air Canada Cargo"), ACGHS Limited Partnership ("Air Canada Ground Handling Services" or "ACGHS") and Touram Limited Partnership ("Air Canada Vacations").

Air Canada is Canada's largest domestic and international airline and the largest provider of scheduled passenger services in the Canadian market, the Canada-US transborder market as well as the international markets to and from Canada. Certain of the scheduled passenger services offered on domestic and Canada-US transborder routes are provided by Jazz through the Jazz capacity purchase agreement ("CPA"). Through Air Canada's global route network, virtually every major market throughout the world is served either directly or through the Star Alliance network. In addition, Air Canada provides certain charter services.

Air Canada Cargo offers air cargo services on domestic and US transborder routes using cargo capacity on aircraft operated by Air Canada and Jazz in these markets. Air Canada offers international cargo services on routes between Canada and major markets in Europe, Asia, South America and Australia using cargo capacity on Boeing 777 and other wide body aircraft operated by Air Canada.

Air Canada Ground Handling Services provides passenger handling services to Air Canada, Jazz and other airlines with a primary focus on Canadian stations. Services covered include passenger check-in, gate management, baggage and cargo handling and processing, cabin cleaning, de-icing as well as aircraft ramp services.

Air Canada Vacations is one of Canada's leading tour operators. Based in Montreal and Toronto, it operates its business in the outgoing leisure travel market (Caribbean, Mexico, Europe, South America and USA) through developing, marketing and distributing vacation travel packages and services through a network of independent travel agencies in Canada as well as through the Air Canada Vacations website, aircanadavacations.com.

C) SIGNIFICANT EVENTS

Air Canada has entered into the following transactions in 2009, in an effort to mitigate Air Canada's liquidity risks as described in D below:

During July 2009

- A secured term credit facility (the "Credit Facility") and warrants for financing proceeds of $600, less fees of approximately $20. ACE's participation in the Air Canada Credit Facility amounted to $150. The Credit Facility is a five-year facility with the first principal repayment due in August 2010, and currently bears interest at 12.75%. The Credit Facility also provides for warrants entitling the debt holders to acquire up to 5% of the shares in the Corporation or up to 10% if certain conditions are not met. Refer to Note 22 for a detailed description of the Credit Facility. As part of the transactions related to the closing of the Credit Facility, existing financing arrangements of $166 were repaid as follows:
  - The revolving credit facility, as further described in Note 9 (j), was repaid in the amount of $49. The rights of the lender under this facility were assigned to the lenders under the Credit Facility;
  - The spare engine financing agreement, as further described below, was partially repaid in the amount of $38. This represented the repayment related to 22 engines under the spare engine financing agreement, with 10 engines remaining under the agreement with a loan value of $81 as at July 31, 2009;
  - The Aeroplan Canada Inc. ("Aeroplan") loan, as further described below, was repaid in the amount of $79. Aeroplan is a participating lender under the Credit Facility.

- Extended or renewed labour agreements for 21 months with all of Air Canada's Canadian-based unions became effective. The agreements provide for no increases to wage rates, no changes to group insurance coverage or benefits, or pension benefit levels during the contract extension periods;

- Pension funding agreements with all of Air Canada's Canadian-based unions (the "Pension MOUs") and the adoption of the *Air Canada Pension Funding Regulations, 2009* (the "Air Canada 2009 Pension Regulations"). The Air Canada 2009 Pension Regulations relieve Air Canada from making any special (past service cost) payments for the period beginning April 1, 2009 and ending December 31, 2010. Thereafter, in respect of the period from January 1, 2011 to December 31, 2013, the aggregate annual past service contributions shall equal the lesser of (i) $150, $175, and $225 in respect of 2011, 2012, and 2013, respectively and (ii) the maximum past service contributions permitted under the Income Tax Act. The Pension MOUs also provide for Air Canada to issue a fully diluted 15% equity ownership of Air Canada, established as of the date of the Pension MOUs, to a trust with all net proceeds of the eventual sale of the shares held by the trust to be contributed to the pension plans;

  As a result of the above, ACE's 75.0% direct ownership interest in Air Canada will be diluted.

- An agreement with a supplier for non-refundable proceeds of approximately $220 in consideration of various contractual commitments;

- Amendments to credit card processing agreements (initiated in the second quarter and completed in July 2009) with one of its principal credit card processors to revise the levels of unrestricted cash required to be maintained as described further below;

- An extension to a short-term loan of $82 (US$75) entered into in 2008, which was originally due in 2009, to 2013. This loan is described in Note 9 (l), except for the amendment to extend the repayment to 2013;

- A memorandum of understanding (the "GECAS MOU") with GE Capital Aviation Services for the sale and leaseback of three Boeing 777 aircraft, which is expected to close prior to September 30, 2009, subject to completion of final documents and third party consents, and to provide net cash proceeds of approximately $122; and;

- A memorandum of understanding for amended terms related to the capacity purchase agreement with Jazz Air LP ("Jazz"), effective August 1, 2009 subject to formal documentation, which would provide for a reduction to rates paid under the agreement.

During the second quarter of 2009

- A secured loan with Aeroplan for net proceeds of $79. This loan, as described above, was terminated in July 2009 pursuant to the transactions relating to the Credit Facility; and;

- Net return of collateral deposits on fuel derivatives in the amount of $72 partially offset by the settlement of fuel derivative contracts in favour of counterparties in the amount of $17.

During the first quarter of 2009

- Financing arrangements secured by spare parts, spare engines and a Boeing 777 aircraft for aggregate proceeds of $267, net of fees of $5. The spare engine financing was partially repaid in July 2009, as described above;

- Sale leaseback of a Boeing 777 aircraft for aggregate proceeds of $172 and the required repayment of a debt obligation related to the aircraft of $128, which included a prepayment fee of $14;

- Inventory financing arrangement under which Air Canada acquired certain spare parts inventories expected to be consumed over the next 12 months for a cash payment of $12 and final payment of $115 in 2010, based on the foreign exchange rate as at March 31, 2009;

- Repayment of pre-delivery financing of $83 on the Boeing 777 aircraft received during the first quarter; and;

- Net return of collateral deposits on fuel derivatives in the amount of $147 offset by the settlement of fuel derivative contracts in favour of counterparties in the amount of $217.

Taking into account the above transactions (excluding the GECAS MOU), at July 31, 2009, Air Canada had Cash and cash equivalents and Short-term investments of $1,320 ($1,005 as at December 31, 2008 and $1,087 as at March 31, 2009 and $907 as at June 30, 2009).

D) AIR CANADA LIQUIDITY RISK

Liquidity risk is the risk that Air Canada will encounter difficulty in meeting obligations associated with its financial liabilities and other contractual obligations. Air Canada monitors and manages liquidity risk by preparing rolling cash flow forecasts, monitoring the condition and value of assets available to be used as security in financing arrangements, seeking flexibility in financing arrangements, and establishing programs to monitor and maintain compliance with terms of financing agreements. Air Canada's principal objective in managing liquidity risk is to maintain a minimum unrestricted cash balance in excess of a target liquidity level of 15% of annual operating revenues. As at July 31, Cash and cash equivalents and Short-term investments were 13% of 2008 annual operating revenues.

Air Canada management believes that the significant events as described above improve Air Canada's current liquidity position however certain risks remain related to the current economic environment, including risks related to market volatility in the price of fuel, foreign exchange and interest rates as well as increased competitive pressures and restrictive terms under Air Canada's financing and other arrangements. During the first half of 2009, demand for Air Canada's air travel and cargo services continued to weaken in both domestic and international markets. Air Canada expects demand to continue to be a challenge for the remainder of the year. The H1N1 influenza virus may also continue to impact demand for air travel. Air Canada is monitoring the H1N1 influenza virus risk, however it is unable to predict if the impact on its operations will be significant. While Air Canada has raised financing proceeds, as described above, and it does not intend on raising further financing of any significance over the course of the next year, the credit markets continue to be constrained. In addition, given the terms and undertakings in the currently outstanding financing arrangements, Air Canada has limited assets which would be available to support additional financings or similar transactions, if required. These factors have had and may continue to have an impact on the liquidity risk of Air Canada.

To date in 2009 including the significant events as described above, Air Canada management continued to undertake various initiatives and develop plans to manage its operating and liquidity risks, taking into account the prevailing economic conditions, including the financing arrangements described above, cost containment initiatives and capacity adjustments with the objective of matching capacity to passenger demand. However, the nature of Air Canada's cost structure is such that fixed costs may not fluctuate proportionately with changes in capacity in the short term.

Pension Funding Obligations

Air Canada maintains several defined benefit pension plans as described in Note 11. Air Canada has reported that the solvency deficit as at January 1, 2009 in the registered pension plans, which is used to determine funding requirements, is $2,835.

As described above, in July 2009 the Federal Government of Canada adopted the Air Canada 2009 Pension Regulations. The Air Canada 2009 Pension Regulations relieve Air Canada from making any special (past service cost) payments in respect of the period beginning April 1, 2009 and ending December 31, 2010. Thereafter, in respect of the period from January 1, 2011 to December 31, 2013, the aggregate annual past service contribution shall equal the lesser of (i) $150, $175, and $225 in respect of 2011, 2012, and 2013, respectively and (ii) the maximum past service contribution permitted under the Income Tax Act.

The Air Canada 2009 Pension Regulations were adopted in coordination with pension funding agreements reached with Air Canada's Canadian-based unions (the "Pension MOUs")and a consultation process with its retirees and non-unionized workforce. The Pension MOUs also provide for Air Canada to issue a fully diluted 15 per cent equity ownership of Air Canada to a trust with all net proceeds of sale to be contributed to the pension plans. A seat on the Board of Directors of Air Canada will be allocated for designation by a trustee representing Air Canada's unions while ownership exceeds 2%. Current service payments will continue to be made in the normal course and there will be no change to the defined benefit plans nor a reduction in benefits while these regulations are in effect.

Based upon the effect of the Air Canada 2009 Pension Regulations, pension funding payments during 2009 will be approximately $407, a decrease of $49 versus 2008.

Covenants in Credit Card Agreements

Air Canada has various agreements for the processing of customer credit card transactions. During the second quarter of 2009 and further amended in July 2009, Air Canada entered into amendments with one of its principal credit card processors to amend certain credit card processing agreements under which the levels of unrestricted cash (as defined per the agreement and generally based on the balances as reported in Cash and cash equivalents and Short-term investments) required to be maintained by Air Canada is reduced to $800 (versus $1,300 prior to the amendments) and Air Canada provides the processor with deposits, to be accumulated over time, and security over certain assets. The triggering event based on a debt service coverage ratio is no longer applicable under the amended agreement. Should Air Canada maintain unrestricted cash of more than $1,200 for two consecutive months, the unrestricted cash requirement increases to $1,100 at which time the processor will return to Air Canada all deposits and security previously provided by Air Canada. As long as unrestricted cash remains at or above $1,100, Air Canada will have no obligation to provide deposits or security to the processor. Pursuant to the amendments entered into in July 2009, should Air Canada's unrestricted cash be less than $1,100, its obligation to provide deposits to the processor would be capped at an amount not in excess of $75, provided unrestricted cash is not less than $800. As at June 30, 2009 a deposit in the amount of $27 had accumulated under these processing agreements, which has further increased to the above-referenced cap of $75 as at July 31, 2009. Deposits under these processing agreements are reported in Prepaid expenses and other current assets.

Cargo Investigations and Proceedings

Air Canada is exposed to potential liabilities related to the proceedings and investigations of alleged anti-competitive cargo pricing activities, as described in Note 20. This preliminary estimate recorded by Air Canada during 2008 is based upon the current status of the investigations and proceedings and Air Canada's assessment as to the potential outcome for certain of them. This provision does not address the proceedings in all jurisdictions, but only where there is sufficient information to do so. Air Canada management has determined it is not possible at this time to predict with any degree of certainty the outcome of all proceedings. Additional material provisions may be required. Amounts could become payable within the year and may be materially different than management's preliminary estimate.

E) DISPOSITION OF AVIATION INTERESTS

The notes to the consolidated financial statements describe various transactions completed in 2008 and 2007 related to the disposition of ACE's holdings of its aviation interests. The transactions include the disposal of Aeroplan Income Fund ("AIF") units and Jazz Air Income Fund ("JAIF") units; the monetization of ACTS; the disposal of shareholdings in US Airways and distributions to ACE shareholders by way of return of capital of AIF and JAIF units. In addition two share buybacks by way of substantial issuer bids were completed on January 10, 2008 and June 18, 2008, respectively.

Gain (loss) on assets realized in 2008 and 2007 as a result of disposition by way of sales of various aviation interests, and impairment of investments and assets were as follows:

		2008	2007
Sale of Aeroplan Income Fund units	Note 3	$ 830	$ 539
Sale of Jazz Air Income Fund units	Note 4	167	233
ACTS monetization	Note 5	-	565
Sale of US Airways shares		-	8
Gain on sale of aviation interests		**997**	**1,345**
Provision for loss on ACTS Aero investment	Note 5	(10)	-
Boeing 767 impairment provision	Note 6	(38)	-
Other		(3)	21
Gain on assets		**$ 946**	**$ 1,366**

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A) PRINCIPLES OF CONSOLIDATION

These consolidated financial statements include the accounts of the Corporation and its aviation interests described in Note 1, with adjustments for non-controlling interests. The consolidated financial statements of the Corporation include the accounts of variable interest entities for which the Corporation is the primary beneficiary. All inter-company balances and transactions are eliminated.

Aeroplan was consolidated up to March 14, 2007 (Refer to Note 3), Jazz was consolidated up to May 24, 2007 (Refer to Note 4) and ACTS was consolidated up to October 16, 2007 (Refer to Note 5).

B) USE OF ESTIMATES

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Significant estimates made in the preparation of the consolidated financial statements include those used in accounting for employee future benefits (Note 11), accounting for income taxes (Note 10), the determination of passenger revenues, the determination of amortization period for long-lived assets, the impairment considerations on long-lived assets and the carrying value of financial instruments recorded at fair value.

C) PASSENGER AND CARGO REVENUES

Airline passenger and cargo advance sales are deferred and included in Current liabilities. Advance sales also include the proceeds from the sale of flight tickets to Aeroplan, a company that provides loyalty program services to Air Canada and purchases seats from Air Canada under the Commercial Participation and Services Agreement ("CPSA") (Note 17). Passenger and cargo revenues are recognized when the transportation is provided, except for revenue on unlimited flight passes which is recognized on a straight-line basis over the period during which the travel pass is valid. Air Canada has formed alliances with other airlines encompassing loyalty program participation, code sharing and coordination of services including reservations, baggage handling and flight schedules. Revenues are allocated based upon formulas specified in the agreements and are recognized as transportation is provided. As described further under Aeroplan Loyalty Program, the estimated fair value of Aeroplan Miles earned through qualifying air travel is deferred at the time the qualifying air travel is provided. Deferred revenues from the issue of Miles (“Miles”) to customers, including Miles sold to loyalty program partners are recorded as passenger revenues when the transportation is provided. Redemptions for non-passenger services are included in other revenues.

Air Canada performs regular evaluations on the deferred revenue liability which may result in adjustments being recognized as revenue. Due to the complex pricing structures; the complex nature of interline and other commercial agreements used throughout the industry; historical experience over a period of many years; and other factors including refunds, exchanges and unused tickets, certain relatively small amounts are recognized as revenue based on estimates. Events and circumstances may result in actual results that are different from estimates; however these differences have historically not been material.

D) CAPACITY PURCHASE AGREEMENTS – JAZZ AND TIER III CARRIERS

Air Canada has capacity purchase agreements with Jazz and certain other regional carriers, which are referred to as Tier III carriers, operating aircraft of 18 seats or less. Under these agreements, Air Canada is responsible for the marketing, ticketing and commercial arrangements relating to these flights and records the revenue it earns under Passenger revenue. Operating expenses under capacity purchase agreements include the capacity purchase fees, which include a variable component that is dependent on Jazz aircraft utilization, and pass-through costs, which are non-marked-up costs charged to Air Canada, which include fuel, airport and user fees and other costs; these expenses are recorded in the applicable category within Operating expenses.

The following table outlines CPA and pass through costs with Jazz for the year:

	2008		2007	
Expenses from CPA with Jazz	$	948	$	923
Pass through fuel expense from Jazz		427		320
Pass through airport expense from Jazz		201		201
Pass through other expense from Jazz		38		36
	$	**1,614**	**$**	**1,480**

CPA expenses with Jazz total $537 for the year ended December 31, 2007 post-deconsolidation on May 24, 2007.

Notwithstanding that Air Canada is no longer the primary beneficiary of Jazz effective May 24, 2007; Air Canada continues to hold a significant variable interest in Jazz through the contractual arrangements with Jazz as described in Note 17.

Refer to Note 1C for a discussion of the memorandum of understanding relating to amended terms to the Jazz CPA concluded subsequent to December 31, 2008.

E) AEROPLAN LOYALTY PROGRAM

Air Canada is an Aeroplan partner providing certain of Air Canada's customers with Aeroplan Miles, which can be redeemed by customers for air travel or other rewards acquired by Aeroplan.

Under the CPSA between Air Canada and Aeroplan, Aeroplan purchases passenger tickets from Air Canada to meet its obligation for the redemption of Aeroplan Miles for air travel. The proceeds from the sale of passenger tickets to Aeroplan are included in Advance ticket sales. Revenue related to these passenger tickets is recorded in passenger revenues when transportation is provided.

For Aeroplan Miles earned by Air Canada customers, Air Canada purchases Miles from Aeroplan in accordance with the terms of the CPSA. The cost of purchasing Aeroplan Miles from Aeroplan is accounted for as a sales incentive and charged against passenger revenues when the points are issued, which is upon the qualifying air travel being provided to the customer.

In November 2008 Air Canada reached agreement with Aeroplan to have the loyalty management company accelerate payment terms on Air Canada redemption tickets issued, in exchange for future credits to be settled in 2009, resulting in the substantial elimination of the trade receivable from Aeroplan relating to the sale of passenger tickets. As a result of this agreement, cash flows from operations have been favourably impacted by $63 as at December 31, 2008.

Up until the date of deconsolidation the current balance was based on Management's estimate as to the portion of the liabilities that will be redeemed in the next twelve months. The remainder of the liabilities was carried in Aeroplan deferred revenues. Prior to deconsolidation Aeroplan Miles that were earned by members through transportation services provided by Air Canada and the transportation services were treated as multiple elements. Aeroplan Miles were recorded at fair values with the residual allocated to transportation services. The proceeds from the sale of Aeroplan Miles to loyalty program commercial partners were deferred. Revenues from Aeroplan Miles issued to members were recognized at the time the Miles were redeemed except for breakage as noted below. Aeroplan Miles redeemed for travel on Air Canada and Jazz were included in Passenger revenue and Miles redeemed for other than travel were included in Other revenues.

Refer to Note 1C for a description of subsequent events.

F) OTHER REVENUES

Other revenue includes revenues from the sale of the ground portion of vacation packages, ground handling services and other airline related services. Vacation package revenue is recognized as services are provided over the period of the vacation. Other airline related service revenues are recognized as the products are sold to passengers or the services are provided.

Other revenue also includes revenue related to the lease or sublease of aircraft to third parties. Lease or sublease revenues are recognized on a straight line basis over the term of the lease or sublease. Rental revenue from operating leases amounted to $113 in 2008 (2007 - $52).

In certain subleases of aircraft to Jazz, Air Canada reports the sublease revenues net against aircraft rent expense as the terms of the sublease match the terms of Air Canada's lease. Air Canada acts as lessee and sublessor in these matters. Refer to Note 17 for the lease commitments under these arrangements.

Air Canada provides certain services to related parties, ACE and Aveos, and former related parties, Aeroplan and Jazz, consisting principally of administrative services in relation to information technology, human resources, finance and accounting, treasury and tax services, corporate real estate, and environmental affairs. Administrative service revenues are recognized as services are provided. Real estate rental revenues are recognized on a straight line basis over the term of the lease.

Other revenue includes revenues from maintenance services and other airline related services. Revenues and costs relating to airframe maintenance services, engine and component maintenance services are deferred and only recognized once the work has been completed. Certain maintenance contracts are referred to as power by the hour whereby the customer makes payments based on their aircraft utilization. Customer receipts under a power by the hour contract are deferred in current liabilities and recognized as revenues as maintenance services are performed.

Other airline related service revenues are recognized as services are provided.

G) EMPLOYEE FUTURE BENEFITS

The cost of pensions, other post-retirement and post-employment benefits earned by employees is actuarially determined annually as at December 31. This is a change in the measurement date of November 30 used in the prior year. The change in date did not have any significant impact on pension and other benefits expense or the net benefit obligations. The cost is determined using the projected benefit method prorated on service, market interest rates, and management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health care costs.

A market-related valuation method is used to value plan assets for the purpose of calculating the expected return on plan assets. Under the selected method, the differences between investment returns during a given year and the expected investment returns are amortized on a straight line basis over 4 years.

Past service costs arising from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment. This period does not exceed the average remaining service period of such employees up to the full eligibility date. The average remaining service life of active employees (or average remaining life expectancy of retired members for a plan with no active members) is between 7 and 16 years for pension plans and between 10 and 11 years for post retirement and post employment benefit plans.

Cumulative unrecognized net actuarial gains and losses in excess of 10% of the greater of the projected benefit obligation or market-related value of plan assets at the beginning of the year are amortized over the remaining service life of active employees.

As described in Note 11, some of Air Canada's employees are contractually assigned to Aveos Fleet Performance Inc. ("Aveos" and formerly called ACTS Aero Technical Support & Services Inc. ("ACTS Aero")) and Aeroplan. These employees are members of Air Canada's sponsored defined benefit pension plans and also participate in Air Canada's sponsored health, life and disability future benefit plans. These consolidated financial statements include all of the assets and liabilities of all sponsored plans of the Corporation. Pension and other employee benefits expenses are recorded net of costs recovered from these entities pertaining to employees assigned by Air Canada to these entities based on an agreed upon formula. The cost recovery reduces Air Canada's benefit cost.

H) EMPLOYEE PROFIT SHARING PLAN

The Corporation has employee profit sharing plans. Expenses are calculated annually on full calendar year results and recorded throughout the year as a charge to salary and wage expense based on the estimated annual payment under the plan.

I) STOCK-BASED COMPENSATION PLANS

Certain employees of the Corporation, for the relevant periods, participate in the ACE and Air Canada stock based compensation plans, as described in Note 13.

The fair value of stock options granted to Corporation employees is recognized as compensation expense and a credit to Contributed surplus on a straight line basis over the applicable vesting period. For a stock option award attributable to an employee who is eligible to retire at the grant date, the fair value of the stock option award is expensed on the grant date. For a stock option award attributable to an employee who will become eligible to retire during the vesting period, the fair value of the stock option award is recognized over the period from the grant date to the date the employee becomes eligible to retire. The amount of compensation cost recognized at any date at least equals the value of the vested portion of the options at that date. Refer to Note 13 for a discussion of the accelerated vesting of ACE stock options in 2007.

Air Canada also maintains an employee share purchase plan. Under this plan, contributions by Air Canada employees are matched to a specific percentage by Air Canada. Employees must remain with the Corporation until March 31 of the subsequent year for vesting of the Corporation's contributions. These contributions are included in Wages, salaries, and benefits expense as earned. During 2007, the ACE employee share purchase plan was wound up.

J) MAINTENANCE AND REPAIRS

Maintenance and repair costs for both leased and owned aircraft, including line maintenance, component overhaul and repair, and maintenance checks, are charged to Operating expenses as incurred, with the exception of maintenance and repair costs related to return conditions on short-term aircraft leases, which are accrued over the term of the lease. Line maintenance consists of routine daily and weekly scheduled maintenance inspections and checks, overhaul and repair involves the inspection or replacements of major parts, and maintenance checks consist of more complex inspections and servicing of the aircraft.

K) OTHER OPERATING EXPENSES

Included in Other operating expenses are expenses related to building rent and maintenance, terminal handling, professional fees and services, crew meals and hotels, advertising and promotion, insurance costs, credit card fees, ground costs for Air Canada Vacations packages, and other expenses. Expenses are recognized as incurred.

L) FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING

Under the Corporation's risk management policy derivative financial instruments are used only for risk management purposes and not for generating trading profits.

Financial assets and financial liabilities, including derivatives, are recognized on the Consolidated Statement of Financial Position when the Corporation becomes a party to the contractual provisions of the financial instrument or non-financial derivative contract. All financial instruments are required to be measured at fair value on initial recognition except for certain related party transactions. Measurement in subsequent periods is dependent upon the classification of the financial instrument as held-for-trading, held-to-maturity, available-for-sale, loans and receivables, or other financial liabilities. The held-for-trading classification is applied when an entity is "trading" in an instrument or alternatively the standard permits that any financial instrument be irrevocably designated as held-for-trading. The held-to-maturity classification is applied only if the asset has specified characteristics and the entity has the ability and intent to hold the asset until maturity. For financial instruments classified as other than held-for-trading, transaction costs are added to the initial fair value of the related financial instrument.

Financial assets and financial liabilities classified as held-for-trading are measured at fair value with changes in those fair values recognized in Non-operating income (expense). Financial assets classified as held-to-maturity, loans and receivables, or other financial liabilities are measured at amortized cost using the effective interest method of amortization. Financial assets classified as available-for-sale are measured at fair value with unrealized gains and losses, including changes in foreign exchange rates, being recognized in Other Comprehensive Income ("OCI"), as described below. Investments in equity instruments classified as available-for-sale that do not have a quoted market price in an active market are measured at cost.

Air Canada enters into interest rate, foreign currency, and fuel derivatives to manage the associated risks. Derivative instruments are recorded on the Consolidated Statement of Financial Position at fair value, including those derivatives that are embedded in financial or non-financial contracts. Changes in the fair values of derivative instruments are recognized in Non-operating income (expense) with the exception of foreign exchange risk management contracts, which are recorded in Foreign exchange gain (loss), and fuel derivatives designated as effective cash flow hedges, as further described below. These contracts are included in the Consolidated Statement of Financial Position at fair value in Prepaid expenses and other current assets, Deposits and other assets, Accounts payable and accrued liabilities, or Other long-term liabilities as appropriate. All cash flows associated with purchasing and selling derivatives are classified as operating cash flows in the Consolidated Statement of Cash Flow.

For financial instruments measured at amortized cost, transaction costs or fees, premiums or discounts earned or incurred are recorded, at inception, net against the fair value of the financial instrument. Interest expense is recorded using the effective interest method. For any guarantee issued that meets the definition of a guarantee pursuant to Accounting Guideline 14, *Disclosure of Guarantees*, the inception fair value of the obligation relating to the guarantee is recognized and amortized over the term of the guarantee. It is the Corporation's policy to not re-measure the fair value of the financial guarantee unless it qualifies as a derivative.

The Corporation has implemented the following classifications:

- Cash and cash equivalents and Short-term investments are classified as held-for-trading and any period change in fair value is recorded through net income.

- Aircraft related and other deposits are classified as held-to-maturity investments and are measured at amortized cost using the effective interest rate method. Interest income is recorded in net income, as applicable.

- Accounts receivable are classified as loans and receivables and are measured at amortized cost using the effective interest rate method. Interest income is recorded in net income, as applicable.

- Accounts payable, credit facilities, bank loans and the financial liability component of convertible notes and convertible preferred shares are classified as other financial liabilities and are measured at amortized cost using the effective interest rate method. Interest income is recorded in net income, as applicable.

Fuel Derivatives Under Hedge Accounting

Air Canada has designated certain of its fuel derivatives as cash flow hedges. In a cash flow hedging relationship, the effective portion of the change in the fair value of the hedging derivative is recognized in OCI while the ineffective portion is recognized in Non-operating income (expense). Upon maturity of the fuel derivatives, the effective gains and losses previously recognized in Accumulated OCI ("AOCI") are recorded in fuel expense.

Hedge accounting is discontinued prospectively when the derivative no longer qualifies as an effective hedge, or the derivative is terminated or sold, or upon the sale or early termination of the hedged item. The amounts previously recognized in AOCI are reclassified to fuel expense during the periods when the derivative matures. Refer to Note 18 for the impact of fuel derivatives during the year.

M) FOREIGN CURRENCY TRANSLATION

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at rates of exchange in effect at the date of the Consolidated Statement of Financial Position. Non-monetary assets and liabilities, revenues and expenses arising from transactions denominated in foreign currencies, are translated at the historical exchange rate or the average exchange rate during the period, as applicable. Adjustments to the Canadian dollar equivalent of foreign denominated monetary assets and liabilities due to the impact of exchange rate changes are recognized in Foreign exchange gain (loss).

N) INCOME TAXES

The Corporation utilizes the asset and liability method of accounting for income taxes under which future income tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amount and the tax basis of assets and liabilities. Future income tax assets and liabilities are measured using substantively enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. Income taxes are recognized in the income statement except to the extent that it relates to items charged or credited to Shareholders' equity, in which case the taxes are netted with such items. The effect on future income tax assets and liabilities of a change in tax rates is recognized in earnings in the period when the change is substantively enacted. Future income tax assets are recognized to the extent that realization is considered more likely than not. The Corporation applied fresh start reporting on September 30, 2004 under which the assets and liabilities of the Corporation were comprehensively revalued, excluding goodwill ("fresh start"). The benefit of future income tax assets that existed at fresh start, and for which a valuation allowance is recorded, will be recognized first to reduce to nil any remaining intangible assets (on a pro-rata basis) that were recorded upon fresh start reporting with any remaining amount as a credit to Shareholders' equity. The benefit of future income tax assets that arise after fresh start will be recognized in the Consolidated Statement of Operations.

O) CASH AND CASH EQUIVALENTS

Cash includes $1,215 pertaining to investments with original maturities of three months or less at December 31, 2008 (2007 - $2,031). Investments include bankers' acceptances and bankers discount notes, which may be liquidated promptly and have original maturities of three months or less. The weighted average interest rate on investments as at December 31, 2008 is 1.74% (2007 - 4.62%).

P) SHORT-TERM INVESTMENTS

Short-term investments, comprised of bankers' acceptances and bankers' discount notes, have original maturities over three months, but not more than one year. The weighted average interest rate on Short-term investments as at December 31, 2008 is 2.90% (2007 - 4.61%).

Q) RESTRICTED CASH

The Corporation has recorded $45 (2007 - $124) in Restricted cash, under Current assets, representing funds held in trust by Air Canada Vacations in accordance with regulatory requirements governing Advance ticket sales, recorded under Current liabilities, for certain travel related activities.

Restricted cash with maturities greater than one year from the balance sheet date is recorded in Deposits and other assets. This restricted cash relates to funds on deposit with various financial institutions as collateral for letters of credit and other items.

R) AIRCRAFT FUEL INVENTORY

Effective January 1, 2008, the Corporation adopted CICA section 3031, *Inventories*, which replaced section 3030, *Inventories*. Section 3031 provides more extensive guidance on measurement, and expands disclosure requirements to increase transparency. The Corporation's accounting policy for Aircraft fuel inventory is consistent with measurement requirements in the new standard and as a result, no adjustment was recorded on transition; however, additional disclosures are required and have been adopted by the Corporation as described below. Aircraft fuel inventory as at December 31, 2008 amounts to $97 (2007 - $98).

The main features of the new standard, which impact the Corporation, include:

- Measurement of inventories at the lower of cost and net realizable value, with guidance on the determination of costs.
- Consistent use of either a first-in first-out or weighted average formula to measure the cost of other inventories. The Corporation uses a weighted average formula to measure cost.
- Reversal of previous write-downs to net realizable value when there is a subsequent increase in the value of inventories. No write downs or reversals were applicable during the periods presented.

- Disclosure of the accounting polices used, carrying amounts, amounts recognized as an expense, write-downs, and the amount of any reversal of any write-downs recognized as a reduction in expenses.

S) PROPERTY AND EQUIPMENT

Property and equipment is initially recorded at cost. Property under capital leases and the related obligation for future lease payments are initially recorded at an amount equal to the lesser of fair value of the property or equipment and the present value of those lease payments.

Property and equipment are depreciated to estimated residual values based on the straight-line method over their estimated service lives. Property and equipment under capital leases and within variable interest entities are depreciated to estimated residual values over the life of the lease. Aircraft and flight equipment, including spare engines and related parts ("rotables") are depreciated over 20 to 25 years, with 10% to 20% estimated residual values. Aircraft reconfiguration costs are amortized over 3 to 5 years. Betterments to owned aircraft are capitalized and amortized over the remaining service life of the aircraft. Betterments to aircraft on operating leases are amortized over the term of the lease.

Buildings are depreciated over their useful lives not exceeding 40 to 50 years on a straight line basis. An exception to this is where the useful life of the building is greater than the term of the land lease. In these circumstances, the building is depreciated over the life of the lease. Leasehold improvements are amortized over the lesser of the lease term or 5 years. Ground and other equipment is depreciated over 3 to 25 years.

T) INTEREST CAPITALIZED

Interest on funds used to finance the acquisition of new flight equipment and other property and equipment is capitalized for periods preceding the dates that the assets are available for service. Capitalized interest related to the acquisition of new flight equipment and other property and equipment is included in purchase deposits within Property and equipment (Note 6). Capitalized interest also includes financing costs charged by the manufacturer on capital commitments as described in Note 17.

U) INTANGIBLE ASSETS

As a result of the application of fresh start reporting, intangible assets were recorded at their estimated fair values at September 30, 2004. For periods subsequent to September 30, 2004, intangible assets are initially recorded at cost. Indefinite life assets are not amortized while assets with finite lives are amortized on a straight line basis to nil over their estimated useful lives.

	Estimated Useful Life
International routes and slots	Indefinite
Air Canada trade name	Indefinite
Other marketing based trade names	Indefinite
Star Alliance membership	25 years
Other contract and customer based intangible assets	10 to 15 years
Technology based intangible assets	1 to 5 years

V) IMPAIRMENT OF LONG-LIVED ASSETS

Long-lived assets are tested for impairment whenever circumstances indicate that the carrying value may not be recoverable. When events or circumstances indicate that the carrying amount of long-lived assets, other than indefinite life intangibles, are not recoverable, the long-lived assets are tested for impairment by comparing the estimate of future expected cash flows to the carrying amount of the assets or groups of assets. If the carrying value is not recoverable from future expected cash flows, any loss is measured as the amount by which the asset's carrying value exceeds fair value and recorded in the period. Recoverability is assessed relative to undiscounted cash flows from the direct use and disposition of the asset or group of assets.

Indefinite life intangible assets are subjected to impairment tests on an annual basis or when events or circumstances indicate a potential impairment. If the carrying value of such assets exceeds the fair values, the assets are written down to fair value.

W) EQUITY INVESTMENTS

Investments subject to significant influence are initially recorded at cost, and the carrying amount is increased or decreased to recognize the Corporation's proportionate share of the investee's net profit or loss. During 2008, ACE recorded a write-down to reflect a loss in value that is other than temporary on its ACTS Aero investment of $10 recorded in Gain (loss) on assets (Note 5).

X) AIRCRAFT LEASE PAYMENTS IN EXCESS OF OR LESS THAN RENT EXPENSE

Total aircraft operating lease rentals over the lease term are amortized to operating expense on a straight-line basis. Included in Deposits and other assets and Other long-term liabilities are the differences between the straight line aircraft rent expense and the payments as stipulated under the lease agreement.

Y) ASSET RETIREMENT OBLIGATIONS

Air Canada records an asset and related liability for the costs associated with the retirement of long-lived tangible assets when a legal liability to retire such assets exists. The fair value of a liability for an asset retirement obligation is recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and then amortized over its estimated useful life. In subsequent periods, the asset retirement obligation is adjusted for the passage of time through charges to income and any changes in the amount of the underlying cash flows through increases or decreases to the asset retirement obligation and related asset. A gain or loss may be incurred upon settlement of the liability.

Z) RELATED PARTY TRANSACTIONS

Related party transactions not in the normal course of operations are measured at the exchange amount when the change in ownership interest in the item transferred is substantive and the exchange amount is supported by independent evidence; otherwise it is recorded at the carrying amount. Related party transactions in the normal course of operations are measured at the exchange amount.

AA) VARIABLE INTEREST ENTITIES

Aircraft Leasing Transactions

Air Canada has aircraft leasing transactions with a number of special purpose entities that are variable interest entities (a "VIE") under Accounting Guideline 15 of the CICA Handbook, Variable Interest Entities ("AcG-15"). As a result of Air Canada being the primary beneficiary of these VIEs, Air Canada consolidates leasing entities covering 44 aircraft.

Fuel Facilities Arrangements

Air Canada participates in fuel facilities arrangements operated through fuel facility corporations (the "Fuel Facility Corporations"), along with other airlines to contract for fuel services at various major Canadian airports. The Fuel Facility Corporations are organizations incorporated under federal or provincial business corporations acts in order to acquire, finance and lease assets used in connection with the fuelling of aircraft and ground support equipment. The Fuel Facilities Corporations operate on a cost recovery basis.

Under AcG-15, Air Canada is the primary beneficiary of three of the Fuel Facility Corporations in Canada. Five of the Fuel Facility Corporations in which Air Canada participates in Canada that have not been consolidated have assets of approximately $150 and debt of approximately $127, which is Air Canada's maximum exposure to loss without taking into consideration any cost sharing and asset retirement obligations that would occur amongst the other contracting airlines. Air Canada considers this loss potential as remote.

AB) FUTURE ACCOUNTING STANDARD CHANGES

The following is an overview of accounting standard changes that the Corporation will be required to adopt in future years:

Goodwill and Intangible Assets

In February 2008, the Canadian Institute of Charted Accountants ("CICA) issued section 3064, *Goodwill and Intangible Assets* which provides guidance on the recognition, measurement, presentation and disclosure for goodwill and intangible assets, other than the initial recognition of goodwill or intangible assets acquired in a business combination. The standard is effective for fiscal years beginning on or after October 1, 2008, and requires retroactive application to prior period financial statements. The Corporation has evaluated the impact of this new standard for adoption on January 1, 2009 and does not expect any significant impact on its consolidated financial statements.

Credit Risk and the Fair Value of Financial Assets and Financial Liabilities

Effective January 1, 2009, the Corporation will adopt the recommendations of the Emerging Issues Committee ("EIC") of the CICA relating to Abstract EIC-173 Credit Risk and the Fair Value of Financial Assets and Financial Liabilities. This Abstract confirms that an entity's own credit risk and the credit risk of the counterparty should be taken into consideration in determining the fair value of financial assets and liabilities, including derivative instruments. The adoption of this guidance will not have a significant effect on the Corporation's consolidated financial statements as collateral deposits with fuel derivative counterparties and master netting arrangements were considered in determining that no credit risk adjustment was required on the valuation of the derivatives.

Business Combinations, Consolidated Financial Statements and Non-controlling Interests

The CICA issued three new accounting standards in January 2009: section 1582, *Business Combinations*, section 1601, *Consolidated Financial Statements*, and section 1602, *Non-controlling interests*. These new standards will be effective for fiscal years beginning on or after January 1, 2011. The Corporation is in the process of evaluating the requirements of the new standards.

Section 1582 replaces section 1581, and establishes standards for the accounting for a business combination. It provides the Canadian equivalent to International Financial Reporting Standard IFRS 3 – *Business Combinations*. The section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011.

Sections 1601 and 1602 together replace 1600 – *Consolidated Financial Statements.* Section 1601, establishes standards for the preparation of consolidated financial statements. Section 1601 applies to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. It is equivalent to the corresponding provisions of International Financial Reporting Standard IAS 27 - *Consolidated and Separate Financial Statements* and applies to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011.

3. AEROPLAN

Aeroplan provides its commercial partners, including Air Canada, with loyalty marketing services designed to stimulate demand for such partners' products and services.

ACE had an indirect ownership interest in Aeroplan Limited Partnership ("Aeroplan") through its holdings in Aeroplan Income Fund ("AIF"). Aeroplan was consolidated until March 14, 2007, the date the Corporation made a special distribution of Aeroplan Income Fund units to the Corporation's shareholders. From March 14, 2007 to May 9, 2008, ACE's investment in Aeroplan was accounted for using the equity method. From May 10, 2008 to June 2, 2008, ACE's investment in Aeroplan was accounted for as an available for sale security. The classification of the investment in Aeroplan as available-for-sale resulted in the investment being carried at fair value. The adjustment to fair value recorded to OCI was $331, net of income taxes of $72.

Since June 2, 2008, subsequent to the sale of all remaining AIF units, ACE has no ownership interest in Aeroplan.

Distributions

During 2006 and 2007, ACE distributed to its common and preferred shareholders 108,477,082 units of AIF. (2007 – 88,272,917 and 2006 – 20,204,165) with an aggregated value, based on the closing price on each respective distribution date, of approximately $1,930 (2007 - $1,679 and 2006 - $251).

Distributions to Common Shareholders

The distributions to holders of Variable Voting Shares and Voting Shares totaling 79,860,637 units of Aeroplan Income Fund ("Aeroplan units") were non-monetary non-reciprocal transfers to owners recorded at the carrying amount of the net assets transferred and did not give rise to a gain or loss. For the May 24, 2007 Aeroplan units distributed, as Aeroplan was an equity investment at the time of distribution, $57 was recorded as a reduction of the negative equity investment in Aeroplan offset by an increase to contributed surplus. The 2007 distributions involved the use of future income tax ("FIT") assets, of which $306 related to the distributions to the common shareholders which was recorded as a reduction in share capital.

Distributions to common shareholders	**Aeroplan units distributed**	**Reduction to share capital due to FIT**
January 10, 2007	45,240,473	$ (166)
March 14, 2007	18,345,927	(71)
May 24, 2007	16,274,237	(69)
	79,860,637	**$ (306)**

Distributions to Preferred Shareholders

The distributions to preferred shareholders of ACE totaled 8,412,280 Aeroplan units. These transactions were considered a non-reciprocal transfer to non-owners since the holders of the Preferred Shares are not considered owners of the Corporation for accounting purposes. The transfers are measured at fair value at the date of distribution and result in net interest expense being recorded, which is the fair value of each distribution less the gain recorded. The gain recorded is the fair value of the distribution in excess of the Corporation's proportionate carrying value of its investment. The fair value of the distribution is based on the closing price of the AIF units on the day of the distribution.

The Aeroplan units distributed to preferred shareholders resulted in net interest expense recorded during the year and a proportionate reduction to intangible assets related to fair value adjustments to Aeroplan intangibles that are recorded on consolidation as a result of the dilution of interests.

The following table summarizes the financial statement impact of the Aeroplan units distributed to preferred shareholders:

Distribution to preferred shareholders	Aeroplan units distributed	Fair value of distribution	Gain on distribution	Net interest expense recorded	Reduction to intangible asset recorded
January 10, 2007	4,759,527	$ 86	$ 78	$ 8	$ (8)
March 14, 2007	1,926,990	37	33	4	(4)
May 24, 2007	1,725,763	37	43	(6)	-
	8,412,280	**$ 160**	**$ 154**	**$ 6**	**$ (12)**

The distributions described above had no cash tax consequences.

In accordance with the terms of the ACE Convertible senior notes, each of the distributions during the year ended December 31, 2007 triggered a conversion rate adjustment (Note 9 (a)). These changes in the conversion rate did not have any accounting consequences.

In accordance with the terms of the ACE stock option plan, each distribution during 2007 triggered an adjustment to the exercise price and the number of options outstanding (Note 13).

Accounting resulting from distributions

Immediately prior to the distribution on March 14, 2007, ACE's net investment in Aeroplan was negative $710, which was negative due to accumulated distributions to ACE in excess of income and capital invested, net of fair value adjustments recorded upon the application of fresh start reporting. Subsequent to the distribution on March 14, 2007, ACE's 40.1% proportionate interest in the accumulated deficit of Aeroplan LP was $284. ACE has retained this negative investment of $284 and reflected the amount in other long term liabilities. As a result, the difference between the net investment prior to and after the distribution was recorded as a credit to Contributed Surplus in the amount of $426. The May 24, 2007 distribution of Aeroplan units further reduced the negative investment in Aeroplan by $63 with a credit to contributed surplus of $57 and a reduction to interest expense of $6 for a total credit to contributed surplus of $483 for the year ended December 31, 2007.

The cash flow impact to ACE of deconsolidating Aeroplan of $231 reflects the Aeroplan cash being removed from the consolidated statement of financial position of ACE and is classified as a cash outflow from investing activities.

The Corporation had various related party transactions after deconsolidation of Aeroplan from ACE and these transactions were recorded at the exchange amount. Related party trade balances arise from the provision of services, and the allocation of employee related costs.

Sales of units

On October 22, 2007, the Corporation sold 22.0 million units of AIF at a price of $21.90 per unit, for net proceeds of $463, resulting in a reduction to the negative investment in Aeroplan of $76 and realized a gain on disposal of $539.

On April 21, 2008, ACE sold a total of 20.4 million units of AIF at a price of $17.50 per unit representing total net proceeds to ACE of $343 and realized a gain on sale of $413 ($340 after tax).

On June 2, 2008, ACE sold the remaining units of AIF for total net proceeds to ACE of $349, and realized a gain on sale of $417 ($344 after tax). Net realized gains of $331, net of tax of $72, were taken into income from OCI.

4. JAZZ

Jazz is the largest regional airline and second largest airline in Canada, after Air Canada, based on fleet size and number of routes operated. Jazz provides service to Air Canada's customers in lower density markets and in higher density markets at off-peak times throughout Canada and to certain destinations in the United States under a capacity purchase agreement between Air Canada and Jazz.

ACE had an indirect ownership interest in Jazz Air LP ("Jazz") through its holdings in Jazz Air Income Fund ("JAIF"). Jazz was consolidated to May 24, 2007. From that date to January 24, 2008, ACE's investment in Jazz was accounted for using the equity method. Subsequent to the sale on January 24, 2008 to February 7, 2008, ACE's investment in Jazz was classified as an available-for-sale investment. The classification of the investment in Jazz as available-for-sale resulted in the investment being carried at fair value. The adjustment to fair value recorded to OCI was $71, net of income taxes of ($15).

Since June 2, 2008, subsequent to the completion of the sale of JAIF units, ACE has no ownership interest in Jazz.

Initial Public Offering

ACE completed an initial public offering of the Jazz Air Income Fund on February 2, 2006. The Jazz Air Income Fund subscribed for 23.5 million units of Jazz at a price of $10.00 per unit for net proceeds of $218, net of offering costs of $17. Concurrent with the closing of the initial public offering, Jazz received proceeds of $113, after fees of $2, representing the drawing under a new term credit facility. On February 27, 2006, following the exercise of the over-allotment option by the underwriters, the Jazz Air Income Fund issued an additional 1.5 million units at a price of $10.00 per unit for additional net proceeds of approximately $14.

The Jazz Air Income Fund is an unincorporated, open-ended trust that indirectly holds 100% of the outstanding limited partnership units of Jazz.

ACE recorded a dilution gain of $220 and a non-controlling interest on the statement of financial position of $10 as a result of the dilution of its interests in Jazz. The dilution gain is the net proceeds of the offering in excess of ACE's proportionate carrying value of its investment in Jazz. In addition, a future income tax expense of $10 was recorded.

Distributions

During 2007, ACE distributed to its common and preferred shareholders of record 37 million units of Jazz Air Income Fund. Based the closing price per unit of Jazz Air Income Fund on dates of distribution, the value of the distributions was approximately $314**.**

<u>Distributions to Common Shareholders</u>

The distributions to holders of Variable Voting Shares and Voting Shares totaling 33,473,182 units of Jazz Air Income Fund ("Jazz units") were non-monetary non-reciprocal transfers to owners. Non-monetary non-reciprocal transfers to owners are recorded at the carrying amount of the net assets transferred and do not give rise to a gain or loss.

For the Jazz units distributed, $23 was recorded as a reduction to share capital and an increase to non-controlling interest on the consolidated statement of financial position, representing the proportionate carrying amount of ACE's investment in Jazz related to the distribution to the common shareholders. The distributions involved the use of future income tax assets, of which $47 related to the distributions to the common shareholders which was recorded as a reduction in share capital.

The following table summarizes the financial statement impact of the Jazz units distributed to Class A and Class B shareholders:

Distributions to common shareholders	Jazz units distributed	Reduction to share capital recorded	Reduction to share capital due to FIT
March 14, 2007	22,623,690	$ (15)	$ (34)
May 24, 2007	10,849,492	(8)	(13)
	33,473,182	**$ (23)**	**$ (47)**

Distributions to Preferred Shareholders

The distributions to preferred shareholders of ACE totaled 3,526,818 Jazz units. These transactions were considered a non-reciprocal transfer to non-owners since the holders of the Preferred Shares are not considered owners of the Corporation for accounting purposes. The transfers are measured at fair value at the date of distribution and results in net interest expense being recorded, which is the fair value of each distribution less the gain recorded. The gain recorded is the fair value of the distribution in excess of the Corporation's proportionate carrying value of its investment. The fair value of the distribution is based on the closing price of the Jazz Air Income Fund units on the TSX on the day of the distribution.

The Jazz units distributed to preferred shareholders resulted in net interest expense recorded during the year and an increase to non-controlling interest as a result of the dilution of interests. The following table summarizes the financial statement impact of the Jazz units distributed to preferred shareholders:

Distribution to preferred shareholders	Jazz units distributed	Fair value of distribution	Gain on distribution	Net interest expense recorded	Non-controlling interest
March 14, 2007	2,376,310	$ 21	$ 19	$ 2	$ (2)
May 24, 2007	1,150,508	10	9	1	(1)
	3,526,818	**$ 31**	**$ 28**	**$ 3**	**$ (3)**

The distributions described above had no cash tax consequences.

In accordance with the terms of the ACE Convertible senior notes, each of the distributions during the year ended December 31, 2007 triggered a conversion rate adjustment (Note 9 (a)). These changes in the conversion rate did not have any accounting consequences. In accordance with the terms of the ACE stock option plan, each distribution during 2007 triggered an adjustment to the exercise price and the number of options outstanding (Note 13).

Accounting resulting from the distributions

The cash flow impact to ACE of deconsolidating Jazz of $138 reflects the Jazz cash being removed from the consolidated statement of financial position of ACE and is classified as a cash outflow from investing activities. The Corporation had various related party transactions after removing Jazz from the consolidation of ACE. These transactions are recorded at the exchange amount. Related party trade balances arise from the provision of services.

Sales of units

On October 22, 2007, the Corporation sold 35.5 million units of Jazz Air Income Fund at a price of $7.75 per unit, for net proceeds of $263 and realized a gain on disposal of $233.

On January 24, 2008, ACE sold a total of 13 million units of JAIF at a price of $7.45 per unit representing total net proceeds to ACE of $97 and realized a gain on sale of $89 ($71 net of taxes).

On June 2, 2008, ACE sold its remaining units of JAIF for total net proceeds to ACE of $85, and realized a gain on sale of $78 ($62 net of taxes). Net realized gains of $65, net of tax of $14, were taken into income from OCI.

5. ACTS AERO

ACTS LP ("ACTS") was a full service aircraft maintenance, repair and overhaul organization and competes on a global basis.

ACTS was consolidated up to October 16, 2007. Subsequently, ACE's investment in ACTS Aero is accounted for using the equity method.

Monetization

On October 16, 2007, ACE sold substantially all the assets and liabilities of ACTS LP to ACTS Aero. As a result of the monetization of ACTS, the $200 intercompany note payable by ACTS to ACE was settled through the issue of additional partnership units of ACTS LP to ACE. After settlement of certain obligations ACE received cash proceeds of $723. Subsequent to December 31, 2007, ACE received an additional $40 in cash proceeds from funds held in escrow that was conditional upon the completion of certain supplier contracts within specified terms. In addition, on closing Air Canada received cash proceeds of $65, comprised of $28 for the sale of a building, $20 pursuant to the Repair Schemes and Non-compete agreement, and $17 as repayment of a note. ACE realized a gain of $565 on the monetization, which includes the funds held in escrow received subsequent to closing. ACE continues to own 100% of ACTS LP, which is now a non-operating company, and ACTS Aero conducts the business previously operated by ACTS LP. Following the redemption of the exchangeable share issued to a party related to Grupo TACA as discussed below and the establishment of an initial ACTS Long Term Incentive Plan ("LTIP"), ACE holds a 23% equity interest in ACTS Aero.

The consolidated statement of financial position as at December 31, 2007 does not include the financial position or results of operations of ACTS Aero, as ACTS Aero is equity accounted for subsequent to the monetization.

As at October 16, 2007, ACE's net investment in ACTS Aero was $76, subsequent to the sale.

The cash flow impact to ACE of deconsolidating ACTS of $7 reflects the ACTS cash being removed from the consolidated statement of financial position of ACE and is classified as a cash outflow from investing activities.

The Corporation has various related party transactions after removing ACTS from the consolidation of ACE. These transactions are recorded at the exchange amount. Refer to Note 21 Related Party Transactions for a description of the transactions between the Corporation and ACTS Aero.

Acquisition of Aeroman

On February 13, 2007, ACTS LP, through a wholly-owned subsidiary, acquired 80% of Aeromantenimiento, S.A. ("Aeroman"), the aircraft maintenance division of Grupo TACA Holdings Limited ("Grupo TACA") of El Salvador. Total consideration for this acquisition included cash as well as a right to acquire an equity stake in ACTS LP. The cash component of US$45 consisted of cash of $50 (US$43) on closing and milestone payments of up to $2 (US$2) in the aggregate, funded by ACTS LP through ACE's available cash resources.

As part of the monetization process, an entity related to Grupo TACA exchanged its exchangeable share and received $31 cash, a 5% equity stake in ACTS and a put option that allowed it to put its 5% equity interest back to ACE for US$18 within 12 months. During 2008, the entity related to Grupo TACA exercised its put option and sold its 5% equity interest to ACE for $19 (US$18) increasing ACE's ownership interest in ACTS Aero from 22.8% to 27.8%. The liability related to this redemption obligation, initially recorded, was settled as part of the transaction.

Impairment of ACTS Aero

In December 2008, the Corporation recorded a write-down to reflect a loss in value that is other than temporary of $10 related to its equity investment in ACTS Aero. As at December 31, 2008, the carrying value of the Corporation's investment in ACTS Aero is nil.

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6. PROPERTY AND EQUIPMENT

		2008		2007
Cost				
Flight equipment, including spare engines (a)	$	6,235	$	5,433
Assets under capital leases (b)		1,940		1,899
Buildings, including leasehold improvements		643		609
Ground and other equipment		160		136
		8,978		8,077
Accumulated depreciation and amortization				
Flight equipment, including spare engines (a)		1,101		685
Assets under capital leases (b)		562		438
Buildings, including leasehold improvements		148		118
Ground and other equipment		49		35
		1,860		1,276
		7,118		**6,801**
Purchase deposits, including capitalized interest (c)		351		1,124
Property and equipment at net book value (d)	**$**	**7,469**	**$**	**7,925**

(a) Included in flight equipment as at December 31, 2008 are rotable parts, including spare engines with a cost of $798 (2007 - $560) less accumulated depreciation of $279 (2007 - $121) for a net book value of $519 (2007 - $439). Also included in flight equipment are 30 aircraft and 1 engine (2007 – 33 aircraft) which are leased to Jazz and third parties with a cost of $942 (2007 - $753) less accumulated depreciation of $289 (2007 - $152) for a net book value of $653 (2007 - $601).

(b) Included in capital leases as at December 31, 2008 are 41 aircraft (2007 - 39) with a cost of $1,874 (2007 - $1,825) less accumulated depreciation of $554 (2007 - $409) for a net book value of $1,320 (2007 - $1,416), computer equipment with a cost of nil (2007 - $28) less accumulated depreciation of nil (2007 - $23) for a net book value of nil (2007 - $5) and facilities with a cost of $66 (2007 - $46) less accumulated depreciation $8 (2007 - $6) for a net book value of $58 (2007 - $40).

(c) Includes $259 (2007 - $867) for Boeing B777/787 aircraft, nil (2007 - $26) for Empresa Brasileira de Aeronautica S.A. ("Embraer") aircraft, $58 (2007 - $205) for the aircraft interior refurbishment program and $34 (2007 - $26) for equipment purchases and internal projects. Refer to Note 9(m) relating to the financing of Boeing pre-delivery payments.

(d) Net book value of Property and equipment includes $836 (2007 - $973) consolidated for aircraft leasing entities and $150 (2007 - $123) consolidated for fuel facility corporations; both of which are consolidated under AcG-15.

As at December 31, 2008, flight equipment included 21 aircraft (2007 - 12), that are retired from active service with a net carrying value of $33 (2007 - $5).

Interest and fees capitalized during 2008 amounted to $37 (2007 - $108) with $10 at an interest rate of 1 month US LIBOR plus 1.14%, $6 at an interest rate of 3 month US LIBOR plus 3.00%, $17 at an interest rate of 7.72%, and $4 of fees.

During 2008:

- The Corporation received delivery of eight Boeing 777 aircraft. Three aircraft were financed with guarantee support from the Export-Import Bank of the United States ("EXIM") (Note 9). Five of the aircraft were financed under sale and leaseback transactions with proceeds of $708. The resulting gain on sale of $81 was deferred and is being recognized as a reduction to Aircraft rent expense over the term of the leases. The leases are accounted for as operating leases with 12 year terms, paid monthly.

- The Corporation recorded an impairment charge of $38 on its fleet of B767-200 aircraft due to the revised retirement date of the aircraft.

- The Corporation sold six Dash-8 aircraft for proceeds of $10 with a book value of $8, resulting in a gain on sale of $2.

- The Corporation sold an A319 aircraft for proceeds of $23 with a book value of $21, resulting in a gain on sale of $2.

During 2007:

- The Corporation sold an in-service aircraft for proceeds of $23 with a book value of $21, resulting in a gain on sale of $2 (loss of $2 net of tax).

- The Corporation sold a building to ACTS Aero for proceeds of $28 which was equal to the carrying value of the asset (Note 21).

- A CRJ-100 aircraft owned by Air Canada and leased to Jazz was damaged beyond repair. As a result of insurance proceeds of $21, Air Canada recorded a gain on disposal of $14 ($10 net of tax).

- The Corporation sold one of its commercial real estate properties for net proceeds of $42 with a carrying value of $37, resulting in a gain on sale of $5 ($4 net of tax).

- The Corporation sold 18 parked aircraft for proceeds of $2 with a nil book value, resulting in a gain on sale of $2 ($1 net of tax).

7. INTANGIBLE ASSETS

	2008		2007	
Indefinite life assets				
International route rights and slots	$	192	$	192
Air Canada trade name		174		174
Other marketing based trade names		15		15
		381		**381**
Finite life assets				
Star Alliance membership		92		92
Other contract and customer based		153		153
Technology based *		277		186
		522		431
Accumulated depreciation and amortization				
Star Alliance membership		(30)		(27)
Other contract and customer based		(93)		(81)
Technology based *		(82)		(57)
		(205)		(165)
Finite life assets, net		**317**		**266**
	$	**698**	**$**	**647**

In 2007, as a result of recognizing the benefit of future income tax assets that existed at fresh start, and for which a valuation allowance was recorded, intangible assets were reduced on a pro-rata basis by $595, including the impact of reversing $530 from the income tax valuation allowance as described in Note 10. In addition, amortization of intangible assets in 2008 amounted to $40 (2007 - $51).

* Refer to Note 22 for a description of subsequent events.

8. DEPOSITS AND OTHER ASSETS

		2008	2007
Aircraft related deposits (a)		$ 203	$ 150
Restricted cash		65	84
Deposit related to the Pension and Benefits Agreement	Note 21	42	101
Equity investments (c)		-	86
Asset backed commercial paper (b)		29	29
Aircraft lease payments in excess of rent expense	Note 2X)	49	51
Other deposits		78	56
Other		29	21
		$ 495	**$ 578**

(a) Represents the amount of deposits with lessors for the lease of aircraft and flight simulators.

(b) Air Canada has $37 ($29 net of a fair value adjustment) in non-bank sponsored ABCP. The carrying value as at December 31, 2008 is based on a number of assumptions as to the fair value of the investments including factors such as estimated cash flow scenarios and risk adjusted discount rates. The assumptions used in estimating the fair value of the investments are subject to change, which may result in further adjustments to non-operating results in the future. No adjustments to the carrying value were recorded during 2008.

(c) As at December 31, 2007, equity investments include Jazz Air Income Fund $14 (Note 4) and ACTS Aero $72 (Note 5).

9. LONG-TERM DEBT AND CAPITAL LEASES

	Base Currency	Final Maturity	Stated Interest Rate (%)	2008	2007
ACE:					
Convertible Senior Notes (a)	CDN	2035	4.25	$ 289	$ 273
Air Canada:					
Embraer aircraft financing (b)	USD	2017 - 2021	3.37-8.49	1,425	1,138
Boeing aircraft financing (c)	USD	2019 - 2020	1.50-5.69	871	647
Boeing aircraft financing (d)	JPY	2020	1.04-1.20	270	-
Conditional sales agreements (e)	USD	2019	4.37-6.44	175	149
Spare engine financing (f)	USD	2013	5.13	95	-
Spare parts financing (g)	USD	2014	6.97	97	-
Lufthansa cooperation agreement (h)	USD	2009	6.50	16	25
GE loan (i)	USD	2015	4.60	24	38
Revolving credit facility (j)	CDN			50	-
Canadian Regional Jet (k)	CDN	2012	4.38	25	33
Short-term loan due 2009 (l)	USD	2009	6.45	190	-
Direct Corporation debt				**3,527**	**2,303**
Air Canada:					
Boeing pre-delivery payments (m)	USD	2009 - 2013	1.61	81	521
Aircraft and engine leasing entities - debt (n)				828	771
Fuel facility corporations - debt (o)				125	125
Debt consolidated under AcG-15				**1,034**	**1,417**
Air Canada:					
Capital lease obligations (p)				1,082	972
Total debt and capital leases				**5,643**	**4,692**
Current portion				(663)	(686)
Long-term debt and capital leases				**$ 4,980**	**$ 4,006**

The Stated Interest Rate in the table above is the rate as of December 31, 2008

(a) During 2005 ACE issued $330 of Convertible Senior Notes due 2035 ("Convertible Notes") for net proceeds of $319. For accounting purposes, the Convertible Notes are presented as a compound instrument. At the date of issuance, the value ascribed to the holders' conversion option, which is presented as equity, was $94 less allocated fees of $2; the value ascribed to the financial liability was $236. The financial liability was originally calculated by discounting the stream of future payments of interest and principal at the prevailing rate for a similar liability that does not have an associated conversion feature.

The Convertible Notes bear interest at a rate of 4.25% per annum payable semi-annually in arrears on June 1 and December 1 in each year commencing December 1, 2005. Holders may convert their Convertible Notes into Class B Voting Shares (if the holder is Canadian) or into Class A Variable Voting Shares (if the holder is not a Canadian) prior to maturity based on an initial conversion rate of 20.8333 Shares per $1,000.00 principal amount of Convertible Notes. Upon notice of conversion, ACE will have the option to deliver cash, shares or a combination of cash and shares for the Convertible Notes surrendered. Holders converting their Notes will not receive any payment upon conversion representing accrued but unpaid interest on such Notes. The amount of cash to be delivered per Convertible Note, will be determined by multiplying the conversion rate by the average closing price (defined as the weighted average, by volume, of the reported last sale price of each class of shares) of the shares on the Toronto Stock Exchange ("TSX") for the ten consecutive trading days ending on the third trading day following the date fixed for redemption. By delivering the amount of cash and/or the number of Shares issuable on conversion, the Corporation will be deemed to have satisfied its obligation to pay the principal amount of the Convertible Notes and its obligation to pay accrued and unpaid interest, attributable to the period from the most recent interest payment date through the conversion date (which amount will be deemed paid in full rather than cancelled, extinguished or forfeited).

In connection with the share purchase and cancellation by ACE on June 18, 2008, described in Note 14, the conversion rate of ACE's 4.25% Convertible Senior Notes Due 2035 was adjusted from 39.0341 to 40.6917 (after it had been adjusted from 37.6879 to 39.0341 effective January 11, 2008) Class A variable voting shares or Class B voting shares per $1,000 principal amount of Convertible Senior Notes and was effective June 19, 2008. During 2007, In connection with the distributions of units of Aeroplan Income Fund and Jazz Air Income Fund to the shareholders of ACE, the conversion rate of the 4.25% Convertible Senior Notes, due 2035 ("Convertible Notes") to Class A variable voting shares (if the holder is not a Canadian) or Class B voting shares (if the holder is Canadian) per $1,000 principal amount of Convertible Senior Notes, has been adjusted to 37.6879 as at December 31, 2007. Adjustments were determined in accordance with the terms of the indenture governing the Convertible Senior Notes.

During 2008, Convertible Senior Notes with a face value of $1 ($6 – 2007) were converted at the option of the holder and ACE settled for cash of $1 ($6 – 2007), reducing the liability and equity portions of the notes. The gain realized on conversion was negligible.

At any time on or after June 6, 2008, ACE may redeem all or a portion of the Convertible Notes at a redemption price equal to 100% of the principal amount of the Convertible Notes, plus accrued interest. Holders may require ACE to purchase all or a portion of the Convertible Notes on June 1, 2010; June 1, 2015; June 1, 2020; June 1, 2025 and June 1, 2030 at a purchase price equal to 100% of the principal amount of the Notes to be purchased, plus accrued and unpaid interest. Upon specified change of control events, holders of Convertible Notes will have the option to require ACE to purchase all or any portion of the Convertible Notes at a price equal to 100% of the principal amount of the Convertible Notes to be purchased, plus accrued and unpaid interest.

ACE may, at its option and subject to certain conditions, elect to satisfy its obligation to repay all or any portion of the principal amount of the Convertible Notes that are to be redeemed, purchased or that are to be repaid at maturity, by issuing and delivering Class A Variable Voting Shares (if the holder is not a Canadian) and Class B Voting Shares (if the holder is Canadian). The number of Shares a holder will receive in respect of each Convertible Note will be determined by dividing the principal amount of the Convertible Notes that are to be redeemed, purchased or repaid at maturity, as the case may be, and that are not paid in cash, by 95% of the average closing price (defined as the weighted average, by volume, of the reported last sale price of each class of shares) of the shares on the Toronto Stock Exchange ("TSX") for the ten consecutive trading days ending on the third trading day following the date fixed for redemption, purchase or maturity date, as the case may be.

As described in Note 19, on January 19, 2009, ACE completed a substantial issuer bid to purchase for cancellation of 80% of its convertible senior notes with an aggregate principal amount of $259 at a purchase price of $900 dollars in cash for each $1,000 dollars principal amount of notes. ACE paid an aggregate purchase price of $233 for the notes tendered.

(b) Embraer aircraft financing amounts to US$1,163 as at December 31, 2008 (2007 - US$1,151). Principal and interest is repaid quarterly until maturity. The loan is secured by the 60 delivered Embraer aircraft, with a carrying value of $1,665.

(c) Boeing aircraft financing amounts to US$711 as at December 31, 2008 (2007 - US$655), which is financed under loan guarantee support provided by the EXIM. Principal and interest is repaid quarterly until maturity. The loan is secured by the 8 delivered aircraft with a carrying value of $1,103.

(d) Boeing aircraft financing amounts to JPY19,995 as at December 31, 2008, which is financed under loan guarantee support provided by the EXIM. Principal and interest is repaid quarterly until maturity. The loan is secured by the 2 delivered aircraft with a carrying value of $244.

(e) US$142 principal outstanding on acquisitions of two A340-500 aircraft financed through conditional sales agreements. Principal and interest is paid quarterly until maturity in 2019. The purchase price installments bear interest at a three month LIBOR rate plus 2.9% (4.37% - 6.44% as at December 31, 2008 and 7.74% - 7.97% as at December 31, 2007). The carrying value of the two A340-500 aircraft provided as security under the conditional sales agreements is $238 as at December 31, 2008.

(f) US$78 principal outstanding to mature in 2013, with quarterly repayments and a final payment at maturity of 50% of the original principal, at a floating interest rate equal to the three month LIBOR rate plus 3.40%. The loan is secured by 10 spare engines with a carrying value of $121.

The loan agreement contains a current market value test, beginning on the first anniversary of the facility, and annually thereafter until expiry. This test relates to 10 engines and under the test, Air Canada may be required to provide additional collateral or prepay certain facility amounts, based on engine current market values, as of the date of the test. Any amounts prepaid would be recorded as a reduction of the loan. The maximum amount payable on the first anniversary, assuming the engines are worth nil and no additional collateral has been provided, is $86 (US$71). This amount declines over time to fifty percent of the original principal upon the loan expiry. In January 2009 an additional $46 (US$37) principal and 22 engines were added under the original agreement with the same terms as described above.

(g) US$80 principal outstanding to mature in 2014, with quarterly repayments, at a floating interest rate equal to the three month LIBOR rate plus the lenders incremental cost of funds rate and a margin of 3.00%. The loan is secured by spare parts and other assets with a carrying value of $295. The loan agreement contains a collateral value test, performed on a monthly basis. This test relates to all inventory collateral and Air Canada may be required to provide additional inventory collateral, cash collateral, letters of credit, prepay some of the loan or any combination of the above based on appraised values, as of the date of the test. Any amounts prepaid would be recorded as a reduction of the loan. This amount declines over time to nil upon the loan expiry. In January 2009 an additional $92 (US$75) principal was added under the original agreement with the same terms as described above.

(h) US$13 principal outstanding to mature in 2009, with semi-annual repayments, at a fixed interest rate of 4.50% plus an annual 2.0% guarantee fee.

(i) US$20 principal outstanding to mature in 2015, with quarterly repayments, at a floating interest rate equal to the six month LIBOR rate plus 2.75% pre-payable on any interest payment date after December 23, 2007. The next interest payment date is March 20, 2009. The debt is secured by certain flight training equipment with a current carrying value of $39.

(j) The revolving credit facility is a $100 senior secured revolving credit facility (the "Credit Facility"). The Credit Facility has a one year term that can be extended at Air Canada's request for additional one-year periods on each anniversary of the closing, subject to prior approval of the lenders. The Credit Facility replaces Air Canada's previous secured syndicated three year revolving credit facility, which was a $400 facility as of December 31, 2007. The total amount available for borrowing under the Credit Facility is subject to a borrowing base restriction based on certain percentages of the values of eligible accounts receivable and eligible real property. As at December 31, 2008, the funds available under the Credit Facility were $50. The Credit Facility is secured by a first priority security interest and hypothec over the present and after-acquired personal property of Air Canada, subject to certain exclusions and permitted liens, and by a first priority charge and hypothec over certain owned and leased real property of Air Canada. Air Canada's obligations are guaranteed by 1209265 Alberta Ltd., a subsidiary of Air Canada, which provides a first priority security interest over its present and after-acquired personal property, subject to certain exclusions and permitted liens, as security for its guarantee obligations. The Credit Facility contains customary representations and warranties and is subject to customary terms and conditions (including negative covenants, financial covenants and events of default). Financial covenants require Air Canada to maintain, as of the last business day of each month, a minimum liquidity level of $900, which includes the unused and available commitment under the facility, and an interest coverage ratio test determined as at the end of each fiscal quarter. The interest rate margin for drawn amounts is, at the option of Air Canada, prime plus 13.00% or bankers' acceptances plus 14.00%.

(k) As at December 31, 2008, the principal outstanding is $25 on four CRJ aircraft (2007 - $33). Principal and interest are paid quarterly to maturity in 2012. The financing bears interest at a floating rate of the 3 month Canadian bankers' acceptance rate plus 1.7%. The loan is secured by the aircraft with a carrying value of $26.

(l) During 2008, Air Canada arranged for and received financing amounting to $190 (US$155). The first payment of US$80 matured and was repaid in January 2009. The remainder of the financing has a term to December 15, 2009 and is repayable prior to then provided Air Canada has received certain additional alternate financing. The financing bears interest at one month LIBOR plus 5.98% (currently 6.45%) and is secured by a security interest and a movable hypothec in the principal amount of $400. The financing can be repaid at any time prior to maturity, in whole or in part, without penalty.

(m) On October 30, 2007, Air Canada entered into an agreement with a syndicate of banks for the financing of pre-delivery payments ("PDP") for 10 of the 16 Boeing B777 aircraft contemplated in the Boeing Purchase Agreement. The PDP financing is a series of loans that are aircraft specific with a maximum aggregate commitment of up to $568 (US$575). The PDP loans have a term of five years, but may be prepaid upon the delivery of the aircraft without penalty. During 2008, Air Canada drew $39 (US$39) (2007 - $585 (US$592)). Air Canada prepaid $516 ($US501) towards 8 aircraft during 2008 (2007 - $64 (US$65) toward one aircraft). In addition, Air Canada has served notice to the PDP syndicate that it will be repaying the final PDP loan on delivery of the tenth aircraft expected to be delivered in February 2009. At year-end 2008, the balance outstanding on the PDP loans was $81 (US$66) (2007 - $521 (US$528)). The year to date capitalized interest relating to this financing is $10 (2007 - $5) at an interest rate of 30 day LIBOR plus 1.14% (1.61% as at December 31, 2008).

(n) Air Canada has entered into aircraft and engine lease transactions with several special purpose entities that qualify as VIEs. The debt has a weighted average effective interest rate of approximately 8% (2007 - 8%). These aircraft have a carrying value of $836 and are charged as collateral against the debt by the owners thereof. The creditors under these leasing arrangements have recourse to Air Canada, as lessee, in the event of default or early termination of the lease. Aircraft related debt amounting to US$676 ($828) (2007 - US$780 ($771)) is summarized as follows:

	Final Maturity	2008	2007
Canadian Regional Jet	2010-2011	$ 257	$ 218
Boeing 767-300	2011-2016	185	163
Engines	2008	-	54
Airbus 319	2011-2014	242	215
Airbus 321	2017	144	121
Total		**$ 828**	**$ 771**

(o) Under AcG-15, Air Canada is the primary beneficiary of certain Fuel Facility Corporations in Canada. The debt is comprised of bankers' acceptances with bankers' acceptance plus 2%, bank loans at prime plus 0.25%, and bonds payable with an interest rate of 5.09%. $107 of debt matures in 2032 with equal semi-annual payments of principal and interest. The remaining debt has varying maturities. The debt is secured by a general security agreement covering all assets of the Fuel Facility Corporations. The carrying value of the assets of the fuel facilities is $150 as at December 31, 2008.

(p) Capital leases, related to computer equipment, facilities and 41 aircraft, total $1,082 ($84 and US$815) [2007 - total $972 ($71 and US$912)]. The debt has a weighted average effective interest rate of approximately 8% and final maturities range from 2009 to 2027. During 2008, Air Canada recorded interest expense on capital lease obligations of $78 (2007 - $96).

Certain aircraft lease agreements contain a fair value test, beginning in Quarter 3 2009, and annually thereafter until lease expiry. This test relates to 26 aircraft under lease of which 23 are accounted for as capital leases. Under the test, Air Canada may be required to prepay certain lease amounts, based on aircraft fair values, as of the date of the test. Any amounts prepaid would be recorded as a reduction of the lease obligation. Air Canada contracts with certain third parties to provide residual value support for certain aircraft. If Air Canada is required under the loan to value test to prepay lease obligations, these amounts are recoverable from the third party residual value support provider upon lease expiry to the extent that the adjusted obligation taking into account prepayments is less than the residual value support. The maximum amount payable on July 1, 2009, assuming the related aircraft are worth nil, is $896 (US$731). The maximum payable amount declines over time to nil upon lease expiry. As Air Canada does not expect to have to prepay any significant amounts based upon expectations of aircraft fair values into the future, the amortized cost of these capital lease obligations reflects the scheduled payments over the term to final maturity.

Interest paid on Long-term debt and capital leases in 2008 by the Corporation was $307 (2007 - $281).

Refer to Note 17 for the Corporation's 5 year principal and interest repayment requirements as at December 31, 2008.

Refer to Note 1C and Note 22 for a description of subsequent events.

10. FUTURE INCOME TAXES

The following income tax related amounts appear in the Corporation's Consolidated statement of financial position:

	2008		2007	
Asset				
Future income tax asset recorded in current assets a)	**$**	**-**	**$**	**200**
Liability				
Long-term tax payable b)	$	(10)	$	(10)
Future income tax liability b)		(50)		(50)
	$	**(60)**	**$**	**(60)**

a) FUTURE INCOME TAX ASSETS

As at December 31, 2008, the Corporation has determined that it is more likely than not that future income tax assets of $1,239 are not recoverable and have been offset by a valuation allowance. However, the future tax deductions underlying the future tax assets remain available for use in the future to reduce taxable income. The benefit of future income tax assets that existed at fresh start, and for which a valuation allowance is recorded, is recognized first to reduce to nil any remaining intangible assets (on a pro-rata basis) that were recorded upon fresh start reporting with any remaining amount as a credit to Shareholders' equity. The benefit of future income tax assets that arise after fresh start are recognized in the Consolidated Statement of Operations.

During 2008, the Corporation realized future income tax assets of $146 on the disposal of AIF units and $34 on the disposal of JAIF units (refer to Notes 3 and 4).

As at December 31, 2007, the Corporation had determined that it was more likely than not that certain future income tax assets of $200 would be realized through a combination of future reversals of temporary differences and taxable income. Also, the Corporation had determined that it was more likely than not that future income tax assets of $890 were not recoverable and continued to be offset by a valuation allowance.

During 2007, a reversal of the valuation allowance of $621 was recorded. Of that amount $530 was recorded as a reduction of intangible assets (on a pro-rata basis) based on the current carrying value of future income tax assets that existed at fresh start and $91 as a recovery of income tax in the consolidated statement of operations for those future income tax assets arising after fresh start.

During 2007, future income tax assets of Air Canada of $345 (see below) were utilized to recover a current tax payable of the same amount. Through the distribution and secondary offering of Aeroplan units, the Corporation realized $123 and $306 of future income tax assets that were respectively recorded as a future income tax expense and as a reduction to share capital (refer to Notes 3 and 14). In addition, through the distribution and secondary offering of Jazz units, the Corporation realized $52 and $47 of future income tax assets that were respectively recorded as a future income tax expense and as a reduction to share capital (refer to Note 4 and 14). The Corporation realized future income tax assets of $82 in the monetization of ACTS (refer to Note 5). In 2006, a future income tax expense of $59 was recorded in equity related to the ACE distribution of Aeroplan Units.

Refer to Note 18 for future income taxes recorded in other comprehensive income related to fuel derivatives designated under hedge accounting.

b) TAXES PAYABLE AND FUTURE INCOME TAX LIABILITY

As part of a tax loss utilization strategy that was planned in conjunction with the initial public offering of Air Canada and corporate restructuring, a current tax payable of $345 was created in 2006. This tax payable arose upon a transaction to transfer tax assets from Air Canada to ACE. This tax payable was recoverable from future income tax assets of Air Canada, and was settled in 2007. The Air Canada segment recorded interest expense of $6 due on the tax balance prior to its recovery. This amount was recorded in Current income taxes on the consolidated statement of operations.

In 2007, Air Canada recorded a Current income tax expense of $10 resulting from the Federal and Ontario harmonization of corporate taxes. Air Canada will have a cash tax payable of $10 that will be payable over a five year period beginning in 2010. This amount is included in Other long-term liabilities.

It has been assumed that certain intangibles and other assets with nominal tax cost and a carrying value of approximately $381, have indefinite lives and accordingly, the associated future income tax liability is not expected to reverse until the assets are disposed of or become amortizable, resulting in the reporting of a future income tax liability of $50.

		2008		2007
Future tax assets				
Loss carry forwards	$	629	$	80
Post-employment obligations		466		556
Accounting provisions not currently deductible for tax		261		129
Tax basis of capital over book basis		-		183
Investments in Aeroplan and Jazz		-		195
Deferred gains		40		8
Other		121		76
Total future tax assets		1,517		1,227
Future tax liabilities				
Book basis of capital over tax basis		219		-
Intangible assets		72		78
Other		37		109
Total future tax liabilities		328		187
Net future tax assets		1,189		1,040
Less valuation allowance		(1,239)		(890)
Net recorded future income tax asset (liability) (1)	**$**	**(50)**	**$**	**150**

1) As at December 31, 2008, the future income tax liability of $50 is recorded in long-term liabilities (2007 - $50).

The reconciliation of income tax attributable to continuing operations, computed at the statutory tax rates, to income tax expense is as follows:

		2008		2007
Provision based on combined federal and provincial rates	$	35	$	683
Non-taxable portion of capital (gains) losses		72		(36)
Non-deductible expenses		69		35
Non-taxable capital gain on distribution and disposal of investments		(155)		(212)
Non-controlling interest		(80)		38
Effect of tax rate changes on future income taxes		82		43
Other		15		16
		38		567
Valuation Allowance (1)		186		(91)
Provision for income taxes	**$**	**224**	**$**	**476**

1) Future income tax assets arising on 2008 losses have been offset by valuation allowance of $186 as it is not more likely than not that these tax benefits will be realized.

Significant components of the provision for income taxes attributable to continuing operations are as follows:

	2008		2007	
Current tax expense	$	3	$	15
Future income tax expense (recovery) relating to temporary differences		(47)		509
Future income tax expense from tax rate changes		82		43
Valuation allowance		186		(91)
Provision for income taxes	**$**	**224**	**$**	**476**

Taxes paid in 2008 by the Corporation were $2 (2007 - $13).

The balances of tax attributes as at December 31, 2008, namely the balances of non-capital loss carry forwards, vary amongst different taxing jurisdictions. The following are the Federal tax loss expiry dates:

	Tax Losses	
2014	$	82
2026		9
2027		1,380
2028		991
	$	**2,462**

There are $47 of net capital losses that have no expiry date (2007 - $61).

11. PENSION AND OTHER BENEFIT LIABILITIES

Air Canada maintains several defined benefit and defined contribution plans providing pension, other post-retirement and post-employment benefits to its employees, including those employees of Air Canada who are contractually assigned to Aveos and Aeroplan.

Air Canada is the administrator and sponsoring employer of ten Domestic Registered Plans ("Domestic Registered Plans") under the Pension Benefits Standard Act, 1985 (Canada). The US plan, UK plan and Japan plan are international plans covering employees in those countries. In addition, Air Canada maintains a number of supplementary pension plans, which are not registered. The defined benefit pension plans provide benefits upon retirement, termination or death based on the member's years of service and final average earnings for a specified period.

The other employee benefits consist of health, life and disability. These benefits consist of both post-employment and post-retirement benefits. The post-employment benefits relate to disability benefits available to eligible active employees, while the post-retirement benefits are comprised of health care and life insurance benefits available to eligible retired employees.

Certain Air Canada employees are contractually assigned to Aveos and Aeroplan. These employees are members of Corporation-sponsored defined benefit pension plans and also participate in Corporation-sponsored health, life and disability future benefit plans. These consolidated financial statements include all of the assets and liabilities of all Corporation-sponsored plans. The employee benefit expense in these consolidated financial statements includes the expenses for all employees participating in the plans less a cost recovery which is charged to Aveos, and Aeroplan for those employees assigned. The cost recovery includes current service costs for pensions along with their portion of post-employment and post-retirement benefits, based on the actuarial calculation for their specific employee group. This cost recovery amounted to $39 for the year ended December 31, 2008 (2007 - $10).

As described in Note 21, Air Canada and Aveos are parties to a Pension and Benefits Agreement covering the future transfer of certain pension and benefit assets and obligations to Aveos.

As described in Note 2, the accounting for pensions requires Air Canada management to make significant estimates including estimates as to the discount rate applicable to the benefit obligation and the expected rate of return on plan assets.

Discount Rate

The discount rate used to determine the pension obligation was determined by reference to market interest rates on corporate bonds rated "AA" or better with cash flows that approximately match the timing and amount of expected benefit payments. An increase of 0.25% results in a decrease of $305 to the pension obligation and $10 to the pension expense. A decrease of 0.25% results in an increase of $313 to the pension obligation and $9 to the pension expense.

Expected Return on Assets Assumption

The expected long-term rate of return on assets assumption is selected based on the facts and circumstances that exist as of the measurement date and the specific portfolio mix of plan assets. Air Canada's management, in conjunction with its actuaries, reviews anticipated future long-term performance of individual asset categories and considers the asset allocation strategy adopted by Air Canada, including the longer duration in its bond portfolio in comparison to other pension plans. These factors are used to determine the average rate of expected return on the funds invested to provide for the pension plan benefits. The determination of the long term rate considers recent fund performance, including the significant drop in the value of plan assets during 2008, and historical returns, to the extent that the past is indicative of the expected long-term, prospective rate. There can be no assurance that the plan will earn the assumed rate of return.

Benefit Obligation and Plan Assets

The following table presents financial information related to the changes in the pension and other post-employment benefits plans:

	Pension Benefits		Other Employee Future Benefits	
	2008	2007	2008	2007
Change in benefit obligation				
Benefit obligation at beginning of year	$ 12,150	$ 13,235	$ 899	$ 966
Current service cost	203	254	62	69
Interest cost	706	649	52	49
Employees' contributions	83	88	-	-
Benefits paid	(677)	(648)	(57)	(51)
Plan amendments	2	-	-	-
Other termination benefits	-	2	-	-
Actuarial gain	(1,738)	(1,278)	(189)	(119)
Deconsolidation of Jazz	-	(100)	-	-
Foreign exchange gain (loss)	-	(52)	23	(15)
	10,729	12,150	790	899
Change in plan assets				
Fair value of plan assets at beginning of year	11,747	11,858	-	8
Actual return (loss) on plan assets	(1,879)	197	-	-
Employer contributions	456	382	57	43
Employees' contributions	83	88	-	-
Benefits paid	(677)	(648)	(57)	(51)
Deconsolidation of Jazz	-	(81)	-	-
Foreign exchange gain (loss)	(13)	(49)	-	-
	9,717	11,747	-	-
Deficit at end of year	**1,012**	**403**	**790**	**899**
Employer contributions after measurement date	-	(7)	-	(5)
Unrecognized past service costs	(2)	-	-	-
Unrecognized net actuarial gain (loss)	(479)	497	321	149
Valuation allowance against accrued benefit	9	1	-	-
Net benefit obligation	**$ 540**	**$ 894**	**$ 1,111**	**$ 1,043**
Weighted average assumptions used to determine the accrued benefit liability				
Discount rate	7.35%	5.75%	6.25 - 7.35%	5.75 - 6.00%
Rate of compensation increase (a)	2.50%	2.50%		

(a) As a result of pay awards, a rate of compensation increase of 1.75% was used for years 2007 and 2008 in determining the net benefit obligation for the pension plan and 2.50% for the remaining years.

Under the terms of the domestic registered and supplementary plans, there is no indexation provided after January 1, 2007.

The pension benefit deficit of only those plans that are not fully funded at the end of the year is as follows:

	2008	2007
Domestic registered plans	$ 383	$ 35
US, UK, and Japan	83	17
Supplementary plans	606	665
	$ 1,072	**$ 717**

The net deficit, on an accounting basis, at December 31, 2008 for pension benefits was $1,012 (2007 - $403). The increase in the accounting deficit is mainly the result of the significant losses on the market value of plan assets offset by the gains resulting from the increase in the discount rate used to value pension obligations along with the funding of past service employer contributions of $189.

The net benefit obligation is recorded in the statement of financial position is as follows:

	2008	2007
Pension benefits	$ 540	$ 894
Other employee future benefits	1,111	1,043
Net benefit obligation	**1,651**	**1,937**
Current portion	(244)	(113)
Pension and other benefit liabilities	**$ 1,407**	**$ 1,824**

The current portion of pension benefits represents past service contributions for the Domestic Registered Plans, scheduled to be paid during 2009 while the current portion of other employee future benefits is an estimate of the claims to be incurred during 2009. The current portion is included in Accounts payable and accrued liabilities.

Total cash payments for 2008, consisting of cash contributed by Air Canada to its defined benefit plans, cash payments to beneficiaries for post-employment and post-retirement plans, and cash contributed to its defined contribution plans were $514 (2007 - $428).

Pension and Other Employee Future Benefit Expense

The Corporation has recorded net defined benefit pension and other employee future benefits expense as follows:

	Pension Benefits		Other Employee Future Benefits	
	2008	2007	2008	2007
Components of Net Periodic Pension Cost				
Current service cost	$ 203	$ 254	$ 62	$ 69
Interest cost	706	649	52	49
Actual return on plan assets	1,879	(148)	-	-
Actuarial gain	(1,738)	(1,278)	(189)	(119)
Plan amendments	2	-	-	-
Other benefits	-	2	-	-
Costs arising in the year	**1,052**	**(521)**	**(75)**	**(1)**
Differences between costs arising in the year and costs recognized in the year in respect of:				
Return on plan assets	(2,711)	(622)	-	-
Actuarial loss	1,742	1,285	172	103
Plan amendments	(2)	-	-	-
Increase in valuation allowance provided against accrued benefit asset	8	1	-	-
Net periodic benefit cost of plans	**89**	**143**	**97**	**102**
Amount charged to Aveos, and Aeroplan	(23)	(6)	(16)	(4)
Net defined benefit pension and other employee benefits expense (1)	**$ 66**	**$ 137**	**$ 81**	**$ 98**
Weighted average assumptions used to determine the accrued benefit cost				
Discount rate	5.75%	5.00%	5.75-6.00%	5.00 - 5.50%
Expected long-term rate of return on plan assets	7.15%	7.15%	n/a	n/a
Rate of compensation increase (2)	2.50%	2.50%		

(1) Includes nil of Pension Benefits related to Jazz (2007 - $4), which was consolidated until May 24, 2007 under AcG-15.

(2) A rate of compensation increase of 1.75% in 2007 and in 2008 was used in determining the net benefit pension expense and 2.50% for the remaining years.

Other Benefits — Sensitivity Analysis

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. An 8.25% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2008 (2007 - 9.25%). The rate is assumed to decrease gradually to 5% by 2015. A one percentage point increase in assumed health care trend rates would have increased the service and interest costs by $1 and the obligation by $16. A one percentage point decrease in assumed health care trend rates would have decreased the service and interest costs by $1 and the obligation by $21.

Pension Plan Cash Funding Obligations

Pension plan cash funding paid in 2008 amounted to $456 for domestic registered plans and other pension arrangements. For domestic registered plans, the funding requirements are based on minimum past service contributions disclosed in the annual actuarial valuation plus a projection of the current service contributions.

As at January 1, 2008, the solvency deficit in the registered domestic plans was $1,175. As at January 1, 2009, the solvency deficit in the registered pension plans is $2,835.

Air Canada is actively monitoring and pursuing a number of initiatives, certain of which are beyond the control of Air Canada, which may reduce the cash funding obligations in and after 2009 as described further below. These include:

- Temporary solvency funding relief proposed by the Government of Canada;
- The asset smoothing method, if any, that could be applied to the value of assets; and
- A review of the legislative and regulatory framework of pension plans by the Government of Canada, which is currently underway.

In November 2008, the Government of Canada proposed temporary solvency funding relief for defined benefit pension plans under federal regulation. The proposed funding relief would allow plans to extend their solvency funding payment schedule to 10 years from 5 in respect of solvency deficiencies that emerged in 2008, subject to certain conditions. In particular, both members and retirees would need to agree to the extended schedule, or the difference between the 5- and 10-year payment schedules would need to be secured by a letter of credit. One of these two conditions would need to be met by December 31, 2009. If agreement by plan members and retirees or a letter of credit were not secured by the end of 2009, the plan would be required to fund the deficiency over the following 5 years. Funding reductions in subsequent years would be dependent upon satisfying on of the two conditions as noted above. There can be no assurance that the proposed relief will be implemented.

The Pension Benefits Standards Act and Regulations allow the use of an asset smoothing method over five years, limited to 110% of the market value of plan assets, to determine minimum funding requirements on a solvency basis. Any such smoothing method would also have to comply with actuarial practice and be accepted by regulators. In January 2009, the Government of Canada announced that it will work with the body that regulates federally regulated pension plans to consider additional funding flexibility options regarding asset smoothing. Air Canada will monitor these developments to determine the impact, if any, on Air Canada's pension funding obligations.

Given the economic uncertainty and the uncertain outcome of the pension funding regulations, Air Canada's actual funding obligations for 2009 cannot be determined with any reasonable degree of certainty however they will rise significantly over 2008 levels. Air Canada management is monitoring the government's actions and dialoguing with government officials on this matter. Until the government finalizes this proposal and the funding valuation is completed during the first half of 2009, uncertainty as to the amount and timing of additional pension funding continue to exist. Any increase in funding obligations for 2009 would be paid in the second half of the year as the funding in the first half of the year is based upon the January 1, 2008 actuarial valuation reports.

Refer to Note 1C and 1D for a description of subsequent events.

Air Canada Pension Plan Solvency Deficiency Funding Regulations - 2004

On August 9, 2004, the Government of Canada adopted the Air Canada Pension Plan Solvency Deficiency Funding Regulations (the "Pension Regulations"). The Pension Regulations allow Air Canada to fund the solvency deficiencies in its Domestic Registered Plans as of January 1, 2004 over ten years, rather than the five years required under the ordinary rules, and to pay down such deficiencies by way of an agreed schedule of variable annual contributions rather than by way of equal annual contributions as required under the ordinary rules. The Pension Regulations came into force upon Air Canada's emergence from CCAA protection on September 30, 2004, on which date Air Canada issued subordinated secured promissory notes in an aggregate amount of approximately $347 in favour of the pension plan trustee. Such notes reduce as the principal amount of the solvency deficiencies is paid down, and will only be called on the occurrence of certain specified events of default. The amount of secured promissory notes outstanding as at December 31, 2008 is $20 (2007 - $89). The effect of the issuance of the subordinated secured promissory notes is included within the value of the obligation for pension benefits as reflected in the Corporation's Consolidated Statement of Financial Position. The funding of the notes is included in all future expected cash flows required to fund the benefit obligation.

The composition of the Domestic Registered Plan assets and the target allocation consist of the following:

	2008	2007	Target Allocation
Equity securities	52.9%	58.9%	59.0%
Bonds and mortgages	43.5%	36.1%	41.0%
Cash and temporary investments	3.6%	5.0%	0.0%
	100.0%	**100.0%**	**100.0%**

Domestic Registered Plans

For the Domestic Registered Plans, the investments conform to the Statement of Investment Policy and Objectives of the Air Canada Pension Master Trust Fund. The investment return objective of the fund is to achieve a total annualized rate of return that exceeds inflation by at least 3.75% over the long term.

In addition to the broad asset allocation, as summarized in the asset allocation section above, the following policies apply to individual asset classes:

- Equity investments can include convertible securities, and are required to be diversified among industries and economic sectors. Foreign equities can comprise 37% to 43% of the total market value of the trust. Limitations are placed on the overall allocation to any individual security at both cost and market value. Derivatives are permitted to the extent they are not used for speculative purposes or to create leverage.

- Bond and Mortgage investments are oriented toward risk averse, long term, investment grade securities rated "A" or higher. With the exception of Government of Canada securities or a province thereof, in which the plan may invest the entire fixed income allocation, these investments are required to be diversified among individual securities and sectors. The target return is comprised of 40% of the total return of the Scotia Capital Universe Bond Index and 60% of the total return of the Scotia Capital Long Term Bond Index.

Similar investment policies are established for the other pension plans sponsored by Air Canada.

Refer to Note 1C and 1D for a description of subsequent events.

Defined Contribution Plans

The Corporation's management, administrative and certain unionized employees may participate in defined contribution plans. Contributions range from 3% to 6% for those employees in Canada and 3% to 7% for those participants in the United Kingdom. The Corporation contributes an equal amount. The Corporation’s expense for defined contribution plans amounted to $1 for the year ended December 31, 2008 (2007 - $4).

12. OTHER LONG-TERM LIABILITIES

		2008	2007
Aeroplan Miles obligations (a)		$ -	$ 29
Unfavourable contract liability on aircraft leases (b)		37	54
Aircraft rent in excess of lease payments	Note 2X)	56	54
Long-term employee liabilities (c)		35	47
Aeroplan investment (d)		-	142
Workplace safety and insurance board liabilities		37	45
Deferred gains on aircraft sale leasebacks		76	-
Other (e)		129	112
		$ 370	**$ 483**

(a) Air Canada has a liability related to Aeroplan Miles which were issued by Air Canada prior to January 1, 2002. As of December 31, 2008 a liability for approximately $35, remains in Air Canada, all of which is included in Advanced ticket sales (2007 - $84).

(b) The unfavourable contract liability on aircraft leases represents the net present value of lease payments in excess of estimated market rents related to lease arrangements that existed on fresh start reporting.

(c) The following table outlines the changes to labour related provisions which are included in long-term employee liabilities:

	2008	2007
Beginning of year	$ 66	$ 109
Interest accretion	4	5
Charges recorded in wages, salaries, and benefits	21	29
Amounts disbursed	(37)	(71)
Deconsolidation of Jazz	-	(4)
Disposal of interest in ACTS	-	(2)
End of year	54	66
Current portion in Accounts payable and accrued liabilities	(19)	(19)
	$ 35	**$ 47**

The Corporation offers certain severance programs to certain employees from time to time. The cost of these programs is recorded within Operating expenses.

In response to record high fuel prices, on June 17, 2008, Air Canada announced a reduction in capacity which had an impact on fleet and staffing levels effective with the implementation of its fall and winter schedule. During 2008, Air Canada recorded an expense of $8 in Wages, salaries and benefits expense related to the reduction of employees under this plan. These costs will be disbursed within a year.

(d) This represents ACE's negative investment in Aeroplan Income Fund (Note 3) as at December 31, 2007.

(e) "Other" includes asset retirement obligations of the Corporation. Under the terms of their respective land leases, each Fuel Facility Corporation has an obligation to restore the land to vacant condition at the end of the lease and to rectify any environmental damage for which it is responsible. If it were found that the Fuel Facility Corporations had to contribute to any remediation costs, each contracting airline would share pro rata, based on system usage, in the costs. For all Fuel Facility Corporations in Canada in which the Corporation participates, the Corporation has recorded an obligation of $8 ($50 undiscounted) (2007 - $7 ($44 undiscounted)) representing the present value of the estimated decommissioning and remediation obligations at the end of the lease using an 8% (2007 - 8%) discount rate, with lease term expiry dates ranging from 2032 to 2039. This estimate is based on numerous assumptions including the overall cost of decommissioning and remediation and the selection of alternative decommissioning and remediation approaches.

13. STOCK-BASED COMPENSATION

ACE Stock Option Plan

Certain of the Corporation's employees participate in the ACE stock option plan. Plan participation is limited to employees holding positions that, in the ACE Board's view (or a committee selected by the Board), have a significant impact on ACE's long term results. The stock option plan provides that the options will have an exercise price of not less than 100% of the market price of the underlying shares at the time of grant. Under the terms of the stock option plan, fifty percent of all options vest over four years. The remaining options vest upon performance conditions that are based on net income targets established by the ACE Board over the same time period. All options expire after seven years. The terms of ACE's stock option plan specify that upon the retirement of the employee, options granted to that employee may be exercised as the options vest within three years of such retirement.

In compliance with the terms of the ACE stock option plan, in November 2007, the Board of ACE resolved to immediately vest all remaining unvested ACE stock options. This resulted in the immediate expense recognition of all deferred stock based compensation on outstanding ACE options granted to Air Canada employees, less amounts previously recognized as compensation expense. This expense of $12 is included in the amount below in 2007. As a result of this immediate vesting of all ACE options granted, no further stock based compensation expense is expected to be recorded related to the ACE stock option plan.

The number of ACE stock options granted to employees, the related compensation expense recorded (post adoption of EIC-162) and the assumptions used to determine stock-based compensation expense, using the Black-Scholes option valuation model were as follows:

	2008	2007
Compensation expense ($ millions)	$ -	$ 19
Number of stock options granted	-	-
Weighted average fair value per option granted ($)	-	-
Aggregated fair value of options granted ($ millions)	-	-
Weighted average assumptions:		
Risk-free interest rate	-	-
Expected volatility	-	-
Dividend yield	-	-
Expected option life (years)	-	-

In 2008, the amount credited to share capital for ACE stock options exercised was $37 (2007 - $86). For ACE stock options exercised, shares from treasury are issued by the Corporation.

A summary of the activity related to the Corporation employees participating in the ACE stock option plan is as follows:

	2008		2007	
	Options (000)	Weighted Average Exercise Price/Share	Options (000)	Weighted Average Exercise Price/Share
Beginning of year	1,682	$ 18.09	3,598	$ 25.98
Granted	-	-	-	-
Exercised	-	-	(27)	18.70
Forfeited	-	-	-	-
Outstanding options, prior to special distribution January 10, 2007 (March 3, 2006)	-	-	3,571	26.04
Adjustment - ACE special distribution (a)	-	-	866	-
Outstanding options, after special distribution (a)	-	-	4,437	20.95
Granted	-	-	-	-
Exercised	-	-	(1,037)	17.42
Forfeited	-	-	(2)	26.16
Outstanding options, prior to special distribution March 14, 2007	-	-	3,398	22.02
Adjustment - ACE special distribution (a)	-	-	591	-
Outstanding options, after special distribution (a)	-	-	3,989	18.75
Granted	-	-	-	-
Exercised	-	-	(10)	18.53
Forfeited	-	-	(125)	25.95
Outstanding options, prior to special distribution May 24, 2007	-	-	3,854	18.53
Adjustment - ACE special distribution (a)	-	-	613	-
Outstanding options, after special distribution (a)	-	-	4,467	15.98
Granted	-	-	-	-
Exercised	(1,612)	18.29	(2,591)	14.15
Forfeited	(9)	11.05	(194)	22.22
Outstanding options, end of year	**61**	**$ 14.11**	**1,682**	**$ 18.09**
Options exercisable, end of year	**61**	**$ 14.11**	**1,682**	**$ 18.09**

(a) In accordance with the terms of the ACE stock option plan, each distribution of Aeroplan and Jazz units during 2007 triggered an adjustment to the weighted average exercise price and the number of options outstanding. Effective on the applicable dates of the distributions, the adjustments were applied to all unexercised ACE stock options, whether vested or not, in a consistent manner with the adjustment to the conversion rate for the convertible senior notes described in Note 9.

The total intrinsic value of options exercised under this plan during 2008 was $5 (2007 - $56).

		2008 Outstanding Options			2008 Exercisable Options	
Range of Exercise Prices	Expiry Dates	Number of Options Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price/Share	Number of Exercisable Options	Weighted Average Exercise Price/Share
$11.05	2011	38,319	3	$ 11.05	38,319	$ 11.05
$19.23	2013	22,911	5	19.23	22,911	19.23
		61,230		**$ 14.11**	**61,230**	**$ 14.11**

		2007 Outstanding Options			2007 Exercisable Options	
Range of Exercise Prices	Expiry Dates	Number of Options Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price/Share	Number of Exercisable Options	Weighted Average Exercise Price/Share
$11.05	2011	410,977	4	$ 11.05	410,977	$ 11.05
$21.13	2012	552,259	5	21.13	552,259	21.13
$19.10 - $20.04	2013	718,970	6	19.79	718,970	19.79
		1,682,206		**$ 18.09**	**1,682,206**	**$ 18.09**

The aggregate intrinsic value of the exercisable options outstanding at December 31, 2008 is nil (2007 - $17) and the weighted average remaining life is 3.3 years.

Air Canada Long-Term Incentive Plan

Certain of Air Canada's employees participate in the Air Canada Long-term Incentive Plan (the "Long-term Incentive Plan") administered by the Board of Directors of Air Canada. The Long-term Incentive Plan provides for the grant of options and performance share units to senior management and officers of Air Canada.

The options to purchase shares granted under the Long-term Incentive Plan have a maximum term of 10 years and an exercise price based on the fair market value of the shares at the time of the grant of the options. Fifty percent of all options vest over four years. The remaining options will vest based upon performance conditions. The performance vesting conditions are based on operating margin (operating income over operating revenues) and net income targets established by the Air Canada Board over the same time period. The terms of the Long-term Incentive Plan specify that upon the retirement of the employee, options granted may be exercised as the rights to exercise accrue within three years from the retirement date.

The number of Air Canada stock options granted to employees, the related compensation expense recorded and the assumptions used to determine stock-based compensation expense, using the Black-Scholes option valuation model were as follows:

	2008	2007
Compensation expense (recovery) ($ millions)	$ (3)	$ 4
Number of stock options granted to Air Canada employees	11,000	482,870
Weighted average fair value per option granted ($)	$ 1.99	$ 4.32
Aggregated fair value of options granted ($ millions)	$ -	$ 2
Weighted average assumptions:		
Risk-free interest rate	3.29%	3.94% - 4.43%
Expected volatility	34%	34% - 35%
Dividend yield	0%	0%
Expected option life (years)	4.50	4.50

During 2008, previously recorded stock-based compensation expense, related to stock options, of $3 was reversed as management had determined that the performance vesting criteria will not be met.

A summary of the activity related to Air Canada employees participating in the Air Canada Long-term Incentive Plan is as follows:

	2008		2007	
	Options	Weighted Average Exercise Price/Share	Options	Weighted Average Exercise Price/Share
Beginning of year	1,720,092	$ 19.24	1,699,678	$ 21.00
Granted	11,000	8.51	482,870	14.74
Forfeited	(29,645)	21.00	(462,456)	21.00
Outstanding options, end of year	**1,701,447**	**$ 19.14**	**1,720,092**	**$ 19.24**
Options exercisable end of year	**362,253**	**$ 19.96**	**154,653**	**$ 21.00**

		2008 Outstanding Options			2008 Exercisable Options	
Range of Exercise Prices	Expiry Dates	Number of Options Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price/Share	Number of Exercisable Options	Weighted Average Exercise Price/Share
$21.00	2013	1,207,577	5	$ 21.00	301,894	$ 21.00
$11.08 - $18.60	2014	482,870	6	14.74	60,359	14.74
$8.51	2015	11,000	7	8.51	-	-
		1,701,447		**$ 19.14**	**362,253**	**$ 19.96**

		2007 Outstanding Options			2007 Exercisable Options	
Range of Exercise Prices	Expiry Dates	Number of Options Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price/Share	Number of Exercisable Options	Weighted Average Exercise Price/Share
$21.00	2013	1,237,222	6	$ 21.00	154,653	$ 21.00
$11.08 - $18.60	2014	482,870	7	14.74	-	-
		1,720,092		**$ 19.24**	**154,653**	**$ 21.00**

Performance Share Units

The Long-term Incentive Plan also includes Performance Share Units ("PSUs"). The value of the PSUs is based on the fair market value of the shares at the time of the grant and is accounted for as an equity settled instrument. The vesting term of PSUs is three years, generally commencing on January 1 of the year following granting, and incorporate performance vesting features based upon achieving the average Earnings Per Share target established over the vesting period. Subject to vesting and other conditions, each PSU shall entitle the employee to receive a payment in the form of one common share, cash in the amount equal to market value of one common share, or a combination thereof, at the discretion of the Board of Directors. The terms of the plan specify that upon the retirement of an employee, the number of PSUs that vest are prorated based on the total number of completed months of active service during the PSU vesting term.

The number of PSUs granted to employees and the related compensation expense were as follows:

	2008	2007
Compensation expense (recovery) ($ millions)	$ (2)	$ 2
Number of PSUs granted	1,125,092	232,760
Weighted average fair value per PSU granted ($)	$ 5.22	$ 16.46
Aggregate fair value of PSUs granted ($ millions)	$ 6	$ 4

During the year 5,275 PSUs were forfeited (2007 – 27,314).

During 2008, previously recorded stock based compensation expense, related to PSUs, of $2 was reversed as management has determined that the performance vesting criteria will not be met.

Employee Share Purchase Plans

Employee share purchase plans have been established for shares of ACE and Air Canada. During 2007, the ACE employee share purchase plan was wound up. Air Canada eligible employees are allowed to invest up to 6% of their base salary for the purchase of shares on the secondary market. Air Canada will match 33.3% of the investments made by the employee. During 2008, Air Canada recorded compensation expense of $1 (2007 - $1).

14. SHAREHOLDERS' EQUITY

The issued and outstanding common shares of ACE, along with potential common shares, are set out below.

Outstanding shares (000)	2008	2007
Issued and outstanding		
Class A variable voting shares (a)	25,614	82,229
Class B voting shares (a)	9,293	23,709
Total issued and outstanding	**34,907**	**105,938**
Potential common shares		
Convertible preferred shares (b)	11,863	11,291
Convertible senior notes (c)	13,133	12,210
Stock options	61	1,682
Total potential common shares	**25,057**	**25,183**

The information presented in the table above reflects the adjustments to the convertible notes and stock options in connection with the distributions of units of Aeroplan Income Fund and units of Jazz Air Income Fund during 2007.

	2008	2007
Share Capital and Other equity		
Common shares (a)	$ 100	$ 243
Total Share Capital	100	243
Convertible preferred shares (b)	117	117
Convertible notes (c)	90	90
Total Share Capital and Other equity	**$ 307**	**$ 450**

During 2008, the Corporation issued 1,611,930 (2007 – 3,665,774) common shares on the exercise of stock options for cash consideration of $30 (2007 - $56), $37 (2007 - $86) including the fair value of exercised stock options transferred to share capital from surplus. In addition during 2007, as a result of the Aeroplan and Jazz distributions $376 was recorded as a reduction in Share capital.

Share capital and other equity are comprised of:

(a) Common shares

Class A Variable Voting Shares

The Class A Variable Voting Shares may be held only by persons who are not Canadians and are entitled to one vote per Class A Variable Voting Share unless (i) the number of Class A Variable Voting Shares outstanding (including the Convertible Preferred Shares, on an as-converted basis), as a percentage of the total number of votes attaching to voting shares outstanding exceeds 25% or (ii) the total number of votes cast by or on behalf of holders of Class A Variable Voting Shares (including the Convertible Preferred Shares on an as-converted basis) at any meeting exceeds 25% of the total number of votes that may be cast at such meeting. If either of the above noted thresholds would otherwise be surpassed at any time, the vote attached to each Class A Variable Voting Share will decrease proportionately such that (i) the Class A Variable Voting Shares as a class (including the Convertible Preferred Shares on an as-converted basis) do not carry more than 25% of the aggregate votes attached to all issued and outstanding voting shares of ACE and (ii) the total number of votes cast by or on behalf of holders of Class A Variable Voting Shares (including the Convertible Preferred Shares on an as-converted basis) at any meeting do not exceed 25% of the votes that may be cast at such meeting.

Class B Voting Shares

The Class B Voting Shares may be held only by persons who are Canadians. Each Class B Voting Share shall confer the right to one (1) vote in person or by proxy at all meetings of shareholders of the ACE.

The changes in the outstanding common shares and their aggregate stated value were as follows:

	2008		
	Number (000)	Amount	
Issued, beginning of year	105,938	$	243
Repurchase and cancellation of common shares	(72,643)		(180)
Shares issued on the exercise of stock options	1,612		37
	34,907	**$**	**100**

	2007		
	Number (000)	Amount	
Issued, beginning of year	102,271	$	533
Shares issued on the exercise of stock options	3,667		86
Special distributions	-		(376)
	105,938	**$**	**243**

(b) Convertible Preferred Shares

As at September 30, 2004, 12,500,000 Convertible Preferred Shares were issued for consideration of $250 before fees of $12. These Convertible Preferred Shares are convertible into 11,863,464 common shares, based on the conversion ratio applicable as at December 31, 2008.

For accounting purposes, the Convertible Preferred Shares are presented as a compound instrument. At the date of issuance, the value ascribed to the holders' conversion option, which is presented as equity, was $123 less allocated fees of $6; the value ascribed to the financial liability was $127. The Convertible Preferred Shares will increase by 5% per annum, compounded semi-annually from the date of issuance ("Fully Accreted Value") resulting in an accretion on the financial liability at an effective interest rate of 12%. The financial liability amounted to $206 at December 31, 2008 ($182 at December 31, 2007).

The holders of Convertible Preferred Shares are entitled to vote on an as converted basis with the Variable Voting Shares and the Voting Shares and to the extent that they are held by persons who are not Canadians they shall be subject to the same proportionate reduction in voting percentage as if, for voting purposes only, the Convertible Preferred Shares had been converted into Variable Voting Shares.

The holders of Convertible Preferred Shares shall participate on an as converted basis with the Variable Voting Shares and the Voting Shares with respect to all dividends, distributions, and similar transactions The Convertible Preferred Shares are convertible at the option of the holders thereof at any time into Variable Voting Shares, if held by a non-Canadian, or into Voting Shares, if held by a Canadian, at a conversion rate equal to the Fully Accreted Value per Convertible Preferred Share (as of the conversion date) divided by the Conversion Price. For the purposes of the terms of the Convertible Preferred Shares, "Conversion Price" is equal to $26 or 130% of the initial per share value attributed to the Variable Voting Shares and Voting Shares on September 30, 2004 of $20. The Conversion Price of the Convertible Preferred Shares is subject to certain adjustments, including customary public company anti-dilution protection for stock splits, stock dividends, subdivisions, combinations and similar transactions. split-off, subscription rights or other offers or rights made available to holders of Variable Voting Shares and Voting Shares and any other similar transactions.

Mandatory Conversion

The holders of the Convertible Preferred Shares will be required to convert the Convertible Preferred Shares into fully paid and non-assessable common shares at the conversion ratio applicable upon the date of conversion, if the closing price of the ACE shares on the principal market for each of thirty consecutive trading days exceeded 175% of the conversion price.

The Convertible Preferred Shares will also be subject to mandatory conversion into fully paid and non-assessable common shares within ten days of each mandatory conversion date, at the conversion ratio applicable upon the date of conversion, upon the following terms and conditions:

- if the closing price of the ACE shares on the principal market exceeds the Fully Accreted Value of a preferred share on at least thirty of the one hundred trading days immediately prior to a particular mandatory conversion date; or
- if the closing price of the ACE shares on the principal market does not exceed the Fully Accreted Value of a preferred share on at least thirty of the one hundred trading days immediately prior to a particular mandatory conversion date, (i) the holders of the Convertible Preferred Shares will not be required to convert their Convertible Preferred Shares into ACE shares and (ii) as of such mandatory conversion date, the then applicable conversion price shall be automatically reduced by 3.75%; and
- if the closing price of the ACE shares on the principal market does not exceed the Fully Accreted Value of a preferred share on at least thirty of the one hundred trading days immediately prior to the final maturity date, then holders of Convertible Preferred Shares will be entitled, upon written notice to ACE given within ten days following the final maturity date, to require ACE to redeem each of the Convertible Preferred Shares in cash at a redemption price equal to the Fully Accreted Value as of the final maturity date.

The first mandatory conversion date is seven years from the date of issuance.

Subject to the rights, privileges, restrictions and conditions attaching to the shares of ACE ranking prior to the Convertible Preferred Shares, upon the liquidation, dissolution or winding-up or distribution of the assets of ACE, the holders of the Convertible Preferred Shares will be entitled to receive, prior to and in preference to the holders of ACE shares, an amount equal to the Fully Accreted Value of the Convertible Preferred Shares as of the date of the liquidation, dissolution, winding-up or distribution.

The holders of Convertible Preferred Shares participate on an as-converted basis with respect to all dividends, distributions, spin-off, split-off, subscription rights or other offers made to holders of Class A Variable Voting Shares and Class B Voting Shares and any other similar transactions.

Refer to Note 19 for details relating to the January 2009 and March 2009 substantial issuer bids resulting in the purchase for cancellation of 74% or 9.3 million of the 12.5 million Convertible preferred shares outstanding as at December 31, 2008.

(c) Convertible Notes

During 2005, the Corporation issued $330 of Convertible senior notes due 2035 ("Convertible Notes") for net proceeds of $319. For accounting purposes, the Convertible Notes are presented as a compound instrument with the conversion option reflected in other equity above. Refer to Note 9 for additional information. In 2008, Convertible senior notes with a face value of $1 (2007 - $6) were converted at the option of the holder.

Refer to Note 19 for details relating to the January 2009 substantial issuer bid resulting in the purchase for cancellation of 80% of the outstanding Convertible senior notes.

(d) Substantial Issuer Bid – January 2008

On January 10, 2008, ACE accepted for purchase and cancellation a total of 40,023,427 Class A variable voting shares and 9,894,166 Class B voting shares at $30.00 per share for an aggregate purchase price of $1,498 in accordance with the terms of a substantial issuer bid. No Convertible preferred shares of ACE were deposited on an as converted basis under the offer.

Upon purchase and cancellation by ACE of the Class A variable voting shares and Class B voting shares, Share capital decreased by $115, Contributed surplus decreased by $228, and Retained earnings decreased by $1,155.

In connection with the share purchase and cancellation by ACE, the conversion rate of ACE's 4.25% Convertible senior notes Due 2035 was adjusted from 37.6879 to 39.0341 Class A variable voting shares or Class B voting shares per $1,000 principal amount of Convertible senior notes. The adjustment was effective January 11, 2008 and was determined in accordance with the terms of the indenture governing the Convertible senior notes.

(e) Substantial Issuer Bid – June 2008

On June 18, 2008, ACE accepted for purchase and cancellation a total of 12,537,084 Class A variable voting shares and 10,190,187 Class B voting shares at $22.00 per share for an aggregate purchase price of $500 in accordance with the terms of a substantial issuer bid. No Convertible preferred shares of ACE were deposited on an as converted basis under the offer.

Upon purchase and cancellation by ACE of the Class A variable voting Shares and Class B voting shares, Share capital decreased by $65, Contributed surplus decreased by $101, and Retained earnings decreased by $334.

In connection with the share purchase and cancellation by ACE, the conversion rate of ACE's 4.25% Convertible senior notes Due 2035 was adjusted from 39.0341 to 40.6917 Class A variable voting shares or Class B voting shares per $1,000 principal amount of Convertible senior notes. The adjustment was effective June 19, 2008 and was determined in accordance with the terms of the indenture governing the Convertible senior notes.

Accumulated Other Comprehensive Income (Loss)

The following table outlines the components of Accumulated other comprehensive income (loss) as at December 31:

For the year ended December 31 (Canadian dollars in millions)	2008		2007	
Accumulated other comprehensive income				
Unrealized change in fair value of derivatives	$	(606)	$	56
(net of tax of 2008 - $6 and 2007 - $28)				
Accumulated currency translation adjustment related to ACTS		-		(2)
Total Accumulated other comprehensive income	**$**	**(606)**	**$**	**54**

15. EARNINGS PER SHARE

The following table outlines the calculation of basic and diluted earnings per share:

(in millions, except per share amounts)	2008	2007
Numerator:		
Numerator for basic earnings per share:		
Income for the year	$ (120)	$ 1,398
Effect of potential dilutive securities:		
Stock options	-	-
Convertible preferred shares	-	30
Convertible senior notes	-	29
Adjusted numerator for diluted earnings per share	**$ (120)**	**$ 1,457**
Denominator:		
Denominator for basic earnings per share:		
Weighted-average shares	46	103
Effect of potential dilutive securities:		
Stock options	-	2
Convertible preferred shares	-	11
Convertible senior notes	-	11
Adjusted denominator for diluted earnings per share	**46**	**127**
Basic earnings per share	**$ (2.59)**	**$ 13.51**
Diluted earnings per share	**$ (2.59)**	**$ 11.44**

The calculation of earnings per share is based on whole dollars and not on rounded millions.
As a result, the above amounts may not be recalculated to the per share amount disclosed above.

The dilutive effect of outstanding stock options on earnings per share is based on the application of the treasury stock method. Under this method, the proceeds from the exercise of such securities are assumed to be used to purchase Class B Voting Shares.

Excluded from the calculation of diluted earnings per share were 61,230 (2007 – nil) outstanding options where the options' exercise prices were greater than the average market price of the common shares for the year.

All options, Convertible senior notes and Convertible preferred shares are anti-dilutive for the year ending December 31, 2008 and were excluded from the calculation.

Refer to Note 19 for details relating to the January 2009 and March 2009 substantial issuer bids resulting in the purchase for cancellation of 74% or 9.3 million of the 12.5 million Convertible preferred shares outstanding as at December 31, 2008.

Refer to Note 19 for details relating to the January 2009 substantial issuer bid resulting in the purchase for cancellation of 80% of the outstanding Convertible senior notes.

16. SEGMENT INFORMATION

Composition of Business Segments

ACE has two reportable segments: Air Canada and Corporate Items and Eliminations ("CIE"). During 2007 ACE had the following reportable segments: Air Canada, Aeroplan Limited Partnership ("Aeroplan") up to March 14, 2007, Jazz Air LP ("Jazz") up to May 24, 2007, ACTS LP ("ACTS") up to October 16, 2007, and CIE.

CIE includes the corporate, financing and investing activities of ACE. ACE's investments in Aeroplan, Jazz and ACTS were changed in 2007 from the consolidation to equity method of accounting reported under the CIE segment. As of May 9, 2008 and February 7, 2008, ACE no longer equity accounts for Aeroplan (Note 3) and Jazz (Note 4), respectively, but distributions from Aeroplan and Jazz are recorded in the CIE segment. CIE also includes certain consolidation adjustments related to revenue recognition differences amongst the operating segments. These consolidation adjustments are related to the timing of recognition and the presentation of revenue related to Aeroplan redemptions (up to March 14, 2007) and the timing of revenue recognition related to maintenance services provided by ACTS (completed contract basis of accounting for engine and component maintenance services, up to October 16, 2007) versus the expense recognition in Air Canada and Jazz, which is as the work is completed. In addition, consolidation adjustments were made related to the timing of revenue and expense recognition pertaining to power-by-the-hour contracts. Subsequent to the change in accounting for ACE's investments in Aeroplan and ACTS, these consolidation adjustments are no longer recorded in CIE. Future income taxes are recorded within the applicable taxable entities and are not allocated to non-taxable entities.

The Aeroplan consolidation adjustments recorded within CIE for the period when Aeroplan was consolidated related mainly to the revenue recognition timing difference from when Aeroplan records revenues, which is at the time a Mile is redeemed for travel, to the consolidated accounting policy of revenue recognition at the time reward transportation is provided. In addition, within the Aeroplan segment of the ACE consolidated financial statements, Aeroplan revenue from the redemption of Miles is recorded in Other revenue, whereas on the consolidated financial statements, Miles redeemed for travel on Air Canada and Jazz are recorded in Passenger revenue. This results in an elimination of certain Aeroplan Other revenue amounts within CIE to reflect the consolidated recognition of Aeroplan Miles redeemed for travel on Air Canada and Jazz within Passenger revenue. This also results in an adjustment to passenger revenue recorded within CIE. In the Aeroplan segment information, the cost to Aeroplan of purchasing rewards is recorded in other operating expenses.

Segment financial information has been prepared consistent with how financial information is produced internally for the purposes of making operating decisions. Segments negotiate transactions between each other as if they were unrelated parties.

A reconciliation of the total amounts reported by each business segment to the applicable amounts in the consolidated financial statements follows:

	2008			2007*					
	Air Canada	CIE	Total ACE	Air Canada	Aeroplan	Jazz	ACTS	CIE	Total ACE
Passenger revenue	$ 9,713	$ -	$ 9,713	$ 9,329	$ -	$ -	$ -	$ 15	$ 9,344
Cargo revenue	515	-	515	548	-	-	-	-	548
Other revenue	851	1	852	649	198	3	193	(109)	934
External revenue	11,079	1	11,080	10,526	198	3	193	(94)	10,826
Inter-segment revenue	3	(3)	-	120	3	610	604	(1,337)	-
Total revenues	**11,082**	**(2)**	**11,080**	**10,646**	**201**	**613**	**797**	**(1,431)**	**10,826**
Aircraft fuel	3,419	-	3,419	2,552	-	125	-	(124)	2,553
Wages, salaries and benefits	1,877	31	1,908	1,920	17	139	272	35	2,383
Airport and navigation fees	1,001	-	1,001	1,022	-	80	-	(81)	1,021
Capacity purchase with Jazz	948	-	948	923	-	-	-	(386)	537
Depreciation, amortization and obsolescence	694	(8)	686	548	3	9	31	(9)	582
Aircraft maintenance	659	-	659	757	-	50	235	(527)	515
Food, beverages and supplies	314	-	314	313	-	6	-	(1)	318
Communications and information technology	286	-	286	275	7	2	13	(16)	281
Aircraft rent	279	-	279	282	-	57	-	(16)	323
Commissions	194	-	194	201	-	-	-	-	201
Special charge for labour restructuring	-	-	-	-	-	-	15	-	15
Other	1,450	10	1,460	1,420	134	83	211	(204)	1,644
Total operating expenses	**11,121**	**33**	**11,154**	**10,213**	**161**	**551**	**777**	**(1,329)**	**10,373**
Operating income (loss) before under noted item	**(39)**	**(35)**	**(74)**	**433**	**40**	**62**	**20**	**(102)**	**453**
Provision for cargo investigations	(125)	-	(125)	-	-	-	-	-	-
Operating income (loss)	**(164)**	**(35)**	**(199)**	**433**	**40**	**62**	**20**	**(102)**	**453**
Interest income	57	27	84	92	3	2	-	29	126
Interest expense	(319)	(54)	(373)	(348)	(3)	(3)	(14)	(52)	(420)
Interest capitalized	37	-	37	108	-	-	-	-	108
Gain (loss) on assets	(34)	980	946	19	-	-	-	1,347	1,366
Gain on financial instruments recorded at fair value	92	-	92	26	-	-	-	-	26
Equity and other investment income (loss)	-	(64)	(64)	-	-	-	-	71	71
Other non-operating income (expense)	(3)	1	(2)	(19)	(1)	1	(2)	9	(12)
Non-controlling interest	(12)	250	238	(9)	-	-	-	(148)	(157)
Foreign exchange gain (loss)	(655)	-	(655)	317	-	-	(4)	-	313
Provision for income taxes	(24)	(200)	(224)	(190)	-	-	-	(286)	(476)
Segment income (loss)	**$ (1,025)**	**$ 905**	**$ (120)**	**$ 429**	**$ 39**	**$ 62**	**$ -**	**$ 868**	**$ 1,398**

**Effective March 14, 2007, May 24, 2007, and October 16, 2007, the results and financial position of Aeroplan, Jazz and ACTS Aero, respectively, are not consolidated with ACE (Refer to Notes 3, 4 and 5, respectively). ACTS Aero equity investment income is recorded within CIE prospectively from October 16, 2007. Aeroplan and Jazz equity investment income is recorded up to May 9, 2008 and February 7, 2008 respectively. Subsequent to these effective dates, distribution income from Aeroplan and Jazz is recorded within CIE. For the year ending December 31, 2008, equity income (loss) of ($69) relating to ACE's equity investments is included in Equity and other investment income (loss).*

Included within Depreciation, amortization and obsolescence is depreciation of property and equipment for 2008 of $646 (2007 - $516). This is broken down by segment as follows; Air Canada $646 (2007 - $505), Jazz nil (2007 - $9), ACTS nil (2007 - $6), and CIE nil (2007 – ($4)).

Geographic Information

Passenger revenues	2008	2007*
Canada	$ 4,108	$ 3,977
US Transborder	1,876	1,887
Atlantic	1,883	1,808
Pacific	995	968
Other	851	704
	$ 9,713	**$ 9,344**

Cargo revenues	2008	2007*
Canada	$ 97	$ 108
US Transborder	18	24
Atlantic	212	219
Pacific	142	158
Other	46	39
	$ 515	**$ 548**

**Effective May 24, 2007 the results and financial position of Jazz are not consolidated within ACE (Note 4).*

Passenger and cargo revenues are based on the actual flown revenue for flights with an origin and destination in a specific country or region. Atlantic refers to flights that cross the Atlantic Ocean with origin and destinations principally in Europe. Pacific refers to flights that cross the Pacific Ocean with origin and destinations principally in Asia. Other revenues are principally derived from customers located in Canada.

Segment Asset Information

	December 31, 2008		
	Air Canada	CIE	Total
Cash and cash equivalents	$ 499	$ 808	$ 1,307
Short-term investments	506	-	506
	$ 1,005	**$ 808**	**$ 1,813**
Equity investment (ACTS Aero)	$ -	$ -	$ -
Additions to capital assets	$ 883	$ -	$ 883
Total assets	**$ 11,364**	**$ 507**	**$ 11,871**

	December 31, 2007		
	Air Canada	CIE	Total
Cash and cash equivalents	$ 527	$ 1,773	$ 2,300
Short-term investments	712	127	839
	$ 1,239	**$ 1,900**	**$ 3,139**
Equity investments (Aeroplan, Jazz, ACTS Aero)	$ -	$ (56)	$ (56)
Additions to capital assets (a)	$ 2,714	$ -	$ 2,730
Total assets	**$ 11,820**	**$ 1,934**	**$ 13,754**

(a) The consolidated total includes additions to capital assets of $16 for ACTS that was a segment up to October 16, 2007.

The total assets of CIE is net of the inter-company eliminations between each of the segments and ACE.

17. COMMITMENTS

Boeing

As at December 31, 2008, Air Canada has outstanding purchase commitments with The Boeing Company ("Boeing") for the acquisition of one Boeing 777 and 37 Boeing 787 aircraft. Air Canada also has purchase rights for 18 Boeing 777 and purchase options for 23 Boeing 787 aircraft. The remaining Boeing 777 aircraft was delivered in the first quarter of 2009 and Air Canada received notice from Boeing that deliveries of the Boeing 787 aircraft will commence in the second half of 2012.

For the remaining firm aircraft orders, Air Canada has financing commitments from Boeing and the engine manufacturer covering the one remaining Boeing 777 and 21 of the 37 Boeing 787. The financing under the commitment covers up to 90% of the capital expenditure and is based on a floating or fixed rate equivalent with an equivalent rate of 7.94% as at December 31, 2008. The term to maturity is 15 years with principal payments made on a mortgage style basis resulting in equal installment payments of principal and interest over the term to maturity. In addition to this available financing, the one remaining Boeing 777 delivery has commitments for loan guarantee support from EXIM. The loan guarantee, subject to conditions, covers a 12 year loan term for 85 percent of the capital expenditure at an interest rate based on floating rates. It is expected that this loan guarantee support will be used for the final Boeing 777 aircraft. Should Air Canada not utilize the Boeing financing commitments on the remaining Boeing 777 aircraft, the financing commitments for the Boeing 787 aircraft will be increased to 31 aircraft of which the terms for 28 aircraft would be revised to cover 80% of the aircraft delivery price and the term to maturity would be reduced to 12 years with straight-line principal repayments over the term to maturity.

In July 2009, Air Canada took delivery of one Boeing 777-300ER on a 10-year operating lease with International Lease Finance Corporation ("ILFC").

Embraer

As of December 31, 2008, Air Canada had 7 Embraer 190 series exercisable options remaining.

Aircraft Interior Refurbishment Program

In addition to acquiring new aircraft, Air Canada commenced a major refurbishment of the interior of its existing aircraft in April 2006. Air Canada has completed the refurbishment of all its Airbus A319, A320 and A321 aircraft, one Airbus A330 and 27 of its 28 Boeing 767-300 aircraft to date, for a total of 116 aircraft. An additional $30 is expected for 2009 refurbishments at which time the refurbishment program will be completed. The Embraer and Boeing 777 aircraft are being delivered with the new seats and entertainment systems already installed. The capital expenditures associated with this program, which are committed, are amortized over a five-year period.

Capital Commitments

The estimated aggregate cost of the future firm deliveries and other capital purchase commitments as at December 31, 2008 approximates $5,414 (of which $3,518 is subject to committed financing, subject to the fulfillment of certain terms and conditions). US dollar amounts are converted using the December 31, 2008 noon day rate of CDN$1.2246. The estimated aggregate cost of aircraft is based on delivery prices that include estimated escalation and, where applicable, deferred price delivery payment interest calculated based on the 90-day US LIBOR rate at December 31, 2008.

2009	2010	2011	2012	2013	Thereafter	Total
$ 141	$ 79	$ 119	$ 438	$ 1,081	$ 3,556	$ 5,414

Operating Lease Commitments

As at December 31, 2008 the future minimum lease payments under existing operating leases of aircraft and other property amount to $2,652 (2007 - $2,108) using year end exchange rates.

	2009	2010	2011	2012	2013	Thereafter	Total
Aircraft	$ 367	$ 360	$ 318	$ 298	$ 271	$ 740	$ 2,354
Other property	49	38	36	33	22	120	298
Total	**$ 416**	**$ 398**	**$ 354**	**$ 331**	**$ 293**	**$ 860**	**$ 2,652**

The above minimum lease payments include residual value guarantees, except for those for which Air Canada has obtained residual value support.

Air Canada subleases certain aircraft to Jazz on a flow through basis, which are reported net on the statement of operations. These subleases relate to 33 Bombardier CRJ-200 aircraft and 15 Bombardier CRJ-705 aircraft. The operating lease commitments under these aircraft, which are recovered from Jazz, are not included in the aircraft operating lease commitments table above but are summarized as follows:

2009	2010	2011	2012	2013	Thereafter	Total
$ 89	$ 68	$ 51	$ 51	$ 51	$ 327	$ 637

The subleases with Jazz have the same terms and maturity as the Air Canada's corresponding lease commitments to the lessors.

The future minimum non-cancellable commitments for the next 12 months under the capacity purchase agreements with Jazz is approximately $764 (2007 - $650) and with unaffiliated regional carriers is $30 (2007 - $20). As described in Note 2D), the initial term of the Jazz CPA expires December 31, 2015 with two automatic renewal periods of five years each, subject to either party's right not to renew by notice at least one year prior to the expiration of the then applicable term. The rates under the Jazz CPA are subject to change based upon, amongst other things, changes in Jazz's costs and the results of a benchmarking exercise with other regional carriers to be completed in 2010. It is not possible to determine the minimum commitment beyond 2009; however the commitment is not expected to change significantly from the 2009 amount.

Maturity Analysis

ACE

ACE's principal and interest repayment requirements as at December 31, 2008 on Long-term debt obligations consist of its Convertible Senior Notes (Refer to Note 9) repayable on June 1, 2010 in the amount of $323. This date represents the first date the holders may require ACE to purchase all or a portion of the Convertible Senior Notes at a purchase price equal to 100% of the principal amount of the notes to be purchased. Interest repayment obligations associated with the Convertible Senior Notes amount to $14 in 2009 and $7 in 2010.

Refer to Note 19 for details relating to the January 2009 substantial issuer bid resulting in the purchase for cancellation of 80% of the Convertible senior notes outstanding as at December 31, 2008. The aggregate principal amount of the repurchased Convertible senior notes was $259.

Air Canada

Principal and interest repayment requirements as at December 31, 2008 on Long-term debt and capital lease obligations, and aircraft, engine and fuel facility debt consolidated as variable interest entities under AcG-15 are as follows:

Principal	2009	2010	2011	2012	2013	Thereafter	Total
Long-term debt obligations	$ 487	$ 239	$ 257	$ 275	$ 325	$ 1,699	$ 3,282
Debt consolidated under AcG-15	70	136	378	90	37	323	1,034
Capital lease obligations	106	110	113	173	124	456	1,082
	$ 663	**$ 485**	**$ 748**	**$ 538**	**$ 486**	**$ 2,478**	**$ 5,398**

Interest		2009		2010		2011		2012		2013		Thereafter		Total
Long-term debt obligations	$	168	$	147	$	135	$	120	$	106	$	323	$	999
Debt consolidated under AcG-15		56		47		28		20		16		58		225
Capital lease obligations		88		79		68		59		44		123		461
	$	**312**	**$**	**273**	**$**	**231**	**$**	**199**	**$**	**166**	**$**	**504**	**$**	**1,685**

Principal repayments in the table above exclude deferred financing charges of $44 which are offset against Long-term debt and capital leases in the Consolidated Statement of Financial Position.

The following is a maturity analysis, based on contractual undiscounted cash flows, for selected financial liabilities. The analysis includes both the principal and interest component of the payment obligations on long-term debt and is based on interest rates and the applicable foreign exchange rate effective as at December 31, 2008.

		2009		2010		2011		2012		2013		Thereafter		Total
Long-term debt obligations	$	655	$	386	$	392	$	395	$	431	$	2,022	$	4,281
Debt consolidated under AcG-15		126		183		406		110		53		381		1,259
Capital lease obligations		194		189		181		232		168		579		1,543
Accounts payable and														-
accrued liabilities		1,440		-		-		-		-		-		1,440
Fuel derivatives		420		-		-		-		-		-		420
	$	**2,835**	**$**	**758**	**$**	**979**	**$**	**737**	**$**	**652**	**$**	**2,982**	**$**	**8,943**

Minimum Committed Purchase of Aeroplan Miles

The Commercial Agreement between Air Canada and Aeroplan outlines a requirement for Air Canada to purchase a minimum number of Aeroplan Miles from Aeroplan. The estimated minimum requirement for 2009 is $208. The annual commitment is based on 85% of the average total Miles actually issued in respect of Air Canada flights or Air Canada airline affiliate products and services in the three preceding calendar years. It is not possible to determine the minimum commitment beyond 2009; however the commitment is not expected to change significantly from the 2009 amount. During 2008, Air Canada purchased $248 from Aeroplan.

Refer to Note 1C for a description of subsequent events.

18. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Summary of Financial Instruments

	Carrying Amounts					
	2008					2007
	Financial instruments classification					
	Held for trading	Held to maturity	Loans and receivables	Liabilities at amortized cost	Total	
Financial Assets						
Cash and cash equivalents	$ 1,307	$ -	$ -	$ -	$ 1,307	$ 2,300
Short-term investments	506	-	-	-	506	839
Restricted cash	45	-	-	-	45	124
Accounts receivable	-	-	700	-	700	793
Collateral deposits for fuel derivatives	328	-	-	-	328	-
Deposits and other assets						
Restricted cash	65	-	-	-	65	84
Asset-backed commercial paper	29	-	-	-	29	29
Aircraft related and other Deposits	-	323	-	-	323	309
Derivative instruments						
Fuel derivatives (1)	-	-	-	-	-	10
Foreign exchange derivatives	64	-	-	-	64	-
Cross-currency interest rate swaps	-	-	-	-	-	-
Interest rate swaps	21	-	-	-	21	7
	$ 2,365	**$ 323**	**$ 700**	**$ -**	**$ 3,388**	**$ 4,495**
Financial Liabilities						
Accounts payable	$ -	$ -	$ -	$ 1,466	$ 1,466	$ 1,125
Current portion of long-term debt and capital leases	-	-	-	663	663	686
Long-term debt and capital leases	-	-	-	4,980	4,980	4,006
Convertible preferred shares	-	-	-	206	206	182
Derivative instruments						
Fuel derivatives (1)	15	-	-	-	15	-
Foreign exchange derivatives	-	-	-	-	-	124
Interest rate swaps	-	-	-	-	-	2
	$ 15	**$ -**	**$ -**	**$ 7,315**	**$ 7,330**	**$ 6,125**

(1) The fuel derivatives above relate to fuel derivatives not designated under fuel hedge accounting. Fuel derivatives under hedge accounting have a fair value of $405 in favour of the counterparties (2007 - $67 in favour of Air Canada) and are described further below.

There have been no changes in classification of financial instruments since December 31, 2007, other than the designation or de-designation of fuel derivatives.

For cash flow purposes, the Corporation may settle, from time to time, certain short-term investments prior to their original maturity. For this reason, these financial instruments do not meet the criteria of held to maturity and are therefore designated as held for trading. They are recorded at fair value with changes in fair value recorded in Interest income.

Collateral Held in Leasing Arrangements

Air Canada holds security deposits with a carrying value of $18 (2007 - $15), which approximates fair value, as security for certain aircraft leased and sub-leased to third parties. These deposits do not pay interest to the lessee or sub-lessee. Of these deposits, $11 (2007 - $4) has been assigned as collateral to secure Air Canada's obligations to the lessors and financiers of the aircraft, with the remaining cash held by Air Canada being unrestricted during the term of the lease. Any collateral held by Air Canada is returned to the lessee or sub-lessee, as the case may be, at the end of the lease or sub-lease term provided there have been no events of default under the leases or sub-leases.

Summary of Gain on Financial Instruments Recorded at Fair Value

	2008	2007
Ineffective portion of fuel hedges	$ 83	$ (12)
Fuel derivatives not under hedge accounting	(9)	26
Cross currency interest rate swaps	4	-
Other	14	12
Gain on financial instruments recorded at fair value (1)	**$ 92**	**$ 26**

(1) See Fuel Price Risk for a discussion of losses on fuel derivatives recorded in Other comprehensive income ("OCI").

Risk Management

Under its risk management policy, Air Canada manages its interest rate risk, foreign exchange risk, and market risk through the use of various interest rate, foreign exchange, and fuel derivative financial instruments. The Corporation uses derivative financial instruments only for risk management purposes, not for generating trading profit.

As noted below, Air Canada engages in derivative hedging to mitigate various risks. The derivative fair values represent the amount of the consideration that could be exchanged in an arm's length transaction between willing parties who are under no compulsion to act. Fair value of these derivatives is determined using active markets, where available. When no such market is available, valuation techniques are applied such as discounted cash flow analysis. Where practical, the valuation technique incorporates all factors that would be considered in setting a price.

Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

Air Canada enters into both fixed and floating rate debt and also leases certain assets where the rental amount fluctuates based on changes in short term interest rates. Air Canada manages interest rate risk on a portfolio basis and seeks financing terms in individual arrangements that are most advantageous taking into account all relevant factors, including credit margin, term and basis. The risk management objective is to minimize the potential for changes in interest rates to cause adverse changes in cash flows to Air Canada. The temporary investment portfolio which earns a floating rate of return is an economic hedge for a portion of the floating rate debt.

The ratio of fixed to floating rate debt outstanding is designed to maintain flexibility in Air Canada's capital structure and is based upon a long term objective of 60% fixed and 40% floating. The ratio at December 31, 2008 is 58% fixed and 42% floating, including the effects of interest rate swap positions.

The following are the current derivatives employed in interest rate risk management activities and the adjustments recorded during 2008:

- During 2008, Air Canada entered into and subsequently terminated three cross-currency interest rate swap agreements with terms of March 2019, May 2019, and June 2019 respectively, relating to Boeing 777 financing with an aggregate notional value of $300 (US$283). These swaps converted US denominated debt principal and interest payments into Canadian denominated debt at a foreign exchange rate of par (US$1/CAD$1) and converted from a fixed interest rate of 5.208% and 5.640% to a floating interest rate. These derivative instruments were not designated as hedges for accounting purposes and were fair valued on a quarterly basis. During 2008, a gain of $4 was recorded in Gain on financial instruments recorded at fair value related to these derivatives. These swaps were terminated on October 1, 2008 with a fair value of $4 in favour of Air Canada.

- As at December 31, 2008, Air Canada had entered into two interest rate swap agreements with terms of July 2022 and January 2024 relating to two B767 aircraft financing agreements with an aggregate notional value of $118 (US$96) (2007 - $103 (US$104)). These swaps convert the lease payments on the two aircraft leases from fixed to floating rates. The fair value of these contracts as at December 31, 2008 was $21 in favour of Air Canada (2007 - $7 in favour of Air Canada). These derivative instruments have not been designated as hedges for accounting purposes and are fair valued on a quarterly basis. During 2008, a gain of $14 was recorded in Gain on financial instruments recorded at fair value related to these derivatives (2007 - $3).

- Air Canada enters into forward interest rate agreements to manage the risks associated with interest rate movement on US dollar and Canadian dollar floating rate debt and investments. During 2006 Air Canada entered into 19 interest rate swaps with a notional value of US$414 to receive floating rates and pay a weighted average fixed rate of 5.81% for the debt to be arranged in relation to the financing of Embraer 190 aircraft between June 2006 and February 2008. The swaps had 15 year terms from the expected delivery date of the aircraft and their maturities ranged from June 2021 to December 2022. Air Canada has settled the interest rate swaps upon delivery of the related aircraft. Air Canada did not apply hedge accounting to these derivative instruments. During 2008, the Air Canada's one remaining Embraer 190 aircraft interest rate swap contract matured, with a fair value of $2 in favour of the counterparty (2007 - $2 in favour of the counterparty). No gain or loss was recorded during the period (2007 – net loss of $10 on 11 contracts).

Interest income includes $47 (2007 - $84) related to Cash and cash equivalents, Short-term investments, and Collateral deposits for fuel derivatives, which are classified as held for trading. Interest expense reflected on the Consolidated Statement of Operations relates to financial liabilities recorded at amortized cost.

Foreign Exchange Risk

Foreign exchange risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

Air Canada's risk management objective is to reduce cash flow risk related to foreign denominated cash flows.

Air Canada's cash inflows are primarily in Canadian dollars, while a large portion of its outflows are in US dollars. This unbalanced mix results in a US dollar shortfall from operations annually. In order to mitigate this imbalance, Air Canada has adopted the practice of converting excess revenues from offshore currencies into US dollars. In 2008, this conversion generated coverage of approximately 30% of the imbalance. The remaining 70% was covered through the use of a variety of foreign exchange derivatives, including spot transactions, which had maturity dates corresponding to the forecasted shortfall dates. The level of foreign exchange derivatives expiring at any one point in time is dependent upon a number of factors, which include the amount of foreign revenue conversion available, US dollar net cash flows, as well as the amount attributed to aircraft and debt payments.

The majority of Air Canada's outstanding debt is denominated in US dollars. The US dollar debt acts as an economic hedge against the related aircraft, which is routinely purchased, leased or sub-leased to third parties, and sold by Air Canada in US dollars.

Air Canada is also exposed to foreign exchange risk on foreign currency denominated trade receivables and foreign currency denominated net cash flows.

As noted below, given the substantial depreciation of the Canadian dollar during the fourth quarter of 2008, Air Canada chose to terminate certain of its foreign currency contracts in order to realize on the positive mark-to-market cash value of these derivatives. Consistent with Air Canada's risk management objectives, new derivative positions are being entered into at current foreign exchange rates.

The following are the current derivatives employed in foreign exchange risk management activities and the adjustments recorded during 2008:

- As at December 31, 2008, Air Canada had entered into foreign currency forward contracts and option agreements converting US dollars and Euros into Canadian dollars on $632 (US$516) and $5 (EUR 3) which mature in 2009 and 2010 (2007 - $2,132 (US$2,158) and $26 (EUR 18) of future purchases in 2008 and 2009). The fair value of these foreign currency contracts as at December 31, 2008 was $64 in favour of Air Canada (2007 - $124 in favour of the counterparties). These derivative instruments have not been designated as hedges for accounting purposes and are fair valued on a quarterly basis. During 2008, a gain of $327 was recorded in Foreign exchange gain (loss) related to these derivatives (2007 - $(221) loss).

- The cross-currency swap as described above under interest rate risk management acted as an economic hedge of the foreign exchange risk on the financing related to two Boeing 777 aircraft with a principal amount of $300 (US$283).

- Air Canada had entered into currency swap agreements for 16 CRJ aircraft operating leases until lease terminations between 2007 and 2011. The final 11 currency swap agreements matured in January 2008 with a nominal fair value (2007 - $10 in favour of Air Canada for five agreements). No gain or loss was recorded during the year (2007 - nil). These currency swaps with third parties had a nominal fair value in favour of Air Canada as at December 31, 2007 and had a notional amount of $78 (US$79). These were not designated as hedges for hedge accounting purposes.

<u>Liquidity risk</u>

Liquidity risk is the risk that the Corporation will encounter difficulty in meeting obligations associated with its financial liabilities and other contractual obligations.

Refer to the maturity analysis in Note 17.

Credit Card Agreement

Air Canada has various agreements with companies that process customer credit card transactions. Approximately 80% of the Air Canada's sales are processed using credit cards, with remaining sales processed through cash based transactions. Air Canada receives payment for a credit card sale generally in advance of when the passenger transportation is provided.

Under the terms of one credit card processing agreement, the credit card processing company may withhold payment of funds to Air Canada upon the occurrence of certain events ("triggering events"), which include Cash, cash equivalents and Short-term investments ("unrestricted cash") being less than a specified amount as at the end of any month and operating losses in excess of certain amounts. The amount of funds withheld ("the deposit") is based upon a specified percentage of credit card sales processed through the credit card processing company for which transportation has not been provided to the passenger. The specified percentage increases based upon the level of unrestricted cash below the specified amount or the level of operating losses. If a triggering event occurred, based upon advance sales as at December 31, 2008, the deposit could be from a minimum of $110 up to a maximum of $425.

Under the terms of the credit card processing agreement, beginning at the end of the second quarter of 2009, the triggering events for deposits will change and be based upon a matrix of unrestricted cash and a debt service coverage ratio. The ratio is based upon an EBITDAR (earnings before interest, income taxes, depreciation, amortization, aircraft rentals, certain non operating income (expense) and special items) to fixed charges (principal, interest and aircraft rentals) ratio for the preceding four quarters. Under these triggering events, beginning at the end of the second quarter 2009, the unrestricted cash required in order to avoid a deposit could be as much as $1.3 billion. The basis for calculating the amount of the deposit, if required, remains consistent, as described above.

Refer to Note 1D for a further discussion on liquidity risk.

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: foreign exchange risk; interest rate risk; and other price risk, which includes commodity price risk.

Air Canada uses derivative instruments to reduce market exposures from changes in foreign currency rates, interest rates, and fuel prices. Air Canada uses derivative instruments only for risk management purposes and not for generating trading profit. As such, any change in cash flows associated with derivative instruments is designed to be offset by changes in cash flows related to the risk being hedged.

Refer to the Asset Backed Commercial Paper section below for information regarding these instruments held by Air Canada and the associated market risks.

Sensitivity Analysis

The following table is a sensitivity analysis for each type of market risk relevant to the significant financial instruments recorded by the Corporation as at December 31, 2008. The sensitivity analysis is based on a reasonably possible movement within the forecast period, being one year. These assumptions may not be representative of actual movements in these risks and should not be relied upon. Given the recent volatility in the financial and commodity markets, the actual percentage changes may differ significantly from the percentage changes outlined below. Each risk is contemplated independent of other risks.

	Interest rate risk(1)	Foreign exchange rate risk (2)		Other price risk (3)		Other price risk (3)	
	Income	Income		Income	OCI, net	Income	OCI, net
	1% change	5% increase	5% decrease	10% decrease		10% increase	
Cash and cash equivalents	$ 13	$ -	$ -	$ -	$ -	$ -	$ -
Short-term investments	$ 5	$ -	$ -	$ -	$ -	$ -	$ -
Aircraft related deposits	$ -	$ (11)	$ 11	$ -	$ -	$ -	$ -
Long-term debt and capital leases	$ 17	$ 262	$ (262)	$ -	$ -	$ -	$ -
Foreign exchange derivatives	$ -	$ (26)	$ 24	$ -	$ -	$ -	$ -
Fuel derivatives	$ -	$ -	$ -	$ (37)	$ (16)	$ 37	$ 16

(1) Changes in interest rates will impact income favourably or unfavourably by approximately the same amount, based on current price levels and assumptions.

(2) Increase (decrease) in foreign exchange relates to a strengthening (weakening) of the Canadian dollar.

(3) Other price risk relates to the Corporation's fuel derivatives. The sensitivity analysis is based upon a 10% decrease or increase in the price of the underlying commodity. It also assumes that hedge accounting is 100% effective for the period and that changes in the fair value for derivatives that mature within one year are recorded in income whereas derivatives maturing beyond one year are recorded in OCI.

Credit Risk

Credit risk is the risk of loss due to a counterparty's inability to meet its obligations. As at December 31, 2008, Air Canada's credit risk exposure consists mainly of the carrying amounts of Cash and cash equivalents, Short-term investments and Accounts receivable as well as Collateral deposits for fuel derivatives extended to counterparties. Cash and cash equivalents and Short-term investments are in place with major financial institutions, the Canadian government, and major corporations. Accounts receivable are generally the result of sales of tickets to individuals, often through the use of major credit cards, through geographically dispersed travel agents, corporate outlets, or other airlines, often through the use of major credit cards. Credit rating guidelines are used in determining counterparties for fuel hedging. In order to manage its exposure to credit risk and assess credit quality, Air Canada reviews counterparty credit ratings on a regular basis and sets credit limits when deemed necessary.

Air Canada has $328 in collateral deposits extended to fuel hedge counterparties. Any credit risk related to these deposits is offset against the related liability to the counterparty under the fuel derivative.

During 2008 a counterparty defaulted under a number of derivative agreements with Air Canada. As a result, Air Canada recorded a loss of $6 and $2 related to these foreign exchange and fuel derivatives, respectively. The loss is recorded in Non-operating income (expense).

Refer to the Asset Backed Commercial Paper section below for further credit risk information.

Fuel Price Risk

In order to manage its exposure to jet fuel prices and to help mitigate volatility in operating cash flows, Air Canada enters into derivative contracts with financial intermediaries. Air Canada uses derivative contracts on jet fuel and also on other crude oil-based commodities, heating oil and crude oil, due to the relative limited liquidity of jet fuel derivative instruments on a medium to long term horizon, since jet fuel is not traded on an organized futures exchange. Throughout 2008 a systematic hedging strategy was applied by adding hedging positions on a regular basis. Air Canada's policy permits hedging of up to 75% of the projected jet fuel purchases for the next 12 months, 50% for the next 13 to 24 months and 25% for the next 25 to 36 months. These are maximum (but not mandated) limits. There is no minimum monthly hedging requirement. There are regular reviews to adjust the strategy in light of market conditions. Air Canada does not purchase or hold any derivative financial instruments for trading purposes.

The types of derivative instruments used by Air Canada within its hedging program, such as swaps and the put options within collar structures, expose Air Canada to the potential to have to make collateral deposits. When fuel prices decrease causing Air Canada's derivative position to be in a liability position below the set credit thresholds with counterparties, Air Canada is responsible for extending collateral to the counterparties. As at December 31, 2008 Air Canada had extended $328 of collateral to counterparties (2007 – nil). $322 of this amount relates to cash outflows reflected in Fuel hedge collateral deposits, net and $6 relates to foreign exchange revaluation reflected in Foreign exchange (gain) loss within Operating activities on the Consolidated Statement of Cash Flow.

As of December 31, 2008, approximately 35% of Air Canada's anticipated purchases of jet fuel for 2009 are hedged at an average WTI-equivalent capped price of USD$100 per barrel, of which 79% is subject to an average WTI-equivalent floor price of US$86 per barrel. Air Canada's contracts to hedge anticipated jet fuel purchases over the 2009 period is comprised of jet fuel, heating oil and crude-oil based contracts. Air Canada also hedged approximately 14% of its 2010 anticipated jet fuel purchases in crude-oil based contracts at an average capped price of USD$110/bbl and subject to an average WTI floor price of USD$103/bbl.

The following table outlines the notional volumes per barrel along with the weighted average floor and capped price for each year currently hedged by type of derivative instruments. These average contract prices represent the equivalent price in West Texas Intermediate ("WTI") using the forward prices for WTI, heating oil, and jet oil as at December 31, 2008.

Derivative Instruments	Term	Volume (BBLs)	WTI-equivalent Average Floor Price (USD$/bbl)	WTI-equivalent Average Capped Price (USD$/bbl)
Call options (a)	2009	1,620,000	n/a	$ 127
Swaps (a)	2009	1,455,000	$ 100	$ 100
	2010	1,250,000	$ 100	$ 100
Collars (a)	2009	4,760,000	$ 82	$ 92
	2010	1,960,000	$ 106	$ 116
Put options (b)	2009	1,200,000	$ 40	n/a

(a) Air Canada is expected to generate fuel hedging gains if oil prices increase above the average capped price and is exposed to fuel hedging losses if prices decrease below the average floor price.

(b) Given the recent significant decrease in oil price, Air Canada purchased crude-oil put options. Air Canada is expected to generate fuel hedging gains if oil prices decrease below the average floor price. Their objective is to protect against potential additional collateral requirements caused from further price decreases. The fair value of these derivative instruments increases as crude oil price decreases, therefore offsetting in part the exposure on the total portfolio and limiting the collateral requirements. The premium paid related to these contracts was $4 (USD$3).

Air Canada designates certain of its fuel derivatives as cash flow hedges and applies hedge accounting as prescribed under CICA section 3865, Hedges. Designated hedging items under cash flow hedges result in all period changes in the fair value of the hedging item that are considered effective being recorded in AOCI until the underlying jet fuel is consumed. Upon maturity of the hedging item, the effective gains and losses are recorded in fuel expense. The ineffective component of the change in fair value is recorded in Non-operating income (expense) when it occurs.

Effectiveness is defined as the extent to which changes in the fair value of a hedged item relating to a risk being hedged is offset by changes in the fair value of the corresponding hedging item. Air Canada's accounting policy measures effectiveness based on the change in the intrinsic value of fuel derivatives compared to the change in the intrinsic value of the anticipated jet fuel purchase (based on Air Canada's weighted average price). As Air Canada's current policy does not take into account variables affecting fair value such as volatility and time value of money, a significant component of the change in fair value of outstanding fuel derivatives may be recorded as ineffective under the current policy.

Ineffectiveness is inherent in hedging diversified jet fuel purchases with derivative positions in crude oil and related commodities and in the differences between intrinsic values and fair market values of the derivative instruments, especially given the magnitude of volatility observed in oil market prices. As a result Air Canada is unable to predict the amount of ineffectiveness for each period. This may result, and has resulted, in increased volatility in the accounting results of Air Canada, but has no impact on the underlying cash flows.

If the hedge ceases to qualify for hedge accounting, any period change in fair value of the fuel derivative instrument is recorded in Non-operating income (expense). For those fuel derivatives that do not qualify for hedge accounting, the period changes in fair value of the fuel derivative is recorded in Non-operating income (expense).

During 2008 hedge accounting was discontinued for certain fuel hedge contracts where the hedging relationship ceased to satisfy the conditions for hedge accounting. The value of the AOCI balance recognized in connection with these derivatives will be taken into fuel expense upon the maturity of the contracts. Air Canada still continues to hold these derivatives as it believes they continue to be good economic hedges in managing its exposure to jet fuel prices. Also during 2008, and as further described below, certain derivatives were terminated by Air Canada prior to their scheduled maturities.

The following information summarizes the financial statement impact of derivatives designated under fuel hedge accounting:

- During 2008, fuel derivative contracts matured with fair values in favour of Air Canada for $118 (2007 - $44).
- During 2008, fuel derivative contracts were terminated with fair values in favour of the counterparties for $137 (2007 - nil). The value of the AOCI balance recognized in connection with these derivatives will be taken into fuel expense in the period where the derivative was scheduled to mature.
- The fair value of outstanding fuel derivatives under hedge accounting at December 31, 2008 was $405 in favour of the counterparties (2007 – $67 in favour of Air Canada). This balance is reflected within Current liabilities on the Consolidated Statement of Financial Position due to the counterparty's ability to terminate the derivatives at fair value at any time prior to maturity.
- The change in fair value of fuel derivatives under hedge accounting during 2008 was $(522) (2007 - $134):
  - The unrealized effective change in the fair value of derivatives recorded in OCI was a loss of $613 (2007 - gain of $84). The realized effective change in the fair value of derivatives recorded in OCI during 2008 was a gain of $8 (2007 – gain of $62). OCI amounts for 2008 and 2007 are presented net of tax expense on Air Canada's Consolidated Statement of Comprehensive Income.
  - The ineffective change in the fair value of derivatives recorded in non-operating income (expense) was a gain of $83 (2007 - loss of $12). The ineffective portion is calculated as the difference between the change in intrinsic value and change in fair market value of the derivatives as well as the difference between the Air Canada proxy derivative value and the counterparty derivative value.
- During 2008, reclassification of realized gains on fuel derivatives resulted in a benefit to fuel expense of $79 (2007 - $36). This benefit was recognized through the removal of the amount from AOCI, which is reported as a reclassification of net realized gains of $57 net of tax (2007 - $25 net of tax).

- During 2008, the net impact to AOCI was a decrease of $684 before tax of $22 (2007 - $110 before tax of $28). As at December 31, 2008, the balance in AOCI was $(606). The estimated net amount of existing losses reported in AOCI that is expected to be reclassified to net income (loss) during the following 12 months is $418 before tax.

The following information summarizes the financial statement impact of derivatives not designated under fuel hedge accounting, but held as economic hedges:

- During 2008, fuel derivative contracts matured in favour of Air Canada for $11 (2007 - $17).

- During 2008, fuel derivative contracts were terminated with fair values in favour of the counterparties for $23 (2007 - nil).

- The fair value of outstanding fuel derivatives not under hedge accounting at December 31, 2008 was $15 in favour of the counterparties. (2007 - $10 in favour of Air Canada).

- The change in fair value of the derivative contracts for the year was a loss of $9 (2007 - gain of $26) and was recorded in Non-operating income (expense).

As noted above, the total fair value of terminated fuel derivative contracts amounted to $160 during 2008 (2007 - nil). The cash outflow is included in Fuel and other derivatives in the Consolidated Statement of Cash Flow.

Subsequent to December 31, 2008, Air Canada modified its fuel hedge portfolio with the termination of swap and sold put option contracts for cash settlements of $156 under hedge accounting and $16 not under hedge accounting, both in favour of the counterparty. For the derivative contracts under fuel hedge accounting, the value of the AOCI balance recognized in connection with these derivatives will be taken into fuel expense in the period where the derivative was scheduled to mature.

Financial Instrument Fair Values in the Consolidated Statement of Financial Position

The carrying amounts reported in the Consolidated Statement of Financial Position for short term financial assets and liabilities, which includes Accounts receivable and Accounts payable, approximate fair values due to the immediate or short-term maturities of these financial instruments. Cash equivalents, Short-term investments, and Collateral deposits for fuel derivatives are classified as held for trading and therefore are recorded at fair value.

The carrying amounts of interest rate swaps, foreign exchange, and fuel derivatives are equal to fair value, which is based on the amount at which they could be settled based on estimated current market rates.

Management estimated the fair value of its long-term debt based on valuation techniques taking into account market rates of interest, the current tightness in credit markets and current estimated credit margins applicable to the Corporation based on recent transactions. The recent decreases in market rates of interest offset any increase in credit margins observed in recent transactions such that the fair value of the Corporation's long-term debt approximates its carrying value of $5,643.

Asset Backed Commercial Paper ("ABCP")

Air Canada has $37 ($29 net of a fair value adjustment) in non-bank sponsored ABCP which has been recorded in Deposits and other assets. The carrying value as at December 31, 2008 is based on a number of assumptions as to the fair value of the investments including factors such as estimated cash flow scenarios and risk adjusted discount rates. The assumptions used in estimating the fair value of the investments are subject to change, which may result in further adjustments to non-operating results in the future. No adjustments to the carrying value were recorded during 2008.

19. CAPITAL DISCLOSURES

ACE is an investment holding company of aviation interests which include, as at December 31, 2008, a controlling interest in Air Canada, and a non-controlling interest in ACTS Aero. ACE manages its capital at the parent company level separately from the capital of its subsidiary, Air Canada. Each of the ACE and Air Canada Boards of Directors approves, the ACE or Air Canada objectives and policies for managing capital as the case may be. For purposes of disclosure of capital management, the Corporation has provided separate information about ACE and Air Canada. The ACE information is provided at the parent company level as if its investments were not consolidated and for Air Canada information is provided based on its consolidated financial statements.

ACE

ACE views capital as the sum of parent company debt consisting of convertible notes, convertible preferred shares, non-controlling interest and shareholders' equity. This definition of capital is used by management and may not be comparable to measures presented by other public companies. Capital managed by ACE, summarized from the consolidated statement of financial position, follows:

	2008	2007
Convertible senior notes*	$ 289	$ 273
Convertible preferred shares*	206	182
Non-controlling interest	512	757
Shareholders' equity*	464	3,217
Capital	**$ 1,471**	**$ 4,429**

* For accounting purposes, the convertible senior notes and convertible preferred shares are presented as compound instruments.

The carrying values ascribed to the holders' conversion options within the senior notes and preferred shares, included in shareholders' equity as at December 31, 2008, amount to $90 ($90 as at December 31, 2007) and $117 ($117 as at December 31, 2007), respectively.

ACE's business strategy, to surface shareholder value and to return capital to its shareholders, has influenced its capital management objectives.

Consistent with ACE's strategy to surface shareholder value, in the year ended December 31, 2008, ACE sold the remaining 40.3 million trust units of Aeroplan Income Fund for net proceeds of $692, and realized a gain on disposal of $830 ($684 after tax). ACE also sold the remaining 24.7 million trust units of Jazz Air Income Fund for net proceeds of $182 and realized a gain on disposal of $167 ($133 after tax). As at December 31, 2008, ACE has retained ownership interests in Air Canada (75.0%) and ACTS Aero (27.8%). ACE no longer has any ownership interest in Aeroplan or Jazz.

During 2008, ACE returned capital to its shareholders by way of two substantial issuer bids, wherein ACE completed the purchase and cancellation of 72.6 million common shares for an aggregate purchase price of $1,998.

On January 19, 2009, ACE completed a substantial issuer bid to purchase for cancellation 80% of its convertible senior notes with an aggregate principal amount of $259 at a purchase price of $900 dollars in cash for each $1,000 dollars principal amount of notes. ACE paid an aggregate purchase price of $233 for the notes tendered.

On January 19, 2009, ACE completed a substantial issuer bid to purchase for cancellation 8.3 million of its convertible preferred shares at a purchase price of $20 dollars in cash per preferred share. ACE paid an aggregate purchase price of $166 for the shares tendered.

On March 19, 2009, ACE completed a substantial issuer bid to purchase for cancellation 1.0 million of its convertible preferred shares at a purchase price of $20 dollars per preferred share. ACE paid an aggregate purchase price of $20 for the shares tendered.

As at December 31, 2008, ACE's capital amounted to $1,471, a decline of $2,958 during the year ended December 31, 2008 ($4,429 as at December 31, 2007) mainly due to the issuer bids. As at December 31, 2008, ACE unconsolidated cash, cash equivalents and short-term investments amounted to $808 ($1,900 as at December 31, 2007).

Air Canada

Air Canada views capital as the sum of Long-term debt and capital leases, Non-controlling interest, Capitalized operating leases, and Shareholders' equity. Air Canada currently has pre-delivery financing arranged, which is related to future deliveries, and, as the aircraft have not yet been delivered, this debt is excluded from the capital base. Air Canada includes capitalized operating leases, which is a measure commonly used in the industry ascribing a value to obligations under operating leases. The value is based on annualized aircraft rent expense multiplied by 7.5, which is a factor commonly used in the airline industry. The measure used may not necessarily reflect the fair value or net present value related to the future minimum lease payments as the measure is not based on the remaining contractual payments and the factor may not recognize discount rates implicit in the actual leases or current rates for similar obligations with similar terms and risks. This definition of capital is used by management and may not be comparable to measures presented by other public companies.

Air Canada also monitors its ratio of adjusted net debt to net debt plus shareholders' equity. Adjusted net debt is calculated as the sum of Long-term debt and capital lease obligations, Non-controlling interest, Capitalized operating leases, and Shareholders' equity less Cash and cash equivalents and Short-term investments.

Air Canada's main objectives when managing capital are:

- to structure repayment obligations in line with the expected life of Air Canada's principal revenue generating assets;
- to ensure Air Canada has access to capital to fund contractual obligations as they become due and to ensure adequate cash levels to withstand deteriorating economic conditions;
- to maintain an appropriate balance between debt supplied capital versus investor supplied capital as measured by the adjusted net debt to net debt plus equity ratio; and
- to maintain Air Canada's credit ratings to facilitate access to capital markets at competitive interest rates.

In order to maintain or adjust the capital structure, Air Canada may adjust the type of capital utilized, including purchase versus lease decisions, defer or cancel aircraft expenditures by not exercising available options or selling current aircraft options, and issuing debt or equity securities, all subject to market conditions and the terms of the underlying third party agreements.

The total capital as at December 31, 2008 and December 31, 2007 is calculated as follows:

	2008	2007
Long-term debt and capital leases	$ 4,691	$ 4,006
Current portion of long-term debt and capital leases	663	413
	5,354	4,419
Non-controlling interest	190	184
Capitalized operating leases	2,093	2,115
Less pre-delivery financing included in long-term debt	(81)	(521)
Adjusted debt and non-controlling interest	7,556	6,197
Shareholders' equity	762	2,443
Total Capital	**$ 8,318**	**$ 8,640**
Adjusted debt and non-controlling interest	**$ 7,556**	**$ 6,197**
Less Cash and cash equivalents and Short-term investments	(1,005)	(1,239)
Adjusted net debt and non-controlling interest	**$ 6,551**	**$ 4,958**
Adjusted net debt to adjusted net debt plus shareholders' equity ratio	**89.6%**	**67.0%**

The adjusted net debt and non-controlling interest amount has increased by $1,593 in 2008 largely attributable to the impact of the substantial depreciation of the Canadian dollar and the resulting impact on US dollar debt. The decrease in the cash balance during the year was also a significant contributor, driven by many factors including high fuel prices during most of 2008, the requirement to fund $322 in fuel collateral deposits (Note 18), higher past service pension funding payments and deteriorating economic conditions impacting travel demand.

To offset these factors, Air Canada has been actively pursuing cost cutting measures and alternate financing arrangements.

20. CONTINGENCIES, GUARANTEES AND INDEMNITIES

Contingencies

Investigations by Competition Authorities Relating to Cargo

The European Commission, the United States Department of Justice and the Competition Bureau in Canada, among other competition authorities, are investigating alleged anti-competitive cargo pricing activities, including the levying of certain fuel surcharges, of a number of airlines and cargo operators, including Air Canada. Competition authorities have sought or requested information from Air Canada as part of their investigations. Air Canada is cooperating with these investigations, which are likely to lead, or have led, to proceedings against Air Canada and a number of airlines and other cargo operators in certain jurisdictions including in the European Union where all formal procedural steps preceding a decision have been completed. Air Canada is also named as a defendant in a number of class action lawsuits that have been filed before the United States District Court and in Canada in connection with these allegations.

During 2008, Air Canada recorded a provision of $125 as a preliminary estimate. This estimate is based upon the current status of the investigations and proceedings and Air Canada's assessment as to the potential outcome for certain of them. This provision does not address the proceedings and investigations in all jurisdictions, but only where there is sufficient information to do so. Air Canada Management has determined it is not possible at this time to predict with any degree of certainty the outcome of all proceedings and investigations. Additional material provisions may be required.

Porter Airlines Inc.

In February 2006, Jazz commenced proceedings before the Ontario Superior Court of Justice against Porter Airlines Inc. ("Porter") and other defendants (collectively the "Porter Defendants") after Jazz became aware that it would be excluded from operating flights from Toronto City Centre (Island) Airport (the "TCCA"). On October 26, 2007, the Porter Defendants counter-claimed against Jazz and Air Canada alleging various violations of competition law, including that Jazz and Air Canada's commercial relationship contravenes Canadian competition laws, and claiming $850 in damages. Concurrently with the Ontario Superior Court of Justice proceedings, Jazz commenced judicial review proceedings against the Toronto Port Authority ("TPA") before the Federal Court of Canada relating to Jazz' access to the TCCA. The Porter Defendants were granted intervener and party status in these proceedings. In January of 2008, Porter filed a defence and counterclaim against Jazz and Air Canada making allegations and seeking conclusions similar to those in the Ontario Superior Court counterclaim. Air Canada views Porter's counterclaims in both jurisdictions as being without merit.

Pay Equity

The Canadian Union of Public Employees ("CUPE"), which represents Air Canada's flight attendants, has a complaint before the Canadian Human Rights Commission where it alleges gender-based wage discrimination. CUPE claims the predominantly female flight attendant group should be paid the same as the predominantly male pilot and mechanics groups because their work is of equal value. The complaint dates from 1991 but has not been investigated on the merits because of a legal dispute over whether the three groups work in the same "establishment" within the meaning of the Canadian Human Rights Act. On January 26, 2006, the Supreme Court of Canada ruled that they do work in the same "establishment" and sent the case back to the Canadian Human Rights Commission, which may now proceed to assess the merits of CUPE's complaint. On March 16, 2007, the Canadian Human Rights Commission referred the complaint against Air Canada for investigation. Air Canada considers that any investigation will show that it is complying with the equal pay provisions of the Canadian Human Rights Act; however, management has determined it is not possible at this time to predict with any degree of certainty the final outcome of the Commission's investigation.

Other Contingencies

Various other lawsuits and claims, including claims filed by various labour groups of Air Canada are pending by and against the Corporation and provisions have been recorded where appropriate. It is the opinion of management that final determination of these claims will not have a significant material adverse effect on the financial position or the results of the Corporation.

With respect to 45 aircraft leases of Air Canada, the difference between the amended rents as a result of the implementation of the Plan of Reorganization, Compromise and Arrangement (the "Plan") under the Companies' Creditors Arrangement Act ("CCAA") on September 30, 2004 and amounts due under the original lease contracts will be forgiven at the expiry date of the leases if no material defaults have occurred. If a material default occurs, which does not include any cross defaults to other agreements, this difference plus interest will become due and payable by Air Canada and all future rent will be based on the original contracted rates. Rent expense is being recorded on the renegotiated lease agreements and any liability would be recorded only at the time management believes the amount is likely to occur.

Guarantees

Guarantees in Fuel Facilities Arrangements

Air Canada participates in fuel facility arrangements operated through Fuel Facility Corporations, along with other airlines that contract for fuel services at various major airports in Canada. The Fuel Facility Corporations operate on a cost recovery basis. The purpose of the Fuel Facility Corporations is to own and finance the system that distributes the fuel to the contracting airlines, including leasing the Land Rights under the land lease. The aggregate debt of the five Fuel Facility Corporations in Canada that have not been consolidated by Air Canada under AcG-15 is approximately $127 as at December 31, 2008 (2007 - $119), which is Air Canada's maximum exposure to loss without taking into consideration any cost sharing that would occur amongst the other contracting airlines. Air Canada views this loss potential as remote. Each contracting airline participating in a Fuel Facility Corporation shares pro rata, based on system usage, in the guarantee of this debt.

Indemnification Agreements

Air Canada enters into real estate leases or operating agreements, which grant a license to Air Canada to use certain premises, in substantially all cities that it serves. It is common in such commercial lease transactions for Air Canada as the lessee to agree to indemnify the lessor and other related third parties for tort liabilities that arise out of or relate to Air Canada's use or occupancy of the leased or licensed premises. Exceptionally, this indemnity extends to related liabilities arising from the negligence of the indemnified parties, but usually excludes any liabilities caused by their gross negligence or willful misconduct. Additionally, Air Canada typically indemnifies such parties for any environmental liability that arises out of or relates to its use or occupancy of the leased or licensed premises.

In aircraft financing or leasing agreements, Air Canada typically indemnifies the financing parties, trustees acting on their behalf and other related parties and/or lessors against liabilities that arise from the manufacture, design, ownership, financing, use, operation and maintenance of the aircraft and for tort liability, whether or not these liabilities arise out of or relate to the negligence of these indemnified parties, except for their gross negligence or willful misconduct. In addition, in aircraft financing or leasing transactions, including those structured as leveraged leases, Air Canada typically provides indemnities in respect of various tax consequences including in relation to the leased or financed aircraft, the use, possession, operation maintenance, leasing, subleasing, repair, insurance, delivery, import, export of such aircraft, the lease or finance arrangements entered in connection therewith, changes of law and certain income, commodity and withholding tax consequences.

When Air Canada, as a customer, enters into technical service agreements with service providers, primarily service providers who operate an airline as their main business, Air Canada has from time to time agreed to indemnify the service provider against liabilities that arise from third party claims, whether or not these liabilities arise out of or relate to the negligence of the service provider, but excluding liabilities that arise from the service provider's gross negligence or willful misconduct.

Under its general by-laws and pursuant to contractual agreements between the Corporation and each of its officers and directors, the Corporation has indemnification obligations to its directors and officers. Pursuant to such obligations, the Corporation indemnifies these individuals, to the extent permitted by law, against any and all claims or losses (including amounts paid in settlement of claims) incurred as a result of their service to the Corporation.

The maximum amount payable under the foregoing indemnities cannot be reasonably estimated. The Corporation expects that it would be covered by insurance for most tort liabilities and certain related contractual indemnities described above.

21. RELATED PARTY TRANSACTIONS

At December 31, 2008 ACE has a 75% ownership interest in Air Canada. On October 16, 2007, ACTS LP sold substantially all its assets, liabilities and business to ACTS Aero, a new entity established to purchase the assets of ACTS LP. ACTS Aero owns 100% of Aveos (Aveos Fleet Performance Inc.) which changed its legal name on September 23, 2008 from its previous name of ACTS Aero Technical Support and Services Inc. As at December 31, 2008 ACE has a 27.8% interest in ACTS Aero. Air Canada has various related party transactions with Aveos, an ACE related entity. Subsequent to the sale of Jazz units on January 24, 2008 and the termination of the Securityholders' Agreement on February 7, 2008, ACE no longer exercised significant influence over Jazz. Refer to Note 2 D) for a summary of transactions under the Jazz CPA. Subsequent to the sale on April 24, 2008 and the termination of the Securityholders' Agreement on May 9, 2008, ACE no longer exercised significant influence over Aeroplan.

Related party trade balances, as outlined below, mainly arise from the provision of services, including the allocation of employee related costs, as further described in Note 11. Trade balances between the related parties have trade terms which generally require payment 30 days after receipt of invoice.

The related party balances resulting from the application of the related party agreements were as follows:

	2008	2007
Accounts receivable		
Aveos (Air Canada)	**$ 120**	**$ 75**
Prepaid Maintenance		
Aveos (Air Canada)	**$ 5**	**$ 24**
Accounts payable and accrued liabilities		
Aveos (Air Canada)	**$ 99**	**$ 88**

Revenues and expenses during 2008 with Aveos and the period from October 16, 2007 to December 31, 2007 subsequent to deconsolidation are summarized as follows:

	2008	2007
Revenues		
Property rental revenues (Aveos)	$ 29	$ 6
Revenues from information technology services (Aveos)	15	3
Revenues from corporate services and other (Aveos)	12	(1)
	$ 56	**$ 8**
Expenses		
Maintenance expense for services from Aveos	$ 478	$ 107
Recovery of wages, salary and benefit expense for employees assigned to Aveos	(249)	(55)
Other	1	-
	$ 230	**$ 52**

Summary of significant related party agreements

The Relationship between the Corporation and Aveos

The ACTS Maintenance Agreements, the ACTS Master Services Agreement, the ACTS General Services Agreements, and the Repair Schemes and Non-Compete Agreement, all between Air Canada and ACTS LP and described below were assigned from ACTS LP to Aveos upon closing of the monetization of ACTS (Note 5).

Pension and Benefits Agreement

Air Canada, ACTS and ACTS Aero entered into a Pension and Benefits Agreement effective as of October 16, 2007, as amended ("Pension and Benefits Agreement"), relating to pension and benefits arrangements pertaining to (i) the non-unionized employees of Air Canada who were previously assigned to the ACTS operation became employees of Aveos on October 16, 2007 and (ii) unionized employees of Air Canada who were assigned to ACTS Aero operation pursuant to general services agreements between Air Canada and ACTS for the assignment of unionized employees from Air Canada to ACTS (these agreements were assigned to ACTS Aero upon the closing of the monetization). Aveos is required to establish new defined benefit and defined contribution pension plans as well as other employee and retiree benefit arrangements (including health, life and disability) are being established by ACTS Aero (the "ACTS Benefit Arrangements").

Upon receipt of regulatory approval where required and based upon valuations of the relevant pension and benefit arrangements of Air Canada (the "Air Canada Benefit Arrangements") as at October 16, 2007, the assets and obligations under the Air Canada Benefit Arrangements pertaining to the transferring non-unionized employees will be transferred to Aveos or the ACTS Benefit Arrangements, as applicable. Amounts with a present value equal to the solvency deficiency in the defined benefit pension plans as at October 16, 2007 related to transferring non-unionized employees will be paid by Air Canada through quarterly payments to ACTS Aero until 2014. Amounts with a present value equal to the accounting liability as at October 16, 2007 in respect of retiree and disability benefits related to transferring non-unionized employees will be paid by Air Canada through quarterly payments to Aveos until 2012. The present value of these quarterly payments is also referred to as the compensation amount. Until such future time as the assets and obligations under the Air Canada Benefit Arrangements pertaining to non-unionized employees are to be transferred to Aveos, the current service pension cost and the current service and interest costs for other employee benefits are expensed by Air Canada with a full offset recorded as an amount charged to affiliates (Aveos).

In addition, the Pension and Benefits Agreement contemplates similar asset and liability transfer and compensation arrangements in respect of unionized employees, which arrangements would take effect at such future time as those unionized employees may commence employment with Aveos pursuant to the Transition MOA, as further described below. However, the solvency deficiencies in respect of transferring unionized employees for which the future quarterly compensation payments would be made are determined as at October 16, 2007, subject to certain adjustments, and the discount rate used to compute the accounting liability for the unionized employees' retiree and disability benefits is fixed as at October 16, 2007. The compensation payments in respect of these solvency deficiencies and accounting liabilities would be made quarterly during the five years beginning after the unionized employees are transferred to Aveos, but only if such a transfer occurs. Until such future time as the assets and obligations under the Air Canada Benefit Arrangement pertaining to unionized employees may be transferred to Aveos, the current service pension cost and the current service and interest costs for other employee benefits in respect of Air Canada employees providing services to Aveos are charged to Aveos.

The Pension and Benefits Agreement also required that Air Canada provide letters of credit to Aveos on October 16, 2007, to secure the above-described payment obligations in respect of the solvency deficiencies of the defined benefit pension plans and accounting liabilities for other retiree and disability benefit arrangements. The letters of credit total $101, subject to adjustment once the exact amounts of the relevant solvency deficiencies and accounting liabilities as at October 16, 2007 are determined by actuarial valuations. The face amount of the letter of credit in respect of the unionized solvency deficiency is also adjusted annually to recognize past service costs paid by Air Canada to the plan in respect of unionized employees assigned to ACTS Aero. The face amount of the letters of credit decreases as the related quarterly funding payments described above are made. During 2008, as described below under "Agreement with Aveos on Revised Payment Terms", Air Canada and Aveos agreed to temporarily cancel certain letters of credit in the amount of $40. Aveos may call the letters of credit in whole or in part, in the event of a default as defined in the Pension and Benefits Agreement. Collateral equal to the amount of the letters of credit was paid in cash with the asset recorded in Deposits and other assets.

During 2008, Air Canada, Aveos, and the union representing the employees assigned to Aveos continued discussions regarding the options under which certain unionized employees would commence employment directly with Aveos and the creation of a separate bargaining unit for those employees at Aveos. In relation to the Transition MOA, Air Canada and Aveos also entered into certain ancillary agreements (the "Ancillary Transition Agreements") to address commercial issues relating to the transition of employees contemplated by the Transition MOA Before taking effect, the parties must complete mediation and, if necessary, arbitration of certain issues they have not yet resolved but have agreed to submit to these processes, and the application to separate the bargaining unit must be ordered by the Canada Industrial Relations Board.

Non-Compete and Repair Schemes Transfer Agreement

Aveos and Air Canada are parties to a non-compete and repair schemes transfer agreement, effective as of October 16, 2007 (the "Repair Schemes and Non-Compete Agreement"). Generally described, repair schemes are processes and methods which may be used in the maintenance and repair of aircraft and related equipment. The Repair Schemes and Non-Compete Agreement confirmed an arrangement and provides for the sale from Air Canada to ACTS Aero (as successor to ACTS LP) of an undivided joint ownership interest in repair schemes owned by Air Canada or approved under Air Canada's airworthiness engineering organization as well as the sale from Aveos to Air Canada of an undivided joint ownership interest in the repair schemes owned or developed by Aveos and applicable to airframe heavy maintenance services provided by ACTS to Air Canada under the parties' airframe heavy maintenance services agreement. However, in September 2004 as part of the implementation of the Corporation's plan of arrangement under the Companies' Creditors Arrangement Act, the Corporation had already granted ACTS full and exclusive right to these schemes on a royalty free basis.

The Repair Schemes and Non-Compete Agreement also restricts Air Canada's ability to own any equity interest in an entity (other than entities in which Air Canada previously held interests), or to carry on a business activity, related to the following commercial maintenance, repair and overhaul services in the airline industry, namely, airframe heavy maintenance and paint services, engine and auxiliary power unit ("APU") overhaul maintenance services, and component maintenance services. The applicable non-compete periods are as follows:

- With respect to airframe heavy maintenance services and paint services, the non-compete period ends one year after the current heavy maintenance services agreement is terminated or expires (the current term of the heavy maintenance services agreement expires October 1, 2011);

- With respect to engine and APU overhaul maintenance services, the non-compete period ends on October 1, 2015; and

- With respect to component maintenance services, the non-compete period ends on October 1, 2016;

The Repair Schemes and Non-Compete Agreement does not restrict Air Canada from holding interests in any entities in which it held interests at the time of concluding the agreement nor does it limit Air Canada's line maintenance activities which it continues to operate.

In consideration for the transfer of the repair schemes, Air Canada received $20 during 2007 (Note 5).

The Repair Schemes and Non-Compete Agreement were assigned to Aveos upon closing of the ACTS Monetization.

Agreement with Aveos on Revised Payment Terms

Air Canada and Aveos entered into an agreement dated October 28, 2008 pursuant to which Air Canada has agreed to temporarily extend payment terms to Aveos under certain related party agreements. In exchange for the extended payment terms, certain letters of credit related to the Pension and Benefits Agreement, as described above, were canceled. The cancellation of the letters of credit provided cash to Air Canada of approximately $40 and is offset by the impact of extended payment terms to Aveos of $22, for a net cash flow benefit of $18 to Air Canada.

Refer to Note 22 for a description of subsequent events.

Maintenance Agreements

Aveos and Air Canada are parties to a general terms and related services agreements effective October 1, 2006, pursuant to which Aveos provides technical services to Air Canada including engine and auxiliary power unit maintenance services, aircraft heavy maintenance services (excluding line and cabin maintenance services which are provided by Air Canada), component maintenance services, paint services, training services and ancillary services. Aveos serves as Air Canada's exclusive repair agency in respect of aircraft heavy maintenance, engine maintenance, auxiliary power unit maintenance services as well as for maintenance services relating to certain components. Aveos serves as Air Canada's non-exclusive repair agency in respect of other services provided. The services agreement relating to aircraft heavy maintenance services which expires in October 2011, will be extended to June 2013 conditional upon the issuance of an order of the Canada Industrial Relations Board establishing that Aveos is a distinct employer, bound by separate collective agreements and providing for the transition of employees from Air Canada to Aveos which are fully within the scope of the Transition MOA and the Ancillary Transition Agreements mentioned above. The services agreement relating to engine maintenance expires in October 2013, except in respect of certain engine types, for which the parties have agreed to extend the term to December 31, 2018. The services agreement relating to paint services expires in October 2009 and each of the other maintenance agreements referred to above expire in October 2013.

Master Services Agreement (MSA)

Aveos and Air Canada are parties to an amended and restated master services agreement (the “Aveos MSA”), effective January 1, 2007, pursuant to which Air Canada provides Aveos with services including infrastructure support and services which are mostly administrative in nature, including information technology, human resources, finance and accounting, and claims services in return for fees paid by Aveos to Air Canada. Aveos may elect to terminate any services under the Aveos MSA or the entire Aveos MSA upon six months' prior written notice, with the exception of services relating to information technology which Aveos cannot terminate prior to the expiry of the Aveos MSA. Air Canada may elect to terminate any services under the Aveos MSA or the entire Aveos MSA upon 18 months' prior written notice. These amounts are recorded in the above table summarizing related party revenues and expenses under Revenues from corporate services and other.

General Services Agreements

Aveos and Air Canada are parties to an amended and restated general services agreement (the “ACTS GSA”), effective as of June 22, 2007, pursuant to which Air Canada provides Aveos with the services of a group of unionized employees for which Air Canada is reimbursed by Aveos for all costs, including salary and benefits, on a fully allocated basis. The Aveos GSA may be terminated by either party at any time upon a 30 days' prior written notice.

Real Estate Agreements

As part of the closing of the monetization of ACTS LP, Air Canada sold a building to Aveos for proceeds of $28 effective as of October 16, 2007. In connection with the sale, Air Canada and Aveos entered into a land sublease for certain land contiguous with the building and a service contract whereby Air Canada provides Aveos certain services related to the operation of the building.

Aveos and Air Canada are parties to a master lease agreement, effective as of October 1, 2006, pursuant to which Aveos leases space from Air Canada at the Vancouver, Winnipeg, Toronto and Montreal airports.

Non-recurring transactions

ACTS LP

During 2008, ACTS LP settled certain contracts with Air Canada for $11, in relation to the monetization of ACTS LP in October 2007. These contracts were accounted for as equity transactions, with a resulting dilution loss of $3 recorded in Non-controlling interest.

Share purchase rights sold from Air Canada to ACE

During 2007 Air Canada entered into an aircraft transaction with an unrelated third party whereby partial consideration was paid to Air Canada in the form of a right to acquire shares of the unrelated third party. The transaction related to the sale by Air Canada of two Airbus A319 aircraft and the sublease by Air Canada of an additional two Airbus A319 aircraft, all of which was completed in 2007 with the exception of one of the Airbus A319 aircraft, which was completed in early 2008. Air Canada sold the right to acquire shares received from the unrelated third party to ACE, at fair value, for proceeds of $1.

Warrants purchased from ACE

During 2007 Air Canada purchased certain share warrants held by ACE for consideration of $4. These warrants are for the purchase of shares of an unrelated third party from which Air Canada purchases services. The equity of the unrelated third party is not quoted in an active market and therefore fair value is not reliably measurable. As such, the financial instrument is recorded at cost, being the carrying amount in ACE of nil.

Air Canada Vacations

During 2007, ACE sold its remaining 49% interest in Air Canada Vacations to Air Canada for proceeds of $10. Air Canada Vacations is now 100% owned by Air Canada and ACE's indirect interest in Air Canada Vacations was reduced from 87.25% to 75%. As a result of the sale, ACE recorded a dilution gain of $3 related to the non-controlling interest in Air Canada in Other non-operating income (expense).

Air Canada Credit Facility

Refer to Note 22 for a description of subsequent events.

22. SUBSEQUENT EVENTS

Term Credit Facility

As described in Note 1C, in July 2009, Air Canada received financing proceeds of $600, less fees of approximately $20 under a secured term credit facility (the "Credit Facility"). On or before the first anniversary and subject to satisfaction of certain conditions, Air Canada may request the increase of the facility by up to an additional $100 by obtaining new commitments from either the existing or new lenders. The Credit Facility is repayable in sixteen (16) consecutive quarterly installments commencing in August 2010 of $30 with the final installment of $120 due in July 2014. Any increase to the facility would increase, on a pro rata basis, the scheduled repayments, including the final payment.

The Credit Facility bears interest at a rate based upon the greater of the bankers' acceptance rate (minimum 3.00%) plus 9.75% (12.75% as at July 31, 2009). The Credit Facility can be repaid at any time, in whole or in part subject to a minimum repayment of $10 and the payment of a repayment fee, which is applicable if the repayment occurs on or prior to the third anniversary of the Credit Facility.

Air Canada's obligations under the Credit Facility are secured by a first priority security interest and hypothec over substantially all the present and after-acquired property of Air Canada and its subsidiaries, subject to certain exclusions and permitted liens. The Credit Facility contains customary representations and warranties and is subject to customary terms and conditions (including negative covenants, financial covenants and events of default). Financial covenants require Air Canada to maintain, as of the last business day of each month, a minimum liquidity level (as defined per the Credit Facility and generally based upon the balances as reported in Cash and cash equivalents and Short-term investments) of $800 and a minimum EBITDAR (earnings before interest, income taxes, depreciation, amortization, aircraft rentals, certain non-operating income (expense) and special items) and an interest coverage ratio test determined as at the end of each fiscal quarter

A requirement of the Credit Facility is that Air Canada maintain securities of $800 in accounts subject to securities control agreements. The securities in such accounts would become restricted if Air Canada defaults on certain terms of the agreement.

Under the Credit Facility, Air Canada issued to the lenders, concurrently with the first drawdown, 5 million warrants for the purchase of Air Canada's Class A variable voting shares or Class B voting shares representing an aggregate of 5% of the total issued and outstanding shares as at the closing date of the Credit Facility, allocated among the lenders based on their pro rata lending commitments under the Credit Facility. ACE's share is 1.25 million warrants. These initial warrants have an exercise price of $1.51 per share, will be exercisable at any time and will expire four years after the date of issuance. Subject to the terms of the Credit Facility, in the event that Air Canada does not grant additional security over certain assets within 90 days of closing, Air Canada would be required to issue to the lenders additional warrants representing up to an additional 5% of the total issued and outstanding shares (determined at the time of issuance of such additional warrants) with an average exercise price established based on a volume weighted average price 5 days before issuance, exercisable at any time and expiring four years after the date of issuance.

As a result of the above, ACE's 75.0% direct ownership interest in Air Canada may be diluted in the future.

Related Party Transactions

Air Canada and Aveos entered into an agreement dated October 28, 2008 pursuant to which Air Canada has agreed to temporarily extend payment terms to Aveos under certain related party agreements. In exchange for the extended payment terms, certain letters of credit related to the Pension and Benefits Agreement, as described in Note 21, were cancelled. The extended payment terms to Aveos were originally scheduled to begin reducing in May 2009 with a corresponding return of the letters of credit to Aveos.

During the second quarter of 2009 the payment terms were further extended with the first reduction expected to begin in August 2009 with the expiration of the extended payment terms over the following six months. By January 2010 the letters of credit would be reinstated to the levels then required under the Pension and Benefits Agreement between the two parties.

ACE is a participant lender in the Credit Facility as described above. ACE's participation in the Credit Facility represents $150 of the outstanding loan of $600 as at July 31, 2009. The participant lenders participate on a pro-rata basis with respect to any warrants and principal and interest payments.

POLARIS

In Quarter 2 2009, Air Canada recorded an impairment charge of $67 related to previously capitalized costs incurred pertaining to the development of a new reservation system, referred to as POLARIS. Air Canada is currently working towards the implementation of certain components of the solution such as web and fare technology but has suspended activity relating to the implementation of the reservation system.