2008
Management's Discussion and Analysis of Results of Operations and Financial Condition

This Management Discussion and Analysis ("MD&A"), which is prepared based on audited consolidated financial statements on a going concern basis, replaces ACE Aviation's MD&A filed on February 13, 2009. The MD&A filed on February 13, 2009 was prepared based on audited financial statements on a liquidation basis of presentation.

August 7, 2009

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1. Preface

ACE Aviation Holdings Inc. ("ACE"), which was incorporated on June 29, 2004, is a holding company of aviation interests. ACE is listed on the Toronto Stock Exchange ("TSX") where its Class A variable voting shares and Class B voting shares are traded under the symbols ACE.A and ACE.B, respectively.

On December 10, 2008, ACE announced its intention to seek court and shareholder approvals for a plan of arrangement pursuant to which it would proceed with a liquidation and its net assets would 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 million, announced on the same day by Air Canada, amounts to $150 million. Given ACE's participation in the facility, it is not management's intention to liquidate at this time.

Therefore, the 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.

This Management's Discussion and Analysis of Results of Operations and Financial Condition ("MD&A") for 2008 should be read in conjunction with ACE's audited consolidated financial statements and notes for 2008. Reference to "Corporation" in this MD&A 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. Except as otherwise noted, all monetary amounts are stated in Canadian dollars. For an explanation of certain terms used in this MD&A, refer to section 20 "Glossary of Terms". Except as otherwise noted, this MD&A is current as of August 7, 2009. Certain comparative figures have been reclassified to conform to the financial statement presentation adopted in the current period.

Forward-looking statements are included in this MD&A. See "Caution Regarding Forward-Looking Information" in section 2 of this MD&A for a discussion of risks, uncertainties and assumptions relating to these statements. For a description of the risks relating to ACE and its subsidiaries, see section 14 "Risk Factors" of this MD&A.

The ACE Audit, Finance & Risk Committee has reviewed this MD&A and the 2008 audited consolidated financial statements and notes and ACE's Board of Directors approved these documents prior to their release. For further information on ACE's public disclosure file, including ACE's Annual Information Form, please consult SEDAR at www.sedar.com, or ACE's website at www.aceaviation.com.

2. Caution Regarding Forward-Looking Information

ACE's communications often contain written or oral forward-looking statements which are included in the MD&A and may be included in filings with securities regulators in Canada and the United States. These forward-looking statements are identified by the use of terms and phrases such as "anticipate", "believe", "could", "estimate", "expect", "intend", "may", "plan", "predict", "project", "will", "would", and similar terms and phrases, including references to assumptions. Such statements may involve but are not limited to comments with respect to strategies, expectations, planned operations or future actions.

Forward-looking statements, by their nature, are based on assumptions and are subject to important risks and uncertainties. Any forecasts or forward-looking predictions or statements cannot be relied upon due to, amongst other things, changing external events and general uncertainties of the business. Actual results may differ materially from results indicated in forward-looking statements due to a number of factors, including without limitation, industry, market, credit and economic conditions, the ability to reduce operating costs and secure financing, pension issues, energy prices, currency exchange and interest rates, employee and labour relations, competition, war, terrorist acts, epidemic diseases, insurance issues and costs, changes in demand due to the seasonal nature of the business, supply issues, changes in laws, regulatory developments or proceedings, pending and future litigation and actions by third parties as well as the factors identified throughout this MD&A and, in particular, those identified in the "Risk Factors" section 14 of this MD&A. The forward-looking statements contained in this discussion represent ACE's expectations as of the date of this MD&A, and are subject to change after such date. However, ACE disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise, except as required under applicable securities regulations.

3. Industry Interests

The following is a listing of ACE's aviation interests as at August 7, 2009.

	Aviation Interests	Ownership
Air Canada (TSX: AC.A, AC.B)	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 and in the international market to and from Canada. Wholly-owned subsidiaries of Air Canada include: • AC Cargo Limited Partnership ("Air Canada Cargo") which, together with Air Canada, are Canada's largest provider of air cargo services. • ACGHS Limited Partnership ("Air Canada Ground Handling Services") which is a passenger and ground handling service provider. • Touram Limited Partnership ("Air Canada Vacations") which is a major Canadian tour operator offering leisure travel packages. * ACE's ownership interest in Air Canada is subject to dilution as a result of certain agreements between Air Canada and its unions and as a result of warrants issued and that may be issued in connection with the Air Canada credit facility (see section 5 of this MD&A).	75.0 %*
ACTS Aero	Aero Technical Support and Services Holdings sarl ("ACTS Aero"), which owns 100% of Aveos Fleet Performance Inc. ("Aveos"), is a global player in the aircraft maintenance, repair and overhaul marketplace. ACTS Aero Technical Support and Services Inc. changed its legal name to Aveos on September 23, 2008.	28.4 %

4. Business Strategy

ACE established its corporate structure in 2004 which was designed to: (i) put in place separate management and business plans for each business to better focus their strategic direction and profit making efforts; (ii) align management, capital and human resource needs within each individual business; (iii) facilitate the development of each business to its fullest individual potential including, where appropriate, through the pursuit of third party business; and (iv) maximize the value of investments that had not been fully recognized.

ACE's value enhancement strategy for its stand-alone entities included considering stand-alone financings, sales and distributions of equity interests and involved outside investors for these and other purposes. Implementation of this strategy has notably involved the initial public offerings of Aeroplan Income Fund, Jazz Income Fund and Air Canada and subsequent distributions or dispositions of ACE's interests in such entities, together with the monetization of ACTS LP and the other transactions as outlined in section 5 "Significant Events" of this MD&A.

5. Significant Events

The following significant events occurred during the period January 1, 2008 to August 7, 2009.

ACE

Substantial Issuer Bid: ACE repurchases $1,498 million of its Variable Voting Shares and Voting Shares
On January 10, 2008, ACE took up and purchased for cancellation 40,023,427 variable voting shares and 9,894,166 voting shares at $30.00 per share for an aggregate purchase price of $1,498 million.

Sale of 13 million Units of Jazz Air Income Fund
On January 24, 2008, ACE sold 13 million units of Jazz Air Income Fund for total net proceeds to ACE of approximately $97 million.

Secondary Offering of Units of Aeroplan Income Fund
On April 21, 2008, ACE sold 20.4 million units of Aeroplan Income Fund for total net proceeds to ACE of approximately $343 million.

Sale of Units of Aeroplan Income Fund and Jazz Air Income Fund
On June 2, 2008, ACE sold its remaining units of Aeroplan Income Fund for total net proceeds to ACE of approximately $349 million, and its remaining units of Jazz Air Income Fund for total net proceeds to ACE of approximately $85 million.

Substantial Issuer Bid: ACE repurchases $500 million of its Variable Voting Shares and Voting Shares
On June 18, 2008, ACE took up and purchased for cancellation 12,537,084 variable voting shares and 10,190,187 voting shares at $22.00 per share for an aggregate purchase price of approximately $500 million.

Substantial Issuer Bids to Purchase all of the Notes and Preferred Shares
On December 10, 2008, ACE announced that the Board of Directors had authorized i) a substantial issuer bid (the "Notes Offer") to purchase for cancellation all of its outstanding 4.25% Convertible Senior Notes due 2035 (the "Notes") at a purchase price of $900 in cash for each $1,000 principal amount of Notes and ii) a substantial issuer bid (the "Preferred Share Offer") to indirectly purchase for cancellation all of its outstanding preferred shares (the "Preferred Shares") at a purchase price of $20.00 in cash per Preferred Share.

On December 10, 2008, ACE also announced that it intended to seek court and shareholder approvals for a plan of arrangement pursuant to which ACE will be liquidated and its net assets, including its shares in Air Canada, will be distributed, in an orderly fashion, after providing for outstanding liabilities and costs of the transaction.

On January 19, 2009, ACE announced that $259 million principal amount of Notes were deposited and taken up under the Notes Offer for an aggregate purchase price of $233 million and that 8.3 million Preferred Shares, at a purchase price of $20.00 in cash per Preferred Share, were deposited and taken up under the Preferred Share Offer for an aggregate purchase price of $166 million.

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 million for the shares tendered.

Participation in the Air Canada Credit Facility
On July 29, 2009, ACE announced that its participation in the Air Canada credit facility of up to $700 million described below amounts to $150 million. ACE's $150 million share is repayable in equal consecutive quarterly installments of $7.5 million starting August 1, 2010, with a final payment of $30 million due by the fifth anniversary of the initial drawdown.

Air Canada

Air Canada has entered into the following transactions in 2009 in an effort to mitigate Air Canada's liquidity risks as described in section 9.2 of this MD&A.

During July 2009

- A secured term credit facility (the "Credit Facility") for financing proceeds of $600 million, less fees of approximately $20 million. 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 million by obtaining new commitments from either the existing or new lenders. ACE's participation in the Air Canada credit facility amounted to $150 million. The Credit Facility is a five-year facility with the first principal repayment due in August 2010, and bears interest at 12.75%. 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. 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.

  As part of the transactions under the Credit Agreement, Air Canada issued to the lenders, concurrently with the first drawdown, five million warrants at an exercise price of $1.51 with a term of four years to July 2013, for the purchase of Air Canada's Class A variable voting shares or Class B voting shares representing an aggregate of five percent of the total issued and outstanding shares. These warrants have been allocated among the lenders based on their pro rata lending commitments under the Credit Agreement, ACE's share is 1.25 million warrants. Subject to the terms of the Credit Agreement, 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 five percent of the total issued and outstanding shares (determined at the time of issuance of such additional warrants).

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

  As part of the transactions related to the closing of the Credit Facility, existing financing arrangements of $166 million were repaid as follows:

  - The revolving credit facility was repaid in full in the amount of $49 million. The rights of the lender under this facility were assigned to the lenders under the Credit Facility;
  - The spare engine financing was partially repaid in the amount of $38 million. 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 million as at July 31, 2009;
  - The Aeroplan Canada Inc. ("Aeroplan") loan was repaid in the amount of $79 million, which was the maximum available amount at that time. 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 million, $175 million, and $225 million 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 MOU, 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 million 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 (as defined per the agreement and generally based on the balances as reported in cash, cash equivalents and short-term investments) required to be maintained as further described in section 9.2 of this MD&A;

- An extension to a short-term loan of $82 million (US$75 million) entered into in 2008, which was originally due in 2009, to 2013;

- A memorandum of understanding with GE Capital Aviation Services (the "GECAS MOU") 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 million; and

- A memorandum of understanding for amended terms related to the capacity purchase agreement with 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 million. 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 million partially offset by the settlement of fuel derivative contracts in favour of counterparties in the amount of $17 million.
- In Quarter 2 2009, Air Canada recorded an impairment charge of $67 million relating to previously capitalized costs incurred towards 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.

During the first quarter of 2009

- Financing arrangements secured by spare parts, spare engines and a Boeing 777 aircraft for aggregate proceeds of $267 million, net of fees of $5 million. 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 million and the required repayment of a debt obligation related to the aircraft of $128 million, which included a prepayment fee of $14 million;

- 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 million and final payment of $115 million in 2010, based on the foreign exchange rate as at March 31, 2009;
- Repayment of pre-delivery financing of $83 million on the Boeing 777 aircraft received during the first quarter; and
- Net return of collateral deposits on fuel derivatives in the amount of $147 million offset by the settlement of fuel derivative contracts in favour of counterparties in the amount of $217 million.

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

For a discussion on Air Canada's liquidity risks, refer to section 9.2 of this MD&A.

6. Accounting Policies

During 2008, ACE had two reportable segments: Air Canada and CIE. During 2007, in addition to Air Canada and CIE, ACE had the following additional reportable segments: Aeroplan Limited Partnership ("Aeroplan") up to March 14, 2007, Jazz Air LP ("Jazz") up to May 24, 2007 and ACTS LP ("ACTS") up to October 16, 2007.

ACE prepares its financial statements, on a going concern basis of presentation, in accordance with Canadian Generally Accepted Accounting Principles ("GAAP").

Significant accounting policies and methods used in preparation of ACE's 2008 audited financial statements are described in Note 2 to ACE's 2008 audited consolidated financial statements.

ACE's results reflect the consolidation of Aeroplan only up to March 14, 2007, the consolidation of Jazz only up to May 24, 2007 and the consolidation of ACTS only up to October 16, 2007. After those dates, ACE's investments in Aeroplan (up to May 9, 2008), ACTS, and Jazz (up to February 7, 2008) are accounted for using the equity method. From May 9, 2008 for Aeroplan and from February 7, 2008 for Jazz, through to June 1, 2008, ACE's investments in these entities were classified as "available-for-sale" investments. Effective June 2, 2008, ACE no longer has an ownership interest in Aeroplan and Jazz. As a result of the above-noted changes, ACE's results of operations for 2008 are not directly comparable to its operating results for 2007.

The preparation of ACE's financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent liabilities and reported amounts of revenues and expenses for the period of the financial statements. ACE evaluates these estimates and assumptions on a regular basis, based on historical experience and other relevant factors. Actual amounts could differ materially from those estimates and assumptions. Refer to section 13 of this MD&A for a discussion of ACE's Critical Accounting Estimates.

Changes in Accounting Policies

The following changes in accounting policies were applicable to ACE for the year ended December 31, 2008 on a going concern basis.

Capital Disclosures and Financial Instruments – Presentation and Disclosure

Effective January 1, 2008, the Corporation adopted three new Canadian Institute Chartered Accountants ("CICA") accounting standards: section 1535, *Capital Disclosures*, section 3862, *Financial Instruments – Disclosures* and section 3863, *Financial Instruments – Presentation*.

Section 1535 establishes disclosure requirements about an entity's capital and how it is managed. The purpose is to enable users of the financial statements to evaluate the entity's objectives, policies and processes for managing capital.

Sections 3862 and 3863 replace section 3861, *Financial Instruments – Disclosure and Presentation*, revising and enhancing its disclosure requirements in certain areas, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. For additional information, refer to section 12 of this MD&A.

Inventories

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 the measurement requirements in the new standard and, as a result, no adjustment was recorded on the transition, however, additional disclosures have been included in ACE's consolidated financial statements commencing in Quarter 1 2008.

Future Accounting Standard Changes

Goodwill and Intangible Assets

In February 2008, the 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 section 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.

International Financial Reporting Standards

The Canadian Accounting Standards Board has confirmed January 1, 2011 as the changeover date for Canadian publicly accountable enterprises to start using International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board. IFRS uses a conceptual framework similar to Canadian GAAP, but there are significant differences in recognition, measurement and disclosures.

As a result, the Corporation has developed a plan to convert its consolidated financial statements to IFRS establishing a cross-functional IFRS team represented by managers in the areas of Accounting, Taxation, IT and Data Systems, Internal Control and Processes, Planning, Compensation, Treasury, Investor Relations and Legal. Updates regarding the progress of the conversion plan are provided to the Corporation's Audit Committee on a quarterly basis.

The plan addresses the impact of IFRS on Accounting policies and implementation decisions, Infrastructure, Business activities and Control activities. A summary status of the key elements of the changeover plan is as follows:

Accounting policies and implementation decisions

- Key activities:
    - Identification of differences in Canadian GAAP and IFRS accounting policies;
    - Selection of the Corporation's ongoing IFRS policies;
    - Selection of the Corporation's IFRS 1 *First-time Adoption of International Financial Reporting Standards* ("IFRS 1") choices;
    - Development of financial statement format;
    - Quantification of effects of change in initial IFRS 1 disclosures and 2010 financial statements.
- Status:
    - The Corporation has identified differences between accounting policies under Canadian GAAP and accounting policy choices under IFRS, both on an ongoing basis and with respect to certain choices available on conversion, made in accordance with IFRS 1;
    - The Corporation will progress towards the quantification of the identified differences and choices throughout 2009 and 2010.

Infrastructure

- Financial reporting expertise
    - Key activity:
        - Development of IFRS expertise.
    - Status:
        - The Corporation has provided training for key employees and stakeholders. Additional training will be ongoing until full adoption in 2011.

- Information technology and data systems
    - Key activity:
        - Development of systems solution for transition period and post-convergence period.
    - Status:
        - The Corporation is in the process of identifying system requirements and solutions.

Business activities

- Financial covenants
    - Key activities:
        - Identification of impact on financial covenants and business practices;
        - Completion of any required renegotiations/changes.
    - Status:
        - The Corporation is in the process of analyzing the contractual implications of IFRS on any financing relationships and other arrangements.

- Compensation arrangements
    - Key activities:
        - Identification of impact on compensation arrangements;
        - Assessment of required changes.
    - Status:
        - The Corporation is in the process of analyzing any compensation policies that rely on indicators derived from the financial statements.

Control activities

- Internal control over financial reporting
  - Key activities:
    - For all accounting policy changes identified, assessment of Internal Controls over Financial Reporting ("ICFR") design and effectiveness implications;
    - Implementation of appropriate changes.
  - Status:
    - The Corporation is in the process of analyzing any issues with respect to ICFR.

- Disclosure controls and procedures
  - Key activities:
    - For all accounting policy changes identified, assessment of Disclosure Controls and Procedures ("DC&P") design and effectiveness implications;
    - Implementation of appropriate changes.
  - Status:
    - The Corporation is in the process of analyzing any issues with respect to DC&P.

7. Results of Operations – Quarter 4 2008

The following table reflects the results of the Corporation, the results of its reportable segments and certain non-GAAP measures for Quarter 4 2008. Segment information has been prepared consistent with how financial information is produced internally for the purposes of making business decisions. Refer to Note 16 "Segment Information" in ACE's 2008 audited consolidated financial statements for additional information.

	Quarter 4 2008		
(Canadian dollars in millions)	**Air Canada**	**CIE**	**ACE Total**
Operating revenue			
Passenger revenue	$ 2,182	$ -	$ 2,182
Cargo revenue	113	-	113
Other revenue	203	(2)	201
	2,498	(2)	2,496
Operating expenses			
Aircraft fuel	792	-	792
Wages, salaries and benefits	444	2	446
Airport and navigation fees	230	-	230
Capacity purchase with Jazz	237	-	237
Depreciation, amortization and obsolescence	174	(2)	172
Aircraft maintenance	157	-	157
Food, beverages and supplies	70	-	70
Communications and information technology	72	-	72
Aircraft rent	80	-	80
Commissions	40	-	40
Other operating expenses	348	2	350
	2,644	2	2,646
Operating loss	**(146)**	**(4)**	**(150)**
Non-operating income (expense)			
Interest income	11	6	17
Interest expense	(88)	(15)	(103)
Interest capitalized	6	-	6
Loss on assets	(5)	(10)	(15)
Gain on financial instruments recorded at fair value	32	-	32
ACTS Aero equity investment loss	-	(62)	(62)
	(44)	(81)	(125)
Loss before the following items	**(190)**	**(85)**	**(275)**
Non-controlling interest	(4)	180	176
Foreign exchange loss	(527)	-	(527)
Provision for income taxes	(6)	(1)	(7)
Income (loss) for the period	**$ (727)**	**$ 94**	**$ (633)**
EBITDAR/EBITDA [1]	**$ 108**	**$ (6)**	**$ 102**

(1) Refer to section 19 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR to operating income (loss).

The following table reflects the results of the Corporation, the results of its reportable segments and certain non-GAAP measures for Quarter 4 2007.

	Quarter 4 2007			
(Canadian dollars in millions)	Air Canada	ACTS [(1)]	CIE	ACE Total
Operating revenue				
Passenger revenue	$ 2,196	$ -	$ -	$ 2,196
Cargo revenue	141	-	-	141
Other revenue	170	9	4	183
External revenue	2,507	9	4	2,520
Inter-segment revenue	6	33	(39)	-
	2,513	**42**	**(35)**	**2,520**
Operating expenses				
Aircraft fuel	615	-	-	615
Wages, salaries and benefits	468	13	20	501
Airport and navigation fees	238	-	-	238
Capacity purchase with Jazz	227	-	-	227
Depreciation, amortization and obsolescence	140	1	(1)	140
Aircraft maintenance	173	11	(17)	167
Food, beverages and supplies	67	-	(1)	66
Communications and information technology	67	1	(3)	65
Aircraft rent	62	-	-	62
Commissions	37	-	-	37
Other operating expenses	347	13	(4)	356
	2,441	**39**	**(6)**	**2,474**
Operating income (loss)	**72**	**3**	**(29)**	**46**
Non-operating income (expense)				
Interest income	22	-	18	40
Interest expense	(89)	-	(16)	(105)
Interest capitalized	20	-	-	20
Gain on assets	-	-	1,339	1,339
Loss on financial instruments recorded at fair value	(1)	-	-	(1)
Equity and other investment income [(2)]	-	-	17	17
Other non-operating income (expense)	(4)	-	1	(3)
	(52)	-	1,359	1,307
Income before the following items	**20**	**3**	**1,330**	**1,353**
Non-controlling interest	(3)	-	(6)	(9)
Foreign exchange gain (loss)	20	(3)	1	18
Provision for income taxes	(2)	-	(232)	(234)
Income for the period	**$ 35**	**$ -**	**$ 1,093**	**$ 1,128**
EBITDAR/EBITDA [(3)]	**$ 274**	**$ 4**	**$ (30)**	**$ 248**

(1) Reflects the consolidation of ACTS results from October 1 to October 15, 2007.
(2) Reflects ACE's investment in ACTS (from October 16, 2007 to December 31, 2007) using the equity method of accounting.
(3) Refer to section 19 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR/EBITDA to operating income (loss).

ACE recorded an operating loss of $150 million in Quarter 4 2008 compared to operating income of $46 million in Quarter 4 2007. Air Canada reported an operating loss of $146 million in Quarter 4 2008 compared to operating income of $72 million in Quarter 4 2007, a deterioration of $218 million from Quarter 4 2007. ACE's consolidated results for Quarter 4 2007 included operating income of $3 million from ACTS. ACE recorded EBITDAR of $102 million in Quarter 4 2008 compared to EBITDAR of $248 million in the same period in 2007. In Quarter 4 2008, Air Canada reported EBITDAR of $108 million compared to EBITDAR of $274 million in the same period in 2007, a decrease of $166 million. In Quarter 4 2007, ACTS recorded EBITDA of $4 million. Refer to section 19 "Non-GAAP Financial Measures".

ACE recorded operating revenues of $2,496 million and operating expenses of $2,646 million in Quarter 4 2008. In the same period in 2007, ACE recorded operating revenues of $2,520 million and operating expenses of $2,474 million. Air Canada's operating revenues of $2,498 million decreased $15 million from the same period in 2007. An increase of $28 million in other revenues was more than offset by decreases in passenger and cargo revenues of $14 million and $29 million, respectively. The decrease in passenger and cargo revenues was mainly the result of a reduction in traffic. Air Canada's operating expenses of $2,644 million increased $203 million from the same period in 2007, largely due to increases in fuel expense and ownership costs and the unfavourable impact of a significantly weaker Canadian dollar versus the US dollar compared to Quarter 4 2007. As a result of the deconsolidation of ACTS, ACE's 2008 operating revenues and expenses are not directly comparable to its operating revenues and expenses for Quarter 4 2007.

Non-operating expense amounted to $125 million in Quarter 4 2008 compared to non-operating income of $1,307 million in Quarter 4 2007. In Quarter 4 2008, ACE recorded a provision for loss on disposal of $10 million related to its equity investment in ACTS Aero. Included in non-operating income in Quarter 4 2007 were gains on disposal of $1,339 million, which included a gain on disposal of $565 million related to the monetization of ACTS completed on October 16, 2007, a gain on disposal of $539 million related to the Aeroplan secondary offering completed on October 22, 2007, and a gain on disposal of $233 million related to the Jazz secondary offering completed on October 22, 2007.

Net interest expense increased $35 million from Quarter 4 2007, reflecting a lower amount of capitalized interest related to new aircraft and a decrease in interest income due to both lower cash balances and interest rates. A decrease in interest expense, largely driven by lower financing costs on the Boeing 777 aircraft commitments due to the favourable impact of the pre-delivery financing arranged in Quarter 4 2007, and lower interest rates on floating rate debt compared to Quarter 4 2007, was offset by the financing of additional aircraft year-over-year and the unfavourable impact of a weaker Canadian dollar versus the US dollar in Quarter 4 2008. Gains on financial instruments recorded at fair value amounted to $32 million in Quarter 4 2008 compared to a loss on financial instruments of $1 million in Quarter 4 2007. Refer to section 12 of this MD&A for additional information on financial instruments. An equity investment loss of $62 million was recorded in Quarter 4 2008 compared to equity investment income of $17 million in Quarter 4 2007. The equity investment loss in Quarter 4 2008 represented ACE's proportionate share of losses recorded by ACTS Aero. The equity investment income recorded in Quarter 4 2007 represented equity accounting for ACE's investments in Aeroplan and Jazz and for its investment in ACTS Aero commencing on October 16, 2007.

In Quarter 4 2008, $176 million of the net loss was allocated to non-controlling interest compared to $9 million of net income being allocated to non-controlling interest in Quarter 4 2007. Quarter 4 2008 reflected the deterioration in Air Canada's net results compared to Quarter 4 2007.

Net losses on foreign exchange amounted to $527 million in Quarter 4 2008 compared to gains of $18 million in Quarter 4 2007. The losses in Quarter 4 2008 were attributable to a weaker Canadian dollar at December 31, 2008 compared to September 30, 2008, partially offset by gains of $174 million related to foreign currency derivatives. The December 31, 2008 noon day exchange rate was US$1 = C$1.2246 while the September 30, 2008 noon day exchange rate was US$1 = C$1.0599.

ACE recorded a provision for income taxes of $7 million in Quarter 4 2008. ACE recorded a provision for income taxes of $234 million for the same period in 2007 on pre-tax income of $1,362 which included gains on disposal of Aeroplan and Jazz units and the monetization of ACTS with related tax expense of $214 million.

The net loss in Quarter 4 2008 amounted to $633 million or $(18.12) per diluted share. In Quarter 4 2007, ACE recorded net income of $1,128 million or $8.88 per diluted share.

7.1. Air Canada

In Quarter 4 2008, Air Canada reported an operating loss of $146 million compared to operating income of $72 million in Quarter 4 2007, a decrease of $218 million. In Quarter 4 2008, EBITDAR amounted to $108 million compared to EBITDAR of $274 million in the same period in 2007, a decrease of $166 million. Refer to section 19 "Non-GAAP Financial Measures".

In response to historically high fuel prices, on June 17, 2008, Air Canada announced capacity reductions for the fall and winter schedule. In Quarter 4 2008, Air Canada reduced its capacity by 7.8% from Quarter 4 2007.

Compared to Quarter 4 2007, passenger revenues decreased $14 million or 0.6% to $2,182 million in Quarter 4 2008 due to a decline in traffic. In Quarter 4 2008, passenger revenues in North America decreased $47 million while passenger revenues in the international market increased $33 million compared to Quarter 4 2007. The decrease in overall passenger revenue as a result of a reduction in traffic was partly offset by additional revenue from increased fares and fuel surcharges. The capacity reduction on many routes also led to an improvement in the mix of economy fares which contributed to a higher average system yield. System yield improved 4.9% from Quarter 4 2007, mainly due to higher fares and increased fuel surcharges and a favourable foreign exchange impact from foreign denominated revenues. A more favourable fare mix in the economy cabin was also a factor in the yield improvement from Quarter 4 2007. A weaker Canadian dollar in Quarter 4 2008, which increases the Canadian dollar value of sales in foreign countries, had a positive impact on foreign currency denominated revenues, accounting for an increase of $35 million to fourth quarter 2008 passenger revenues compared to Quarter 4 2007. In Quarter 4 2008, a traffic decline of 5.3% was less than a capacity decrease of 7.8% resulting in a 2.1 percentage point improvement in passenger load factor from Quarter 4 2007. RASM increased 7.8% from Quarter 4 2007 due primarily to the growth in yield but also to the passenger load factor improvement.

Quarter 4 2008 cargo revenues amounted to $113 million and were $29 million or 20% below Quarter 4 2007. Reduced freighter revenues accounted for almost two thirds of the revenue decrease due to cancellation of freighter flying in 2008.

Other revenues of $203 million in Quarter 4 2008 increased $28 million or 16% from Quarter 4 2007, largely due to an increase of $21 million in aircraft sublease revenues, of which $5 million was due to the favourable impact of foreign exchange on US denominated sublease revenues.

Operating expenses were $2,644 million in Quarter 4 2008, an increase of $203 million or 8% from Quarter 4 2007. As Air Canada incurs significant expenses in US dollars such as fuel, aircraft maintenance and airport user fees, the significantly weaker Canadian dollar versus the US dollar was a major contributing factor to the increase in operating expenses in Quarter 4 2008, accounting for approximately $180 million in additional expense.

Including fuel expense, CASM increased 17.4% over Quarter 4 2007. Excluding fuel expense, CASM increased 9.9% over Quarter 4 2007. A significantly weaker Canadian dollar versus the US dollar compared to Quarter 4 2007, higher ownership costs reflecting Air Canada's investment in new aircraft and the aircraft interior refurbishment program in Quarter 4 2008 and the capacity reduction were factors in the year-over-year increase in CASM in Quarter 4 2008. A decrease of 5.4% in aircraft utilization and a reduction of 2.8% in average stage length were also contributing factors in the year-over-year increase in CASM compared to Quarter 4 2007.

Non-operating expense amounted to $44 million in Quarter 4 2008 compared to non-operating expense of $52 million in Quarter 4 2007. Gains relating to fair value adjustments on derivatives instruments amounted to $32 million in Quarter 4 2008 versus a loss of $1 million in the same quarter of 2007. For additional information on Air Canada's financial instruments, refer to section 12 of this MD&A. Net interest expense increased $24 million from Quarter 4 2007, reflecting a lower amount of capitalized interest related to new aircraft and a decrease in interest income due to both lower cash balances and lower rates of return. A decrease in interest expense, largely driven by lower financing costs on the Boeing 777 aircraft commitments due to the favourable impact of the pre-delivery financing arranged in Quarter 4 2007, lower interest rates on floating rate debt compared to Quarter 4 2007 was offset by the financing of additional aircraft year-over-year and the unfavourable impact of a weaker Canadian dollar versus the US dollar in Quarter 4 2008.

Net losses on foreign exchange amounted to $527 million in Quarter 4 2008 compared to gains of $20 million in Quarter 4 2007. The losses in Quarter 4 2008 were attributable to a weaker Canadian dollar at December 31, 2008 compared to September 30, 2008, partially offset by gains of $174 million related to foreign currency derivatives. The December 31, 2008 noon day exchange rate was US$1 = C$1.2246 while the September 30, 2008 noon day exchange rate was US$1 = C$1.0599.

Air Canada recorded a provision for income taxes of $6 million in Quarter 4 2008. The tax provision reflected future income tax that has been reclassified from other comprehensive income to income for realized gains on fuel derivatives. The recovery of future income taxes on the 2008 loss has been offset by a valuation allowance. The provision for income taxes was $2 million in Quarter 4 2007 as income tax was favourably impacted by a credit related to changes in federal corporate income tax rates during the period amounting to $12 million, after consideration of a valuation allowance.

A segment loss of $727 million was recorded in Quarter 4 2008 compared to segment income of $35 million in Quarter 4 2007.

7.2. Corporate Items and Eliminations ("CIE")

CIE includes the corporate, financing and investing activities of ACE. As previously discussed, the accounting for ACE's investment in ACTS Aero was changed in October 2007 from consolidation to the equity method of accounting reported under the CIE segment. Up until the time of deconsolidating ACTS, the CIE segment also included certain consolidation adjustments related to revenue recognition differences for maintenance services provided by ACTS (completed contract basis of accounting for engine and component maintenance services versus the expense recognition basis in Air Canada and Jazz, which is as the work is completed). In addition, consolidation adjustments were previously made related to the timing of revenue and expense recognition pertaining to power-by-the-hour contracts. Subsequent to the change in the accounting for ACE's investment in ACTS, these consolidation adjustments are no longer required.

CIE recorded an operating loss of $4 million in Quarter 4 2008 compared to an operating loss of $29 million in Quarter 4 2007. Negative EBITDAR of $6 million was recorded in Quarter 4 2008 compared to negative EBIDTAR of $30 million in Quarter 4 2007. Refer to section 19 "Non-GAAP Financial Measures".

In Quarter 4 2008, ACE recorded a provision for loss on disposal of $10 million related to its equity investment in ACTS Aero. As at December 31, 2008, ACE's investment in ACTS Aero has a carrying value of nil.

In Quarter 4 2007, ACE recorded gains on disposal of assets of $1,339 million, within the CIE segment, mainly comprised of the following transactions:

- A gain on disposal of $565 million related to the monetization of ACTS completed on October 16, 2007;
- A gain on disposal of $539 million related to the secondary offering of 22,000,000 trust units of Aeroplan Income Fund completed on October 22, 2007; and
- A gain on disposal of $233 million related to the secondary offering of 35,500,000 trust units of Jazz Air Income Fund completed on October 22, 2007.

An equity investment loss of $62 million was recorded in Quarter 4 2008 compared to equity investment income of $17 million in Quarter 4 2007, a deterioration of $79 million from Quarter 4 2007. The equity investment loss in Quarter 4 2008 represented ACE's proportionate share of losses recorded by ACTS Aero. The equity investment income recorded in Quarter 4 2007 represented equity accounting for ACE's investments in Aeroplan and Jazz and for its investment in ACTS Aero commencing on October 16, 2007.

In Quarter 4 2008, $180 million of the net loss was allocated to non-controlling interest compared to $6 million of net income being allocated to non-controlling interest in Quarter 4 2007. Quarter 4 2008 reflected the deterioration in Air Canada's net results compared to Quarter 4 2007.

8. Results of Operations – 2008

The following table reflects the results of the Corporation, the results of its reportable segments and certain non-GAAP measures for the year ended December 31, 2008. Segment information has been prepared consistent with how financial information is produced internally for the purposes of making business decisions. Refer to Note 16 "Segment Information" in ACE's 2008 audited consolidated financial statements for additional information.

(Canadian dollars in millions)	2008 Air Canada	CIE	ACE Total
Operating revenue			
Passenger revenue	$ 9,713	$ -	$ 9,713
Cargo revenue	515	-	515
Other revenue	854	(2)	852
	11,082	(2)	11,080
Operating expenses			
Aircraft fuel	3,419	-	3,419
Wages, salaries and benefits	1,877	31	1,908
Airport and navigation fees	1,001	-	1,001
Capacity purchase with Jazz	948	-	948
Depreciation, amortization and obsolescence	694	(8)	686
Aircraft maintenance	659	-	659
Food, beverages and supplies	314	-	314
Communications and information technology	286	-	286
Aircraft rent	279	-	279
Commissions	194	-	194
Other operating expenses	1,450	10	1,460
	11,121	33	11,154
Operating loss before under-noted item	**(39)**	**(35)**	**(74)**
Provision for cargo investigations	(125)	-	(125)
Operating loss	**(164)**	**(35)**	**(199)**
Non-operating income (expense)			
Interest income	57	27	84
Interest expense	(319)	(54)	(373)
Interest capitalized	37	-	37
Gain (loss) on assets	(34)	980	946
Gain on financial instruments recorded at fair value	92	-	92
Equity and other investment loss	-	(64)	(64)
Other non-operating income (expense)	(3)	1	(2)
	(170)	890	720
Income (loss) before the following items	**(334)**	**855**	**521**
Non-controlling interest	(12)	250	238
Foreign exchange loss	(655)	-	(655)
Provision for income taxes	(24)	(200)	(224)
Income (loss) for the year	**$ (1,025)**	**$ 905**	**$ (120)**
EBITDAR/EBITDA before the provision for cargo Investigations [(1)]	**$ 934**	**$ (43)**	**$ 891**
EBITDAR/EBITDA [(1)]	**$ 809**	**$ (43)**	**$ 766**

(1) Refer to section 19 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR before the provision for cargo investigations to operating income (loss) and EBITDAR/EBITDA to operating income (loss).

The following table reflects the results of the Corporation, the results of its reportable segments and certain non-GAAP measures for 2007.

(Canadian dollars in millions)	Air Canada	Aeroplan[1]	Jazz [2]	ACTS [3]	CIE	ACE Total
	2007					
Operating revenue						
Passenger revenue	$ 9,329	$ -	$ -	$ -	$ 15	$ 9,344
Cargo revenue	548	-	-	-	-	548
Other revenue	649	198	3	193	(109)	934
External revenue	10,526	198	3	193	(94)	10,826
Inter-segment revenue	120	3	610	604	(1,337)	-
	10,646	**201**	**613**	**797**	**(1,431)**	**10,826**
Operating expenses						
Aircraft fuel	2,552	-	125	-	(124)	2,553
Wages, salaries and benefits	1,920	17	139	272	35	2,383
Airport and navigation fees	1,022	-	80	-	(81)	1,021
Capacity purchase with Jazz	923	-	-	-	(386)	537
Depreciation, amortization and obsolescence	548	3	9	31	(9)	582
Aircraft maintenance	757	-	50	235	(527)	515
Food, beverages and supplies	313		6		(1)	318
Communications and information technology	275	7	2	13	(16)	281
Aircraft rent	282	-	57	-	(16)	323
Commissions	201	-	-	-	-	201
Special charge for labour restructuring	-	-	-	15	-	15
Other operating expenses	1,420	134	83	211	(204)	1,644
	10,213	**161**	**551**	**777**	**(1,329)**	**10,373**
Operating income (loss)	**433**	**40**	**62**	**20**	**(102)**	**453**
Non-operating income (expense)						
Interest income	92	3	2	-	29	126
Interest expense	(348)	(3)	(3)	(14)	(52)	(420)
Interest capitalized	108	-	-	-	-	108
Gain on assets	19	-	-	-	1,347	1,366
Gain on financial instruments recorded at fair value	26	-	-	-	-	26
Equity and other investment income [4]	-	-	-	-	71	71
Other non-operating income (expense)	(19)	(1)	1	(2)	9	(12)
	(122)	(1)	-	(16)	1,404	1,265
Income before the following items	**311**	**39**	**62**	**4**	**1,302**	**1,718**
Non-controlling interest	(9)	-	-	-	(148)	(157)
Foreign exchange gain (loss)	317	-	-	(4)	-	313
Provision for income taxes	(190)	-	-	-	(286)	(476)
Income for the year	**$ 429**	**$ 39**	**$ 62**	**$ -**	**$ 868**	**$ 1,398**
EBITDAR/EBITDA [5]	**$ 1,263**	**$ 43**	**$ 128**	**$ 51**	**$ (127)**	**$ 1,358**

(1) Reflects the consolidation of Aeroplan results from January 1 to March 13, 2007.
(2) Reflects the consolidation of Jazz results from January 1 to May 23, 2007.
(3) Reflects the consolidation of ACTS results from January 1 to October 15, 2007.
(4) Reflects ACE's investment in Aeroplan (from March 14, 2007 to December 31, 2007), in Jazz (from May 24, 2007 to December 31, 2007) and ACTS (from October 16, 2007 to December 31, 2007) using the equity method of accounting.
(5) Refer to section 19 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR/EBITDA to operating income (loss) and EBITDAR/EBITDA excluding special charge to operating income (loss).

As a result of a dilution in ACE's ownership interest in Aeroplan, Jazz and ACTS, ACE's results of operations for 2008 are not directly comparable to its operating results for 2007.

ACE recorded an operating loss of $74 million, before a provision for cargo investigations, in 2008 compared to operating income of $453 million in 2007. In 2008, Air Canada reported an operating loss of $39 million, before a provision for cargo investigations, compared to operating income of $433 million in 2007, a deterioration of $472 million compared to the same period in 2007. In 2008, Air Canada recorded a provision for cargo investigations of $125 million relating to alleged anti-competitive cargo pricing activities. ACE's consolidated results for 2007 included operating income from Aeroplan, Jazz and ACTS of $40 million, $62 million and $20 million, respectively. ACE recorded EBITDAR of $891 million, before the provision for cargo investigations, in 2008 compared to EBITDAR of $1,358 million in the same period in 2007. In 2008, Air Canada reported EBITDAR of $934 million, before the provision for cargo investigations, compared to EBITDAR of $1,263 million in the same period in 2007, a decrease of $329 million. In 2007, ACE's EBITDAR included EBITDAR from Aeroplan, Jazz and ACTS of $43 million, $128 million and $51 million, respectively. Refer to section 19 "Non-GAAP Financial Measures".

ACE recorded operating revenues of $11,080 million and operating expenses of $11,154 million in 2008. In the same period in 2007, ACE recorded operating revenues of $10,826 million and operating expenses of $10,373 million. As a result of the deconsolidation of Aeroplan, Jazz and ACTS, ACE's operating revenues and expenses for 2008 are not directly comparable to its operating revenues and expenses for 2007.

Non-operating income amounted to $720 million in 2008 compared to non-operating income of $1,265 million in 2007. In 2008, ACE recorded gains totalling $830 million on ACE's sale of Aeroplan Income Fund units, gains of $167 million on ACE's sale of Jazz Air Income Fund units and a provision for loss on disposal of $10 million related to ACE's equity investment in ACTS Aero. In addition, Air Canada recorded an impairment charge of $38 million related to the retirement of its fleet of Boeing 767-200 aircraft. In 2007, ACE recorded gains on disposal of assets totalling $1,366 million, mainly comprised of a gain of $565 million related to the monetization of ACTS, a gain of $539 million related to the sale of Aeroplan Income Fund units, a gain of $233 million related to the sale of Jazz Air Income Fund units and a gain of $8 million related to the sale of shares in US Airways. In addition, Air Canada recorded gains of $14 million related to a damaged aircraft and gains of $5 million mainly pertaining to the sale of one real estate property. Gains on financial instruments recorded at fair value amounted to $92 million in 2008 compared to gains of $26 million in 2007. For additional information on financial instruments, refer to section 12 of this MD&A.

An equity investment loss of $64 million was recorded in 2008 compared to equity investment income of $71 million in 2007, a deterioration of $135 million from 2007. The equity investment loss in 2008 represented ACE's proportionate share of losses recorded by ACTS Aero partly offset by equity and other investment income from Aeroplan and Jazz up to June 2008. The equity investment income recorded in 2007 represented equity accounting for ACE's investments in Aeroplan (from March 14, 2007 to December 31, 2007) and Jazz (from May 24, 2007 to December 31, 2007) and for its investment in ACTS Aero (from October 16, 2007 to December 31, 2007).

Net losses on foreign exchange amounted to $655 million in 2008 compared to gains of $313 million in 2007. The losses in 2008 were attributable to a weaker Canadian dollar at December 31, 2008 compared to December 31, 2007, partially offset by gains of $327 million related to foreign currency derivatives. The December 31, 2008 noon day exchange rate was US$1 = C$1.2246 while the December 31, 2007 noon day exchange rate was US$1 = C$0.9881.

In 2008, $238 million of the net loss was allocated to non-controlling interest compared to $157 million of net income being allocated to non-controlling interest in 2007. Non-controlling interest mainly reflected the deterioration in Air Canada's net results and, to a lesser extent, the change in accounting methodology for Aeroplan and Jazz.

A provision for income taxes of $224 million was recorded in 2008 and included $24 million related to Air Canada and $180 million related to the disposal of Aeroplan and Jazz units. A provision for income taxes of $476 million was recorded in 2007 and included $190 million related to Air Canada, $219 million related to the sale of aviation interests and $37 million related to the special distributions of Aeroplan and Jazz units.

In 2008, ACE recorded a net loss of $120 million or $(2.59) per diluted share. The net loss in 2008 included the significant gains on the disposal of the remaining units of Aeroplan Income Fund and Jazz Air Income Fund but this was more than offset by a deterioration in Air Canada's segment results including the provision for cargo investigations of $125 million recorded in Quarter 1 2008 and net losses on foreign exchange of $655 million. In 2007, ACE recorded net income of $1,398 million or $11.44 per diluted share. The net income in 2007 included the significant gains related to the monetization of ACTS and from the secondary offerings of both Aeroplan and Jazz.

8.1. Air Canada

In 2008, Air Canada reported an operating loss, before a provision for cargo investigations, of $39 million compared to operating income of $433 million in 2007, a deterioration of $472 million. An increase in operating revenues of $436 million or 4% was more than offset by a fuel expense increase of $867 million or 34%.

In 2008, EBITDAR, before the provision for cargo investigations, amounted to $934 million compared to EBITDAR of $1,263 million in the same period in 2007, a decrease of $329 million. Refer to section 19 "Non-GAAP Financial Measures".

In response to historically high fuel prices, on June 17, 2008, Air Canada announced capacity reductions for the fall and winter schedule. In the first half of 2008, Air Canada increased its capacity by 3.4% from the first half of 2007. In the second half of 2008, Air Canada reduced its capacity by 5.4% compared to the same period in 2007. ASM capacity for the full year 2008 decreased 1.2% from the full year 2007.

Compared to 2007, passenger revenues increased $384 million or 4.1% to $9,713 million in 2008 mainly due to increased fares and fuel surcharges to partially offset higher fuel prices. Passenger revenue growth was reflected in all markets with the exception of the US transborder market which showed a relatively small reduction in passenger revenues. System yield improved 4.3% from 2007, mainly due to higher fares and increased fuel surcharges to partially offset higher fuel prices. A more favourable fare mix in both the economy and premium cabins was also a factor in the yield improvement from 2007. A stronger Canadian dollar in 2008, which lowers the Canadian dollar value of sales in foreign countries, had a negative impact on foreign currency denominated revenues, accounting for a decrease of $111 million to 2008 passenger revenues compared to 2007. The traffic decline of 0.2% in 2008 was less than the capacity decrease of 1.2% resulting in a 0.8 percentage point improvement in passenger load factor from 2007. RASM increased 5.3% from 2007 due to the growth in yield and, to a lesser extent, the passenger load factor improvement.

2008 cargo revenues amounted to $515 million and were $33 million or 6% below 2007. Non-freighter revenues increased $23 million or 5%, reflecting higher revenues in international markets. Freighter revenues were down $58 million as Air Canada operated one MD-11 freighter aircraft to Europe in the first half of 2008 versus one MD-11 freighter to Europe for the full year 2007 and one freighter to Asia in the first half of 2007.

Other revenues of $854 million in 2008 increased $87 million or 11% from 2007 mainly due to higher aircraft sublease revenues of $61 million versus 2007 and an increase of $18 million in revenues at Air Canada Vacations, mainly as a result of higher passenger volumes compared to 2007.

Operating expenses were $11,121 million in 2008, an increase of $908 million or 9% from 2007, reflecting the significant fuel expense increase of $867 million and higher ownership costs of $143 million compared to the same period in 2007. These increases were partly offset by a reduction in aircraft maintenance expense of $98 million versus 2007.

Including fuel expense, CASM increased 10.2% over 2007. Excluding fuel expense, CASM increased 1.7% over 2007. Higher unit cost of ownership, reflecting Air Canada's investment in new aircraft and the aircraft interior refurbishment program, and the capacity reduction in the last half of 2008 were factors in the year-over-year increase in CASM, excluding fuel expense. A significant reduction in aircraft maintenance expense, the stronger Canadian dollar versus the US dollar for most of 2008 and unit cost savings related to the Boeing 777 aircraft partially offset the overall unit cost increase, excluding fuel expense.

Non-operating expense amounted to $170 million in 2008 compared to non-operating expense of $122 million in 2007. Gains relating to fair value adjustments on derivatives instruments amounted to $92 million in 2008 versus gains of $26 million in 2007. Net interest expense increased $77 million over the same period in 2007. A lower amount of capitalized interest related to new aircraft and a decrease in interest income largely due to lower cash balances and lower rates of return more than offset a $29 million decrease in interest expense. In 2008, Air Canada recorded an impairment charge of $38 million related to the retirement of its fleet of Boeing 767-200 aircraft. In 2007, Air Canada recorded a gain on disposal of $14 million from insurance proceeds relating to a CRJ-100 aircraft owned by Air Canada and leased to Jazz which was damaged beyond repair.

Net losses on foreign exchange amounted to $655 million in 2008 compared to gains of $317 million in 2007. The losses in 2008 were attributable to a weaker Canadian dollar at December 31, 2008 compared to December 31, 2007, partially offset by gains of $327 million related to foreign currency derivatives. The December 31, 2008 noon day exchange rate was US$1 = C$1.2246 while the December 31, 2007 noon day exchange rate was US$1 = C$0.9881.

Air Canada recorded a provision for income taxes of $24 million in 2008. The tax provision reflects future income tax that has been reclassified from other comprehensive income to income for realized gains on fuel derivatives. A potential recovery of future income taxes of $148 million on the current year loss has been offset by a valuation allowance. This compared to a provision for income taxes of $190 million, at an effective income tax rate of 31%, for the same period in 2007. The effective income tax rate for 2007 was favourably impacted by the capital portion of certain foreign exchange gains reported in the year, which were tax-affected at 50% of the income tax rate. In addition, the favourable impact of a reduction in the federal corporate income tax rate was recognized in 2007. In 2007, Air Canada also recorded a current tax expense of $10 million related to the harmonization of Ontario and federal income taxes. This change in tax law resulted in a tax liability of $10 million payable over a period of five years, beginning in 2010.

A segment loss of $1,025 million was recorded in 2008 compared to segment income of $429 million in 2007. The segment loss in 2008 included the provision for cargo investigations of $125 million and the net losses on foreign exchange of $655 million.

8.2. Corporate Items and Eliminations ("CIE")

CIE includes the corporate, financing and investing activities of ACE. As a result of the change in the accounting for ACE's investment in Aeroplan, effective March 14, 2007, certain consolidation adjustments relating to Aeroplan are no longer recorded in CIE. As previously discussed, the accounting for ACE's investment in ACTS was changed in October 2007 from consolidation to the equity method of accounting reported under the CIE segment. Up until the time of deconsolidating ACTS, the CIE segment also included certain consolidation adjustments related to revenue recognition differences for maintenance services provided by ACTS (completed contract basis of accounting for engine and component maintenance services versus the expense recognition basis in Air Canada and Jazz, which is as the work is completed). In addition, consolidation adjustments were previously made related to the timing of revenue and expense recognition pertaining to power-by-the-hour contracts. Subsequent to the change in the accounting for ACE's investment in ACTS, these consolidation adjustments are no longer required.

CIE recorded an operating loss of $35 million in 2008 compared to an operating loss of $102 million in 2007. Negative EBITDAR of $43 million was recorded in 2008 compared to negative EBIDTAR of $127 million in 2007. Refer to section 19 "Non-GAAP Financial Measures".

An equity investment loss of $64 million was recorded in 2008 compared to equity investment income of $71 million in 2007, a deterioration of $135 million from 2007. The equity investment loss in 2008 represented ACE's proportionate share of losses recorded by ACTS Aero partly offset by equity and other investment income from Aeroplan and Jazz up to June 2008. The equity investment income recorded in 2007 represented equity accounting for ACE's investments in Aeroplan (from March 14, 2007 to December 31, 2007) and Jazz (from May 24, 2007 to December 31, 2007) and for its investment in ACTS Aero (from October 16, 2007 to December 31, 2007).

In 2008, $250 million of the net loss was allocated to non-controlling interest compared to $148 million of net income being allocated to non-controlling interest in 2007. Non-controlling interest mainly reflected the deterioration in Air Canada's net results and, to a lesser extent, the change in accounting methodology for Aeroplan and Jazz.

The following gains and losses on disposals were recorded in CIE during 2008:

- Gains on disposal of $830 million related to the sale of units of Aeroplan Income Fund;
- Gains on disposal of $167 million related to the sale of units of Jazz Air Income Fund;
- A provision for loss on disposal of $10 million related to ACE's investment in ACTS Aero.

The following gains on disposals were recorded in CIE during 2007:

- A gain on disposal of $565 million related to the monetization of ACTS completed on October 16, 2007;
- A gain on disposal of $539 million related to the secondary offering of 22,000,000 units of Aeroplan Income Fund completed on October 22, 2007;
- A gain on disposal of $233 million related to the secondary offering of 35,500,000 units of Jazz Air Income Fund completed on October 22, 2007;
- A gain on disposal of $8 million related to the sale of 500,000 shares in US Airways.

9. Financial and Capital Management

The following table summarizes ACE's consolidated statement of financial position as at December 31, 2008 and as at December 31, 2007.

Condensed Consolidated Statement of Financial Position (Canadian dollars in millions)	**December 31, 2008**	**December 31, 2007**
Assets		
Cash, cash equivalents and short-term investments	$ 1,813	$ 3,139
Other current assets	1,396	1,465
Current assets	3,209	4,604
Property and equipment	7,469	7,925
Intangible assets	698	647
Deposits and other assets	495	578
	$ 11,871	**$ 13,754**
Liabilities		
Current liabilities	$ 3,882	$ 3,235
Long-term debt and capital leases	4,980	4,006
Pension and other benefits liabilities	1,407	1,824
Other long-term liabilities	626	715
	10,895	**9,780**
Non-controlling interest	**512**	**757**
Shareholders' equity	**464**	**3,217**
	$ 11,871	**$ 13,754**

9.1. Analysis of Financial Position

ACE

Cash, cash equivalents and short-term investments

Refer to section 9.2 of this MD&A for a discussion of the change in unconsolidated Cash, cash equivalents and short-term investments.

Non-controlling interest

ACE's non-controlling interest amounted to $512 million as at December 31, 2008, a reduction of $245 million from December 31, 2007. The change in non-controlling interest was mainly due to the non-controlling interests' share of the loss experienced by Air Canada in 2008. Refer to section 8.1 of this MD&A for a discussion of the 2008 Air Canada results of operations.

Shareholders' equity

ACE's shareholders' equity amounted to $464 million as at December 31, 2008, a reduction of $2,753 million from December 31, 2007. The change in shareholders' equity was mainly due to the substantial issuer bids where ACE accepted for purchase and cancellation a total of 52,560,511 Class A variable voting shares and 20,084,353 Class B voting shares for an aggregate purchase price of $1,998 million under the terms of the substantial issuer bids. These transactions are further described in section 9.7 of this MD&A. Refer to ACE's audited consolidated statement of changes in shareholders' equity for the detailed change in shareholders' equity.

Air Canada

Net assets of Air Canada declined $1,681 million during the year reflecting the loss for the year of $1,025 million and the loss in the fair value of Air Canada's fuel derivatives recorded in other comprehensive income. The loss for the year was significantly impacted by losses on Air Canada's US denominated debt and the provision for cargo investigations of $125 million.

Property and equipment amounted to $7,469 million at December 31, 2008, a reduction of $450 million from December 31, 2007, mainly due to the impact of depreciation expense of $646 million recorded during the year. In 2008, the impact of additions to capital assets of $883 million was largely offset by the disposal of assets related to the sale and leaseback of five Boeing 777 aircraft.

Long-term debt and capital leases, including the current portion, amounted to $5,354 million at December 31, 2008, an increase of $935 million from December 31, 2007. The increase was mainly due to a substantial depreciation of the Canadian dollar and the resulting impact on Air Canada's US denominated debt, which amounted to approximately $985 million. In 2008, the impact of additional borrowings of $871 million, which included new financings raised during the fourth quarter of 2008 amounting to $434 million, was more than offset by long-term debt and capital lease repayments of $992 million.

The decline in pension and other benefits liabilities of $417 million from December 31, 2007 was due to pension funding of $316 million in excess of pension expense and the reclassification of $132 million from pension and other benefits liabilities to current liabilities. Refer to section 9.4 of this MD&A for a discussion of Air Canada's pension funding obligations.

9.2. Consolidated Cash Flows

As previously discussed, ACE's results reflect the consolidation of Aeroplan's operations only up to March 14, 2007, the consolidation of Jazz's operations only up to May 24, 2007 and the consolidation of ACTS' operations only up to October 16, 2007.

The following table summarizes ACE's consolidated statement of cash flows for the indicated periods.

(Canadian dollars in millions)	Quarter 4					
	2008	2007	$ Change	2008	2007	$ Change
Cash from (used for) operating activities	$ (291)	$ 67	$ (343)	$ (110)	$ 637	$ (747)
Cash from (used for) financing activities	269	657	(388)	(2,095)	1,403	(3,498)
Cash from (used for) investing activities	8	598	(605)	1,212	(1,594)	2,806
Net change in cash and cash equivalents during the period	**(14)**	**1,322**	**(1,336)**	**(993)**	**446**	**(1,439)**
Cash and cash equivalents - Beginning of period *	**1,321**	**978**	**343**	**2,300**	**1,854**	**446**
Cash and cash equivalents - End of period *	**$ 1,307**	**$ 2,300**	**$ (993)**	**$ 1,307**	**$ 2,300**	**$ (993)**

** Cash and cash equivalents exclude Short-term investments of $506 as at December 31, 2008 ($839 as at December 31, 2007).*

ACE

The following summarizes significant transactions or factors which impacted ACE's unconsolidated cash and cash equivalents in 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 million, in accordance with the terms of a substantial issuer bid;
- ACE received cash proceeds of $40 million representing the full balance of funds held in escrow on closing of the monetization of ACTS on October 16, 2007;
- ACE received net proceeds of $97 million related to the sale of Jazz Air Income Fund units on January 21, 2008;
- ACE received net proceeds of $343 million related to the sale of Aeroplan Income Fund units on April 21, 2008;
- ACE received net proceeds of $85 million related to the sale of its remaining Jazz Air Income Fund units on June 2, 2008; and
- ACE received net proceeds of $349 million related to the sale of its remaining units of Aeroplan Income Fund on June 2, 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 million, in accordance with the terms of a substantial issuer bid; and
- In June 2008, an entity related to Grupo TACA exercised its put option and sold its 5% equity interest in ACTS Aero to ACE for $19 million.

The following summarizes significant transactions or factors which impacted ACE's unconsolidated cash, cash equivalents and short-term investments in 2007:

- ACE received net proceeds of $723 million related to the monetization of ACTS on October 16, 2007;
- ACE received net proceeds of $463 million related to the secondary offering of Aeroplan Income Fund on October 22, 2007;
- ACE received net proceeds of $263 million related to the secondary offering of Jazz Air Income Fund on October 22, 2007; and
- ACE received net proceeds of $16 million related to the sale of its remaining shares of US Airways.

In 2007, cash flows used for investing activities included the Jazz cash of $138 million which was removed from ACE's consolidated statement of financial position as a result of the deconsolidation of Jazz effective May 24, 2007.

In 2007, cash flows used for investing activities included cash payments of $53 million in connection with the acquisition of Aeroman, and the Aeroplan cash of $231 million which was removed from ACE's consolidated statement of financial position as a result of the deconsolidation of Aeroplan effective March 14, 2008.

Air Canada Liquidity

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. At July 31, 2009, cash, cash equivalents and short-term investments were $1.32 billion, or 13% of 2008 annual operating revenues.

Air Canada management believes that the significant events as described in section 5 of this MD&A 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 in section 5 of this MD&A, 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. Refer to section 9.3 of this MD&A for information on Air Canada's contractual obligations.

To date in 2009, including the significant events as discussed in section 5 of this MD&A, 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 in section 5 of this MD&A, 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

Refer to section 9.4 of this MD&A for a discussion on Air Canada's pension funding obligations.

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 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, cash equivalents and short-term investments) required to be maintained by Air Canada is reduced to $800 million (versus $1,300 million prior to the amendments) and Air Canada provides the processor with deposits, to be accumulated over time, and security. 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 million for two consecutive months, the unrestricted cash requirement increases to $1,100 million 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 million, 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 million, its obligation to provide deposits to the processor would be capped at an amount not in excess of $75 million, provided unrestricted cash is not less than $800 million. As at June 30, 2009, a deposit in the amount of $27 million had accumulated under these processing agreements, which has further increased to the above-referenced cap of $75 million as at July 31, 2009. Deposits under these processing agreements are reported in prepaid expenses and other current assets on ACE's consolidated statement of financial position.

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 section 14 of this MD&A. 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 Air Canada management's preliminary estimate.

Collateral deposits for fuel derivatives

The types of derivative instruments used by Air Canada within its hedging program, such as swaps and put options within collar structures, expose Air Canada to the potential of posting cash collateral deposits. The drastic decrease in fuel prices observed in the fourth quarter of 2008 resulted in a significant negative fair value for Air Canada's portfolio of fuel hedges. Once the fair value in favour of the counterparty of certain fuel derivatives exceeds Air Canada's credit thresholds with those counterparties, Air Canada is responsible for extending collateral to the counterparties. As at July 31, 2009, the total cash collateral deposits held by counterparties amounted to $99 million ($109 million at June 30, 2009, $181 million at March 31, 2009 and $328 million at December 31, 2008). Refer to section 12 of this MD&A for a discussion on fuel price risk.

9.3. Contractual Obligations

ACE

ACE's contractual obligation consists of its Convertible Senior Notes repayable on June 1, 2010 in the amount of $323 million which excludes the impact of the January 2009 substantial issuer bid described below. Reference to June 1, 2010 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. As at December 31, 2008, interest repayment obligations associated with the Convertible Senior Notes amount to $14 million in 2009 and $7 million in 2010.

In January, 2009, the Corporation completed a substantial issuer bid to purchase for cancellation 80% of its convertible senior notes outstanding as at December 31, 2008, at a purchase price of $900 dollars in cash for each $1,000 dollars principal amount of notes. The aggregate principal amount of the repurchased Convertible senior notes was $259. On January 21, 2009, the Corporation paid an aggregate purchase price of $233 for the notes tendered.

Air Canada

The table below provides Air Canada's current contractual obligations for 2009 for the next four years and after 2013.

(Canadian dollars in millions)	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
Interest repayment obligations (1)	312	273	231	199	166	504	1,685
Operating lease obligations (2)	416	398	354	331	293	860	2,652
Committed capital expenditures (3)	141	79	119	438	1,081	3,556	5,414
Total contractual obligations (4)	**$ 1,532**	**$ 1,235**	**$ 1,452**	**$ 1,506**	**$ 2,026**	**$ 7,398**	**$ 15,149**

(1) The interest repayment obligations relate to long-term debt, debt consolidated under AcG-15 and capital leases.
(2) The operating lease obligations above mainly relate to US dollar aircraft operating leases.
(3) The committed capital expenditures above mainly relate to US dollar aircraft-related expenditures. These expenditures also include purchases relating to system development costs, facilities and leasehold improvements.
(4) Total contractual obligations exclude commitments for goods and services required in the ordinary course of business. Also excluded are other long-term liabilities mainly due to reasons of uncertainty of timing of cash flows and items which are non-cash in nature.

Refer to section 9.4 below for information on Air Canada's pension plan funding obligations.

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, the Corporation 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. The Corporation contracts with certain third parties to provide residual value support for certain aircraft. If the Corporation is required to prepay lease obligations as a result of value tests, these amounts would be 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 million (US$731 million). The maximum payable amount declines over time to nil upon lease expiry. As the Corporation 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. However, there can be no assurance that aircraft fair values will not decrease in the future such that the Corporation would be required to prepay significant amounts.

Pro forma contractual obligations including the effects of the financing transactions which occurred subsequent to June 30, 2009 as described in section 5

ACE

In January, 2009, the Corporation completed a substantial issuer bid to purchase for cancellation 80% of its convertible senior notes outstanding as at December 31, 2008, at a purchase price of $900 dollars in cash for each $1,000 dollars principal amount of notes. The aggregate principal amount of the repurchased Convertible senior notes was $259. On January 21, 2009, the Corporation paid an aggregate purchase price of $233 for the notes tendered.

Following the substantial issuer bid described above, ACE's contractual obligation consists of its Convertible Senior Notes repayable on June 1, 2010 in the amount of $64 million. Reference to June 1, 2010 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. As at June 30, 2009, interest repayment obligations associated with the Convertible Senior Notes amount to $1 million for the remainder of 2009 and $1 million in 2010.

Air Canada

The table below provides Air Canada's current contractual obligations, including the effects of the financing transactions which occurred subsequent to June 30, 2009, for the remainder of 2009, for the next four years and after 2013.

(Canadian dollars in millions)	Remainder of 2009	2010	2011	2012	2013	Thereafter	Total
Long-term debt, capital leases and interest repayment obligations (1)	$ 290	$ 834	$ 1,079	$ 802	$ 846	$ 2,930	$ 6,781
Operating lease obligations (2)	159	365	324	304	269	804	2,225
Committed capital expenditures (3)	26	53	49	115	733	3,864	4,840
Total contractual obligations (4)	**$ 475**	**$ 1,252**	**$ 1,452**	**$ 1,221**	**$ 1,848**	**$ 7,598**	**$ 13,846**

(1) The interest repayment obligations relate to long-term debt, debt consolidated under AcG-15 and capital leases.
(2) The operating lease obligations above mainly relate to US dollar aircraft operating leases.
(3) The committed capital expenditures above mainly relate to US dollar aircraft-related expenditures. These expenditures also include purchases relating to system development costs, facilities and leasehold improvements.
(4) Total contractual obligations exclude commitments for goods and services required in the ordinary course of business. Also excluded are other long-term liabilities mainly due to reasons of uncertainty of timing of cash flows and items which are non-cash in nature.

9.4. Air Canada Pension Funding Obligations

Air Canada's cash pension funding contributions in 2008 and 2007 were as follows:

(Canadian dollars in millions)	2008	2007
Past service domestic registered plans	$ 189	$ 134
Current service domestic registered plans	165	160
Other pension arrangements (1)	102	84
Pension funding contributions	**$ 456**	**$ 378**

(1) Includes retirement compensation arrangements, supplemental plans and international plans.

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 million.

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 million, $175 million, and $225 million 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 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% 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 million, a decrease of $49 million versus 2008.

The following table provides Air Canada's pension funding obligations, on a cash basis, based on the Air Canada 2009 Pension Regulations as described above, for the remainder of 2009 as at June 30, 2009, for the full year 2009, for the next four years.

(Canadian dollars in millions)	Remainder of 2009	Full Year 2009	2010	2011	2012	2013
Past service domestic registered plans	$ 29	$ 140	$ -	$ 138	$ 173	$ 221
Current service domestic registered plans	108	188	161	165	170	175
Other pension arrangements (1)	49	79	78	79	81	83
Projected pension funding obligations	**$ 186**	**$ 407**	**$ 239**	**$ 382**	**$ 424**	**$ 479**

(1) Includes retirement compensation arrangements, supplemental plans and international plans.

In May 2009, Air Canada and Aeroplan reached an agreement with the Canadian Auto Workers (CAW) Local 2002, providing for a process for the approximately 750 Air Canada employees then working in the Aeroplan contact centres to choose to transition to employment at Aeroplan, effective June 1, 2009, or to remain employees of Air Canada. Employees at Air Canada work locations who become surplus to Air Canada's needs, due to employees then working at Aeroplan contact centres who are senior to them, choosing to remain employees of Air Canada, were given the option to transition to employment at Aeroplan. Certain employees at Air Canada work locations transitioning to Aeroplan will continue to work for Air Canada until, at the latest, October 4, 2009, due to Air Canada's operational needs. The date these employees become Aeroplan employees depends on the date they are released from employment with Air Canada. For those employees transitioning to Aeroplan, their service, which largely determines benefit levels under the Air Canada pension and other employee benefit plans, will cease to accrue as of the date of employment with Aeroplan.

Refer to section 5 of this MD&A for additional information.

9.5. Capital Management

ACE's Board of Directors approves ACE's objectives and policies for managing capital as the case may be. ACE views capital as the sum of parent company capital consisting of convertible senior notes, convertible preferred shares, non-controlling interest and shareholders' equity. This definition of capital used by management may not be comparable to measures presented by other public companies.

Capital managed by ACE, summarized from the consolidated statement of financial position as at December 31, 2008 and as at December 31, 2007 follows:

(Canadian dollars in millions)	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**

9.6. Air Canada Capital Expenditures and Related Financing Arrangements

Boeing
In November 2005, Air Canada concluded agreements with Boeing for the acquisition of Boeing 777 and Boeing 787 aircraft.

As at December 31, 2008, 15 of the 16 Boeing 777 firm aircraft under the purchase agreement with Boeing had been delivered, with the remaining firm aircraft delivery expected in the first quarter of 2009. The seven aircraft delivered in 2007 were financed under a loan guarantee facility with the Export-Import Bank of the United States ("EXIM"). In January 2008, the Corporation received a commitment for loan guarantee support from EXIM for all nine 2008 Boeing 777 firm aircraft deliveries. The loan guarantee, subject to certain conditions, covers a 12-year loan term for 85% of the capital expenditure at an interest rate based on a floating rate. As at February 12, 2009, eight of the nine 2008 Boeing 777 aircraft have been delivered, three of these aircraft were financed using the EXIM facility and the other five aircraft were, concurrently with their purchase, sold by and leased back to Air Canada. The five leases are accounted for as operating leases with 12-year terms. All leases are at market rates at their inception date. These sale and leaseback transactions replace an equivalent number of aircraft loan guarantee commitments provided by EXIM. The table below assumes that Air Canada's remaining Boeing 777 firm aircraft expected for delivery in 2009 will be financed under the loan guarantee facility with EXIM.

In July 2009, the Corporation expects to take delivery of one Boeing 777-300ER aircraft on a 10-year operating lease.

Boeing notified Air Canada that its first Boeing 787 aircraft originally scheduled for delivery in February 2010 has been rescheduled for delivery for the second half of 2012, with additional deliveries, originally scheduled for completion between 2010 and 2014, being delayed by approximately three years. Air Canada will be seeking compensation from Boeing. Air Canada is evaluating alternatives to mitigate any potential impact of this delay.

As at June 30, 2009, Air Canada had outstanding purchase commitments with The Boeing Company ("Boeing") for the acquisition of 37 Boeing 787 aircraft. Subsequent to June 30, 2009, Air Canada and Boeing agreed to amend the purchase agreement for the Boeing 787 aircraft to reduce the number of options for Boeing 787 aircraft by ten, from 23 to 13, and to provide for purchase rights for ten Boeing 787 aircraft. Air Canada continues to have 37 firm orders for Boeing 787 aircraft. Air Canada and Boeing also agreed to amend certain commercial terms, including to revise delivery dates and to provide for certain financial adjustments. Air Canada's first Boeing 787 aircraft is now scheduled for delivery in the second half of 2013. Air Canada continues to hold purchase rights for 18 Boeing 777 aircraft.

Projected Planned and Committed Capital Expenditures

The table below provides Air Canada's current projected planned and committed capital expenditures for 2009, for the next four years and after 2013.

(Canadian dollars in millions)	2009	2010	2011	2012	2013	Thereafter
Projected committed expenditures	$ 141	$ 79	$ 119	$ 438	$ 1,081	$ 3,556
Projected planned but uncommitted expenditures	108	118	72	121	111	
Total projected expenditures (1) (2)	249	197	191	559	1,192	
Projected financing on committed expenditures	(130)	-	-	(315)	(862)	
Total projected expenditures, net of financing	**$ 119**	**$ 197**	**$ 191**	**$ 244**	**$ 330**	

(1) US dollar amounts are converted using the December 31, 2008 noon day exchange rate of US$1 = C$1.2246. Final aircraft delivery prices include estimated escalation and interest on deferred delivery payments, which is calculated based on the 90-day USD LIBOR rate at December 31, 2008.
(2) The dollar amounts reflected above do not include obligations pertaining to day-to-day operations.

Pro forma projected planned and committed capital expenditures including the effects of the financing transactions which occurred subsequent to June 30, 2009 as described in section 5

The table below provides Air Canada's current projected, planned and committed capital expenditures, including the effects of the financing transactions which occurred subsequent to June 30, 2009, for the remainder of 2009, for the next four years and after 2013.

(Canadian dollars in millions)	Remainder of 2009	2010	2011	2012	2013	Thereafter
Projected committed expenditures	$ 26	$ 53	$ 49	$ 115	$ 733	$ 3,864
Projected planned but uncommitted expenditures	51	77	80	132	112	
Total projected expenditures [1] [2]	77	130	129	247	845	
Projected financing on committed expenditures	-	-	-	-	(584)	
Total projected expenditures, net of financing	**$ 77**	**$ 130**	**$ 129**	**$ 247**	**$ 261**	

(1) US dollar amounts are converted using the July 31, 2009 noon day exchange rate of US$1 = C$1.0790 Final aircraft delivery prices include estimated escalation and interest on deferred delivery payments.

(2) The dollar amounts reflected above do not include obligations pertaining to day-to-day operations.

9.7. Share Information

At July 31, 2009, the issued and outstanding common shares of ACE, along with common shares potentially issuable, pursuant to convertible preferred shares, convertible senior notes and stock options were as follows:

Number of shares (000)	July 31, 2009	December 31, 2008
Issued and outstanding common shares		
Class A variable voting shares	25,680	25,614
Class B voting shares	10,011	9,293
Total issued and outstanding common shares	**35,691**	**34,907**
Common shares potentially issuable		
Convertible preferred shares	3,125	11,863
Convertible senior notes	2,600	13,133
Stock options	58	61
Total common shares potentially issuable	**5,783**	**25,057**
Total outstanding and potentially issuable common shares	**41,474**	**59,964**

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 million under the terms of a substantial issuer bid. No convertible preferred shares of ACE were deposited on an "as converted basis" under the offer.

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.

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 million, 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.

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.

Substantial Issuer Bids – January 2009

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.

Substantial Issuer Bid – March 2009

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.

10. Related Party Transactions

At December 31, 2008 ACE has a 75% ownership interest (75% ownership interest as at August 7, 2009) 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 (28.4% interest as at August 7, 2009) 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.

Summary of Significant Related Party Agreements

The Relationship between Air Canada and Aveos

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

Pension and Benefits Agreement

Air Canada, ACTS and Aveos 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 and who became employees of Aveos on October 16, 2007 and (ii) those 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 (i.e. Aveos) upon closing of the ACTS Sale). Under the Pension and Benefits Agreement, 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) (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 are to 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 Aveos 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 are to 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 described further 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 will 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 initially totaled $101 million, subject to adjustment once the exact amounts of the relevant solvency deficiencies and accounting liabilities as at October 16, 2007 were 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 Aveos. 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 also agreed to temporarily cancel certain letters of credit in the amount of $40 million. 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.

In 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. On January 8, 2009, these same parties entered into a Memorandum of Agreement (the "Transition MOA") in order to resolve certain remaining issues and in order to (i) facilitate the orderly transition of certain Air Canada employees to Aveos and (ii) to establish terms and conditions of employment that will apply to those Air Canada employees who elect to become employees of 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 a 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. Generally described, repair schemes are processes and methods which may be used in the maintenance and repair of aircraft and related equipment. The Non-Compete and Repair Schemes Transfer 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 Air Canada's plan of arrangement under the CCAA, Air Canada had already granted ACTS full and exclusive right to these schemes on a royalty free basis.

The Non-Compete and Repair Schemes Transfer 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 Non-Compete and Repair Schemes Transfer 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 million.

The Non-Compete and Repair Schemes Transfer Agreement was assigned to Aveos upon closing of the ACTS sale.

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 million and is offset by the impact of extended payment terms to Aveos of $22 million, for a net cash flow benefit of $18 million to Air Canada.

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.

In 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.

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 "Aveos 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 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 million 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.

The Relationship between ACE and Air Canada

Master Services Agreement
Air Canada provides certain administrative services to ACE in return for a fee. Such services relate to finance and accounting, information technology, human resources and other administrative services.

Non-recurring transactions

ACTS LP
In 2008, ACTS LP settled certain contracts with Air Canada for $11 million, 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 million recorded in non-controlling interest.

Share Purchase Rights Sold by Air Canada to ACE
In 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 the 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 owned Airbus A319 aircraft, which was completed in 2008. Air Canada sold the right to acquire the shares received from the unrelated third party to ACE, for proceeds of $1 million.

Warrants purchased from ACE
In 2007, Air Canada purchased certain share warrants held by ACE for consideration of $4 million. 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.

Purchase of Air Canada Vacations
In 2007, ACE sold its remaining 49% interest in Air Canada Vacations to Air Canada for proceeds of $10 million. 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 million related to the non-controlling interest in Air Canada in other non-operating income (expense).

Air Canada Credit Facility
ACE is a participant lender in the Credit Facility as described in section 5 of this MD&A. ACE's participation in the Credit Facility amounts to $150 million of the outstanding loan of $600 million as at July 31, 2009. The participant lenders participate on a pro-rata basis with respect to any warrants and principal and interest payments.

Revenues and expenses with related parties are summarized as follows:

(Canadian dollars in millions)	Quarter 4 2008	2008
Revenues		
Property rental revenues (Aveos)	$ 7	$ 29
Revenues from information technology services (Aveos)	4	15
Revenues from corporate services and other (Aveos)	(8)	12
	$ 3	**$ 56**
Expenses		
Maintenance expense for services (Aveos)	$ 110	$ 478
Recovery of wages, salary and benefit expense for employees assigned to Aveos	(57)	(249)
Other	1	1
	$ 54	**$ 230**

11. Off-Balance Sheet Arrangements

The following is a summary of Air Canada's more significant off-balance sheet arrangements.

Guarantees

Performance Obligations Relating to Aircraft Leasing Agreements
With respect to 45 Air Canada aircraft leases, 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, this difference plus interest will become due and payable 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 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 was approximately $127 million as at December 31, 2008 ($119 million as at December 31, 2007), 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's 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 or similar extra-contractual liabilities that arise out of or relate to the Corporation'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 and similar extra-contractual liabilities and certain related contractual indemnities described above.

12. Financial Instruments and Risk Management

The Corporation adopted Canadian Institute of Chartered Accountants ("CICA") sections 3862 and 3863 effective January 1, 2008. These new standards enhance disclosures with respect to financial instruments.

The following discusses matters related to the Corporation's 75% equity investment in Air Canada. For a description of additional risks relating to ACE and Air Canada, see section 14 of this MD&A.

Risk Management
Air Canada is exposed to the following risks as a result of holding financial instruments: market risk, credit risk, fuel price risk, interest rate risk, foreign exchange risk and liquidity risk. The following is a description of these risks and how they are managed by Air Canada.

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.

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.

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, cash equivalents and short-term investments and accounts receivable as well as collateral deposits for fuel derivatives extended to counterparties. Cash 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.

As of January 31, 2009, Air Canada had $158 million in collateral deposits extended to fuel hedge counterparties ($328 million as of December 31, 2008).

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

Fuel Price Risk
Air Canada enters into derivative contracts with financial intermediaries. Throughout 2008, a systematic hedging strategy was applied by adding hedging positions on a regular basis. There are regular reviews to adjust the strategy in light of market changes. During 2008, fuel prices experienced extreme volatility and declined from a peak of US$145 per barrel of WTI crude oil in mid-2008 to US$34 per barrel of WTI crude oil in December 2008, which triggered collateral deposit requirements. Air Canada does not purchase or hold any derivative financial instruments for trading purposes.

As of December 31, 2008, approximately 35% of Air Canada's anticipated purchases of fuel for 2009 are hedged at an average WTI-equivalent capped price of US$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.

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

At December 31, 2008				
Derivative Instruments	**Term**	**Volume (BBLs)**	**WTI-equivalent Average Floor Price (US$ per barrel)**	**WTI-equivalent Average Capped Price (US$ per barrel)**
Call Options (1)	2009	1,620,000	n/a	127
Swaps (1)	2009	1,455,000	100	100
	2010	1,250,000	100	100
Collars (1)	2009	4,760,000	82	92
	2010	1,960,000	106	116
Put options (2)	2009	1,200,000	40	n/a

(1) 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 oil prices decrease below the average floor price.

(2) Given the recent significant decrease in oil prices, Air Canada also 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 prices decrease, therefore offsetting in part the exposure on the total portfolio and limiting the collateral requirements. The premium paid related to these contracts was $4 million (US$3 million).

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 ("Accumulated Other Comprehensive Income") 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. Air Canada also holds certain fuel derivative instruments that do not qualify for hedge accounting, but which still constitute good economic hedges. These contracts, classified as economic hedges, are recorded at fair value at each balance sheet date and the change in fair value is recognized in non-operating income (expense) when it occurs.

At December 31, 2008, the fair value of the outstanding fuel derivatives was $420 million in favour of the counterparties ($77 million in favour of Air Canada in 2007). Fuel derivatives include both derivatives designated and not designated under fuel hedge accounting and are recorded within current liabilities on Air Canada's consolidated statement of financial position. In 2008, the total decrease in the fair value of Air Canada's fuel derivatives amounted to $531 million in 2008 (a gain of $160 million in 2007). Of the fair value loss, a loss of $606 million was recorded in other comprehensive income ("OCI") and the remaining $74 million was recorded as a gain in non-operating income (expense) in 2008.

The accounting treatment in either OCI or non-operating expense, as described above, does not alter the economic impact of Air Canada's fuel hedging program. During 2008, the fuel derivative contracts matured with a fair value in favour of Air Canada for $129 million ($61 million in 2007) generating cash inflows which helped Air Canada, along with fuel surcharges, managing the significant jet fuel price increases it faced in the first half of 2008. The benefit to fuel expense was $79 million in 2008 ($36 million in 2007).

During 2008, fuel derivative contracts were terminated with fair values in favour of the counterparties for $160 million. 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. As at December 31, 2008, the balance in AOCI was $606 million. 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 million before tax.

Subsequent to December 31, 2008, Air Canada modified its fuel hedge portfolio with the termination of swap and put option contracts for cash settlements of $156 million under hedge accounting and $16 million not under hedge accounting, both in favour of the counterparty. 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.

As of June 30, 2009, approximately 28% of Air Canada's anticipated purchases of jet fuel for the remainder of 2009 are hedged at an average West Texas Intermediate ("WTI")-equivalent capped price of US$106 per barrel, of which 52% is subject to an average WTI-equivalent floor price of US$83 per barrel. Air Canada has also hedged approximately 13% of its 2010 anticipated jet fuel purchases in crude oil-based contracts hedged at an average capped price of US$110 per barrel, of which 87% is subject to an average floor price of US$101 per barrel.

The following table outlines the notional volumes per barrel outstanding at June 30, 2009, 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 WTI using the forward prices for WTI, heating oil, and jet fuel as at June 30, 2009.

Outstanding at June 30, 2009				
Derivative Instruments	**Term**	**Volume (BBLs)**	**WTI-equivalent Average Floor Price (US$ per barrel)**	**WTI-equivalent Average Capped Price (US$ per barrel)**
Call Options [(1)]	2009	1,600,000	n/a	121
	2010	400,000	n/a	134
Swaps [(1)]	2009	570,000	99	99
	2010	1,070,000	99	99
Collars [(1)]	2009	1,140,000	75	87
	2010	1,560,000	102	112

(1) 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 oil prices decrease below the average floor 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 causing 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 was 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 in 2008:

- In 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 aircraft financing with an aggregate notional value of $300 million (US$283 million). 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. In 2008, a gain of $4 million 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 million 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 Boeing 767 aircraft financing agreements with an aggregate notional value of $118 million (US$96 million) ($103 million (US$104 million) in 2007). 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 million in favour of Air Canada ($7 million in favour of Air Canada in 2007). These derivative instruments have not been designated as hedges for accounting purposes and are fair valued on a quarterly basis. In 2008, a gain of $14 million was recorded in gain on financial instruments recorded at fair value related to these derivatives ($3 million in 2007).

- 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. In 2006, Air Canada entered into 19 interest rate swaps with a notional value of US$414 million 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 settled the interest rate swaps upon delivery of the related aircraft. Air Canada did not apply hedge accounting to these derivative instruments. During 2008, Air Canada's one remaining Embraer 190 aircraft interest rate swap contract matured, with a fair value of $2 million in favour of the counterparty ($2 million in favour of the counterparty in 2007). No gain or loss was recorded in 2008 (a net loss of $10 million on 11 contracts was recorded in 2007).

Interest income includes $47 million in 2008 ($84 million in 2007) related to cash, cash equivalents, short-term investments and collateral deposits for fuel derivatives which are classified as held-for-trading. Interest expense reflected on Air Canada's 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 an annual US dollar shortfall from operations. 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. As a result of the significant drop in the price of fuel, Air Canada's US dollar requirements have also declined proportionally.
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 subleased 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 Quarter 4 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 in 2008 and as at January 31, 2009:

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 million (US$516 million) and $5 million (EUR 3 million) which mature in 2009 and 2010 (2007 - $2,132 million (US$2,158 million) and $26 million (EUR 18 million) of future purchases in 2008 and 2009). The fair value of these foreign currency contracts as at December 31, 2008 was $64 million in favour of Air Canada (2007 - $124 million 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. In 2008, a gain of $327 million was recorded in foreign exchange gain (loss) related to these derivatives (2007 - $(221) million loss).

As at January 31, 2009, Air Canada had entered into foreign currency forward contracts and option agreements converting US dollars and Euros into Canadian dollars on $367 million (US$297 million) and $5 million (EUR 3 million) which mature in 2009 and 2010. The fair value of these foreign currency contracts as at January 31, 2009 was $51 million 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.

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 million (US$283 million).

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 million in favour of Air Canada for five agreements). No gain or loss was recorded during the period (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 million (US$79 million). These were not designated as hedges for hedge accounting purposes.

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.

For additional information on Air Canada's liquidity risks, refer to section 9.2 of this MD&A.

13. Critical Accounting Estimates

Critical accounting estimates are those that are most important to the portrayal of the Corporation's financial condition and results of operations. They require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Actual results could differ from those estimates under different assumptions or conditions. The Corporation has identified the following areas that contain critical accounting estimates utilized in the preparation of its consolidated financial statements:

Passenger and Cargo Revenues
Air Canada 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 the Corporation and purchases seats from Air Canada under the Aeroplan Commercial Participation and Services Agreement ("Aeroplan CPSA"). 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.

The Corporation 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.

Employee Future Benefits
Air Canada maintains several defined benefit and defined contribution plans providing pension, other retirement and post-employment benefits to its employees, certain employees who are contractually assigned to Aveos 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. The Corporation's audited consolidated financial statements for 2008 include all of the assets and liabilities of all the sponsored plans of the Corporation. Employee benefits expense reflects a cost recovery which is charged to Aveos and Aeroplan, for those employees who are contractually assigned, and to ACE, for those employees currently performing work for their benefit. 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. The cost recovery amounted to $40 million for the year ended December 31, 2008 ($40 million for the year ended December 31, 2007).

Management makes a number of assumptions in the calculation of both the accrued benefit obligation as well as the pension costs:

	December 31, 2008	December 31, 2007
Weighted average assumptions used to determine the accrued benefit liability		
Discount rate	7.35%	5.75%
Rate of compensation increase (1)	2.50%	2.50%
Weighted average assumptions used to determine the accrued benefit cost		
Discount rate	5.75%	5.00%
Expected long-term rate	7.15%	7.15%
Rate of compensation increase (2)	2.50%	2.50%

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

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 million to the pension obligation and $10 million to the pension expense. A decrease of 0.25% results in an increase of $313 million to the pension obligation and $9 million to the pension expense.

Expected Return on Assets Assumption
Air Canada's expected long-term rate of return on assets assumption is selected based on the facts and circumstances that existed 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. A sensitivity analysis on pension expense assuming a change in the expected return on plan assets is provided below.

Asset Allocation
The composition of the domestic registered plan assets and the target allocation consists of the following:

	2008	2007	Target allocation
Equity	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%
Total	**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 (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, fixed income 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.

The Corporation's 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. Management reviewed anticipated future long-term performance of individual asset categories and considered the asset allocation strategy adopted by the Corporation, 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. While the review considers recent fund performance and historical returns, the assumption is primarily a long-term, prospective rate.

Sensitivity Analysis

Sensitivity analysis on the 2008 pension expense based on different actuarial assumptions with respect to discount rate and expected return on plan assets is as follows:

	0.25 percentage point	
Impact on 2008 pension expense in $ millions	**Decrease**	**Increase**
Discount rate on obligation assumption	$ 9	$ (9)
Long-term rate of return on plan assets assumption	$ 28	$ (28)

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 2007 (9.25% was assumed for 2007). 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 million and the obligation by $16 million. A one percentage point decrease in assumed health care trend rates would have decreased the service and interest costs by $1 million and the obligation by $21 million.

Income Taxes

The Corporation utilizes the assets and liability method of accounting for income taxes under which future income tax assets and liabilities are recognized for the estimated future income tax consequences attributable to differences between the financial statement carrying value amount and the tax basis of assets and liabilities. Management uses judgment and estimates in determining the appropriate rates and amounts in recording future taxes, giving consideration to timing and probability. Actual taxes could significantly vary from these estimates as a result of future events, including changes in income tax law or the outcome of reviews by tax authorities and related appeals. The resolution of these uncertainties and the associated final taxes may result in adjustment to the Corporation's tax assets and tax liabilities.

Future income tax assets are recognized to the extent that realization is considered more likely than not. The Corporation considers past results, current trends and outlooks for future years in assessing realization of income tax assets.

Cash Tax Projections
As at December 31, 2008, the Corporation has substantial tax attributes in the form of loss carry forwards and other tax attributes to shelter future taxable income. These tax attributes are expected to continue to increase over the next several years due to capital expenditures related to aircraft acquisitions. The Corporation does not forecast having any significant current taxes payable within the foreseeable future.

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 value 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 of long-lived assets 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.

Fair value under Canadian GAAP is defined as "the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act". Assessing the fair value of intangible assets requires significant management estimates on discount rates to be applied in the analysis and future cash flows to be generated by the assets, including the estimated useful life of the assets. Discount rates are determined with reference to estimated risk adjusted market rates of return for similar cash flows and were increased in 2008 reflecting a higher risk premium. The Corporation performs sensitivity analysis on the discount rates applied. The discount rates used are subject to measurement uncertainty.

Property and Equipment
Property and equipment is originally 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 within variable interest entities are depreciated to estimated residual values over the life of the lease. Air Canada's 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 three to five 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 five years. Ground and other equipment is depreciated over three to 25 years.

Aircraft depreciable life is determined through economic analysis, a review of existing fleet plans and comparisons to other airlines operating similar fleet types. Residual values are estimated based on the Corporation's historical experience with regard to the sale of aircraft and spare parts, as well as forward-looking valuations prepared by independent third parties.

Intangible Assets
The identifiable intangible assets of the Corporation were recorded at their estimated fair values at September 30, 2004 upon emergence from CCAA. Since that time, the intangible assets have been reduced by a tax allocation of $914 million. Indefinite-life intangible assets are subject to impairment tests under Canadian GAAP 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.

14. Risk Factors

The risks described herein may not be the only risks faced by the Corporation. Other risks which the Corporation is not aware of or which the Corporation currently deems to be immaterial may surface and have a material adverse impact on the Corporation's business, results from operations and financial condition.

Risks Related to ACE

Dependence upon Principal Investment
ACE is a holding company of various aviation interests, including Air Canada which is its principal investment. The value of ACE's interest in Air Canada is subject to market conditions based on the financial performance of Air Canada, movements in the price of publicly-traded airline stocks and general market conditions. Any decrease in the market price of Air Canada shares will reduce the value of these shares which can be realized.

Canada Revenue Agency Advance Tax Ruling Re: Part VI.1 Tax on Purchase/Redemption of Preferred Shares
ACE has obtained an advance income tax ruling from Canada Revenue Agency ("CRA") dated December 8, 2008 which provides that the purchase structure to be used does not result in "taxable preferred shares" or "short-term preferred shares" being purchased, which could have resulted in Part VI.1 tax being payable by ACE upon the purchase or redemption of its Preferred Shares at a tax rate of 50% of the purchase or redemption price.

If ACE does not purchase the remaining Preferred Shares under an appropriate purchase structure, ACE could be subject to Part VI.1 tax on settlement of certain Preferred Shares which would reduce the amount available for distribution to the stakeholders under a plan of arrangement.

A Substantial Portion of ACE's Cash is Invested in Cash Equivalents
A substantial portion of ACE's cash is invested in cash equivalents which are subject to credit exposure and interest rate fluctuations which could change the value of these investments. These investments are made in accordance with an investment policy approved by the Board of Directors. Although ACE's investment policy is designed to provide for short-term liquidity and low levels of risk, such investments are subject to credit exposure and interest rate fluctuations. Consequently, the value of such investments could increase or decrease accordingly. Any decrease in the fair value of these investments would reduce the amount available for distribution to the stakeholders under a plan of arrangement.

Going Concern
As a result of ACE's intention, announced on December 10, 2008, to seek court and shareholder approvals for a plan of arrangement pursuant to which ACE will be liquidated, ACE changed its basis of presentation from going concern to liquidation and filed its financial statements on that basis on February 13, 2009.

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

If ACE subsequently proceeds with the liquidation of its net assets, ACE will again adopt a liquidation basis of presentation which will result in net assets in liquidation being presented on a nonconsolidated basis.

Risks Related to Air Canada

Operating Results

Prior to emergence from its restructuring under the CCAA on September 30, 2004, Air Canada had sustained significant losses and Air Canada may sustain significant losses in the future. In 2008, Air Canada recorded an operating loss before a provision for cargo investigations of $39 million. Current economic conditions may result in significant losses for Air Canada. Despite ongoing business initiatives and efforts at securing cost reductions and additional sources of financing, Air Canada may not be able to successfully achieve positive net profitability or realize the objectives of any or all of its initiatives, including those which seek to offset or mitigate risks facing Air Canada, including those relating to economic conditions, liquidity, pension funding, unexpected volatility in fuel costs and other expenses.

Leverage

Air Canada has, and is expected to continue to have and incur, a significant amount of indebtedness, including substantial fixed obligations under aircraft leases and financings, and as a result of challenging economic or other conditions affecting Air Canada, Air Canada may incur greater levels of indebtedness. The amount of indebtedness that Air Canada currently has and which it may incur in the future could have a material adverse effect on Air Canada, for example, by (i) limiting Air Canada's ability to obtain additional financing, (ii) requiring Air Canada to dedicate a substantial portion of its cash flow from operations to payments on its indebtedness and fixed cost obligations, thereby reducing the funds available for other purposes, (iii) making Air Canada more vulnerable to economic downturns, and (iv) limiting Air Canada's flexibility in planning for, or reacting to, competitive pressures or changes in its business environment.

The ability of Air Canada to make scheduled payments under its indebtedness will depend on, among other things, its future operating performance and its ability to refinance its indebtedness, if necessary. Each of these factors is, to a large extent, subject to economic, financial, competitive, regulatory, operational and other factors, many of which are beyond Air Canada's control. In addition, as Air Canada incurs indebtedness which bears interest at fluctuating interest rates, to the extent these interest rates increase, its interest expense will increase. There can be no assurance that Air Canada will be able to generate sufficient cash from its operations to pay its debts and lease obligations.

Need for Additional Capital and Liquidity

Air Canada faces a number of challenges in its business, including in relation to economic conditions, pension plan funding, volatile fuel prices, contractual covenants which could require Air Canada to deposit cash collateral with third parties, foreign exchange rates and increased competition from international, transborder and low-cost domestic carriers. Air Canada's liquidity levels may be adversely impacted by these as well as by other factors and risks identified throughout this MD&A. As part of Air Canada's efforts to meet such challenges and to support Air Canada's business strategy, significant liquidity and significant operating and capital expenditures are, and will in the future be, required. There can be no assurance that Air Canada will continue to be able to obtain on a timely basis sufficient funds on terms acceptable to Air Canada to provide adequate liquidity and to finance the operating and capital expenditures necessary to overcome challenges and support its business strategy if cash flows from operations and cash on hand are insufficient.

Failure to generate additional funds, whether from operations or additional debt or equity financings, could require Air Canada to delay or abandon some or all of its anticipated expenditures or to modify its business strategy and could have a material adverse effect on Air Canada's business, results from operations and financial condition. Furthermore, competitors with greater liquidity or their ability to raise money more easily and on less onerous terms could create a competitive disadvantage for Air Canada.

Air Canada's credit ratings influence its ability to access capital markets and its liquidity. There can be no assurance that Air Canada's credit ratings will not be downgraded, which would add to Air Canada's borrowing and insurance costs, hamper its ability to attract capital, adversely impact its liquidity, and limit its ability to operate its business, all of which could have a material adverse effect on Air Canada's business, results from operations and financial condition.

Pension Plans
Canadian federal pension legislation requires that the funded status of registered pension plans be determined periodically, on both a going concern basis (essentially assuming indefinite plan continuation) and a solvency basis (essentially assuming immediate plan termination).

In May 2004, Air Canada and OSFI agreed on a protocol pursuant to which the solvency funding requirements for Air Canada's registered pension plans provided for in the then-existing federal regulations were amended with effect retroactive to January 1, 2004. Air Canada is required to make substantial annual cash contributions, and the level of those contributions increases in the event of poor pension fund investment performance and/or further declines in long-term Government of Canada bond rates. Under funded pension plans or a failure or inability by Air Canada to make required cash contributions to its registered pension plans could have a material adverse effect on Air Canada's business, results from operations and financial condition.

The solvency deficit is influenced primarily by long-term interest rates and by the investment return on plan assets, which in turn may be dependant on a variety of factors, including economic conditions. The interest rate used to calculate benefit obligations for solvency purposes is a prescribed rate derived from the interest rates on long-term Government of Canada bonds. Deteriorating economic conditions may result in significant increases in Air Canada's funding obligations, which could have a material adverse effect on Air Canada's business, results from operations and financial condition.

Refer to section 9.4 for information on Air Canada's pension funding obligations.

Economic and Geopolitical Conditions
Airline operating results are sensitive to economic and geopolitical conditions which can have a significant impact on Air Canada. For example, economic and geopolitical conditions may impact demand for air transportation, as well as Air Canada's operating costs, pension plan contributions and costs and availability of capital and supplies required by Air Canada. Especially in light of Air Canada's substantial fixed cost structure, any prolonged or significant impact arising from economic and geopolitical conditions, including weakness of the Canadian, US or world economies, could have a material adverse effect on Air Canada's business, results from operations and financial condition.

Airline fares and passenger demand have fluctuated significantly in the past and may fluctuate significantly in the future. Air Canada is not able to predict with certainty market conditions and the fares that Air Canada may be able to charge. Customer expectations can change rapidly and the demand for lower fares may limit revenue opportunities. Travel, especially leisure travel, is a discretionary consumer expense. Depressed economic conditions in North America and other areas served by Air Canada, as well as geopolitical instability in various areas of the world, concerns about the environmental impacts of air travel and tendencies towards "green" travel initiatives where consumers reduce their travel activities, could have the effect of reducing demand for air travel in Canada and abroad and could materially adversely impact Air Canada's profitability.

Fuel Costs
Fuel costs constituted the largest percentage of the total operating costs of Air Canada in 2008. Fuel prices fluctuate widely depending on many factors including international market conditions, geopolitical events and the Canada/US dollar exchange rate. Air Canada cannot accurately predict fuel prices. During 2006, 2007 and 2008, fuel prices increased and fluctuated near or at historically high levels. Should fuel prices fluctuate significantly or increase significantly above current levels, fuel costs could have a material adverse effect on Air Canada's business, results from operations and financial condition. Due to the competitive nature of the airline industry, Air Canada may not be able to pass on increases in fuel prices to its customers by increasing its fares. Based on 2008 volumes, Air Canada estimates that a US$1 per barrel movement in the average price of WTI crude oil would have resulted in an approximate Cdn$25 million change in 2008 fuel expense for Air Canada (excluding any impact of fuel surcharges, foreign exchange rates and fuel hedging), assuming flying capacity remained unchanged and that refining spreads between WTI crude oil and jet fuel as well as foreign exchange rates remained constant.

Foreign Exchange
Air Canada's financial results are sensitive to the changing value of the Canadian dollar. In particular, Air Canada has a significant annual net outflow of US dollars and is affected by fluctuations in the Canada/US dollar exchange rate. Air Canada estimates that during 2008, a $0.01 increase in the US dollar/C exchange rate (i.e., $1.23 to $1.24 per US dollar) would have had an estimated $30 million unfavourable impact on operating income. Conversely, an opposite change in the exchange rate would have had the opposite effect. Air Canada incurs significant expenses in US dollars for such items as fuel, aircraft rental charges, interest payments, debt servicing and computerized reservations system fees, while a substantial portion of its revenues are generated in Canadian dollars. A significant deterioration of the Canadian dollar relative to the US dollar would increase the costs of Air Canada relative to its US competitors and could have a material adverse effect on Air Canada's business, results from operations and financial condition. In addition, Air Canada may be unable to appropriately hedge the risks associated with fluctuations in exchange rates.

Labour Costs and Labour Relations
Labour costs constitute one of Air Canada's largest operating cost items. There can be no assurance that Air Canada will be able to maintain such costs at levels which do not negatively affect its business, results from operations and financial condition. There can be no assurance that future agreements with employees' unions or the outcome of arbitrations will be on terms consistent with Air Canada's expectations or comparable to agreements entered into by Air Canada's competitors. Any future agreements or outcome of negotiations, mediations or arbitrations including in relation to wages or other labour costs or work rules may result in increased labour costs or other charges which could have a material adverse effect on Air Canada's business, results from operations and financial condition.

Most of Air Canada's employees are unionized. With the exception of the collective agreement with the IBT representing certain airport and call centre employees in the United States, which was renewed in 2008 for a term of three years, the most recent collective agreements with the unions representing the largest groups of employees were concluded in 2003 and 2004 and expire in 2009 (other than the collective agreements covering two groups of crew schedulers, which were concluded more recently). No strikes or lock-outs may lawfully occur during the term of the collective agreements, nor during the negotiations of their renewal until a number of pre-conditions, in respect of the unions for Canadian-based employees, prescribed by the Canada Labour Code, have been satisfied. There can be no assurance that collective agreements will be renewed without labour conflict or action or that there will not be a labour conflict that could lead to an interruption or stoppage in Air Canada's service or otherwise adversely affect the ability of Air Canada to conduct its operations, all of which could have a material adverse effect on its business, results from operations and financial condition.

If there is a labour disruption or work stoppage by any of the unionized work groups of Jazz, there could also likely be a material adverse effect on Air Canada's business, results from operations and financial condition. In addition, labour conflicts at Air Canada's Star Alliance® partners could result in lower demand for connecting traffic with Air Canada and, ultimately, could have a material adverse effect on Air Canada's business, results from operations and financial condition.

Airline Industry Characterized by Low Gross Profit Margins and High Fixed Costs
The airline industry is characterized by low gross profit margins and high fixed costs. The costs of operating any particular flight do not vary significantly with the number of passengers carried and, therefore, a relatively small change in the number of passengers or in fare pricing or traffic mix could have a significant effect on Air Canada's operating and financial results. This condition has been exacerbated by aggressive pricing by low-cost carriers, which has had the effect of driving down fares in general. Accordingly, a shortfall from expected revenue levels could have a material adverse effect on Air Canada's business, results from operations and financial condition. Air Canada incurs substantial fixed costs which do not meaningfully fluctuate with overall capacity. As a result, should Air Canada be required to reduce its overall capacity or the number of flights operated, it may not be able to successfully reduce certain fixed costs in the short term and may be required to incur important termination or other restructuring costs, which could have a material adverse effect on Air Canada's business, results from operations and financial condition.

Competition
Air Canada operates within a highly competitive industry. Over the past few years, several carriers have entered or announced their intention to enter into the domestic, the US transborder and international markets in which Air Canada operates.

Canadian low-cost and other carriers have entered and/or expanded or announced their intention to compete in many of Air Canada's key domestic markets and, along with some US carriers have also entered and/or expanded their operations in the US transborder market. Carriers against which Air Canada may compete, including US carriers, may undergo (and some of whom who have undergone) substantial reorganizations (including by way of merger with or acquisition by another carrier), creating reduced levels of indebtedness and lower operating costs and may be in a position to more effectively compete with Air Canada. Air Canada is also facing increasing competition in international markets as carriers increase their international capacity, both by expansion and by shifting existing domestic capacity to international operations to avoid low-cost domestic competition.

If Canadian low-cost and other carriers are successful in entering or expanding into Air Canada's domestic and the US transborder markets, if additional US or other carriers against which Air Canada competes are successful in entering Air Canada's transborder market or if carriers are successful in their expansion in international markets of Air Canada, Air Canada's business results from operations and financial condition could be materially adversely affected.

Air Canada also encounters substantial price competition. The expansion of low-cost carriers in recent years, along with the advent of Internet travel websites and other travel products distribution channels, has resulted in a substantial increase in discounted and promotional fares initiated by Air Canada's competitors. The decision to match competitors' fares, to maintain passenger traffic, results in reduced yields which, in turn, could have a material adverse effect on Air Canada's business, results from operations and financial condition. Furthermore, Air Canada's ability to reduce its fares in order to effectively compete with other carriers is dependent on Air Canada's ability to achieve acceptable operating margins and may also be limited by government policies to encourage competition.

In addition, consolidation in the airline industry could result in increased competition as some airlines emerging from such consolidations may be able to compete more effectively against Air Canada which could have a material adverse effect on Air Canada's business, results from operations and financial condition.

Limitations Due to Restrictive Covenants
Some of the financing and other major agreements of Air Canada contain restrictive, financial (including in relation to liquidity and debt coverage ratios) and other covenants which affect and, in some cases, significantly limit or prohibit, among other things, the manner in which Air Canada may structure or operate its business, including by reducing the Corporation's liquidity, limiting Air Canada's ability to incur indebtedness, create liens, sell assets, make capital expenditures and engage in acquisitions, mergers or restructurings. Future financing and other major agreements may also be subject to similar covenants which limit Air Canada's operating and financial flexibility, which could materially and adversely affect Air Canada's profitability.

A failure by Air Canada to comply with its contractual obligations (including restrictive, financial and other covenants), or to pay its indebtedness and fixed costs could result in a variety of material adverse consequences, including the acceleration of its indebtedness, the withholding of credit card proceeds by the credit card service providers and the exercise of remedies by its creditors and lessors, and such defaults could trigger additional defaults under other indebtedness or agreements. In such a situation, it is unlikely that Air Canada would be able to repay the accelerated indebtedness or fulfill its obligations under certain contracts, make required aircraft lease payments or otherwise cover its fixed costs. Also, the lenders under the financing arrangements could foreclose upon all or substantially all of the assets of Air Canada which secure Air Canada's obligations.

Airport User Fees and Air Navigation Fees
With the privatization of airports and air navigation authorities over the last decade in Canada, new airport and air navigation authorities have imposed significant increases in their fees. If authorities in Canada or elsewhere continue to increase their fees at the rate at which they have increased them in the recent past, Air Canada's business, results from operations and financial condition could be materially adversely affected.

Strategic, Business, Technology and Other Important Initiatives
In order to operate its business, achieve its goals and remain competitive, Air Canada continuously seeks to identify and devise, invest in and implement strategic, business, technology and other important initiatives, such as those relating to the aircraft fleet restructuring program, the aircraft refurbishment program, the new revenue model, the reservation and airport customer service initiative (which will also support the revenue model), the business process initiatives and others. These initiatives, including activities relating to their development and implementation, may be adversely impacted by a wide range of factors, many of which are beyond Air Canada's control. Such factors include the performance of third parties, including suppliers, the implementation and integration of such initiatives into Air Canada's other activities and processes as well as the adoption and acceptance of initiatives by Air Canada's customers, suppliers and personnel. A delay or failure to sufficiently and successfully identify and devise, invest in or implement these initiatives could adversely affect Air Canada's ability to operate its business, achieve its goals and remain competitive and could have a material adverse effect on Air Canada's business, results from operations and financial condition.

For instance, a key component of Air Canada's business plan is the restructuring of its aircraft fleet, including the elimination and replacement of older, less efficient aircraft, and the modernization of its wide-body fleet through the acquisition of new and more efficient aircraft. A delay or failure in the completion of Air Canada's fleet restructuring, including delays by the manufacturers in the delivery of the wide-body aircraft, or an inability to remove, as planned, certain aircraft from the fleet in coordination with the planned entry into service of new aircraft, could adversely affect the implementation of Air Canada's business plan which may, in turn, have a material adverse effect on Air Canada's business, results from operations and financial condition.

Dependence on Technology
Air Canada relies on technology, including computer and telecommunications equipment and software and Internet-based systems, to operate its business, increase its revenues and reduce its costs. These systems include those relating to Air Canada's telecommunications, websites, computerized airline reservations and airport customer services and flight operations.

These technology systems may be vulnerable to a variety of sources of failure, interruption or misuse, including by reason of third party suppliers' acts or omissions, natural disasters, terrorist attacks, telecommunications failures, power failures, computer viruses, unauthorized or fraudulent users, and other operational and security issues. While Air Canada continues to invest in initiatives, including security initiatives and disaster recovery plans, these measures may not be adequate or implemented properly. Any such technology systems failure, interruption or misuse could materially and adversely affect Air Canada's operations and could have a material adverse effect on Air Canada's business, results from operations and financial condition.

Key Supplies and Suppliers
Air Canada is dependent upon its ability to source, on favourable terms and costs, sufficient quantities of goods and services in a timely manner, including those available at airports or from airport authorities or otherwise required for Air Canada's operations such as fuel, aircraft and related parts and aircraft maintenance services (including maintenance services obtained from Aveos). In certain cases, goods and services may only be available from a limited number of suppliers and transition to new suppliers may take significant amounts of time and require significant resources. A failure, refusal or inability of a supplier may arise as a result of a wide range of causes, many of which are beyond Air Canada's control. Any failure or inability of Air Canada to successfully source goods and services, including by reason of a failure, refusal or inability of a supplier, or to source goods and services on terms and pricing and within the timeframes acceptable to Air Canada, could have a material adverse effect on Air Canada's business, results from operations and financial condition.

Aeroplan
Through its relationship with Aeroplan, Air Canada is able to offer its customers who are Aeroplan members the opportunity to earn Aeroplan miles. Based on customer surveys, Air Canada believes that rewarding customers with Aeroplan miles is a significant factor in customers' decision to travel with Air Canada and Jazz and contributes to building customer loyalty. The failure by Aeroplan to adequately fulfill its obligations towards Air Canada under the Aeroplan CPSA and in connection with the Aeroplan program, or other unexpected interruptions of Aeroplan services which are beyond Air Canada's control, could have a material adverse effect on Air Canada's business, results from operations and financial condition.

Jazz
Under the Jazz CPA, Jazz provides Air Canada's customers service in lower density markets and higher density markets at off-peak times throughout Canada and to and from certain destinations in the United States and also provides valuable traffic feed to Air Canada's mainline routes. Pursuant to the terms of the Jazz CPA, Air Canada pays Jazz a number of fees which are determined based upon certain costs incurred by Jazz. Air Canada also reimburses Jazz, without mark-up, for certain pass-through costs incurred directly by Jazz, such as fuel, navigation, landing and terminal fees and certain other costs. Significant increases in such pass-through costs, the failure by Jazz to adequately fulfill its obligations towards Air Canada under the Jazz CPA, or other unexpected interruptions of Jazz's services which are beyond Air Canada's control could have a material adverse effect on Air Canada's business, results from operations and financial condition. In addition, the Jazz CPA requires that Jazz maintain a minimum fleet size and contains a minimum average daily utilization guarantee which requires that Air Canada make certain minimum payments to Jazz regardless of the revenue generated by Jazz.

Star Alliance®
The strategic and commercial arrangements with Star Alliance® members provide Air Canada with important benefits, including codesharing, efficient connections and transfers, reciprocal participation in frequent flyer programs and use of airport lounges from the other members. Should a key member leave Star Alliance® or otherwise fail to meet its obligations thereunder, Air Canada's business, results from operations and financial condition could be materially adversely affected.

Interruptions or Disruptions in Service
Air Canada's business is significantly dependent upon its ability to operate without interruption at a number of hub airports, including Toronto Pearson International Airport. Delays or disruptions in service, including those due to security or other incidents, weather conditions, labour conflicts with airport workers, baggage handlers, air traffic controllers and other workers not employed by Air Canada or other causes beyond the control of Air Canada could have a material adverse impact on Air Canada's business, results from operations and financial condition.

Current Legal Proceedings
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 million 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 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.

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 million 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's access to the TCCA. The Porter Defendants were granted intervener and party status in these proceedings. In January of 2008, Porter filed a defense 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.

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, Air Canada has determined that it is not possible at this time to predict with any degree of certainty the final outcome of the Commission's investigation.

Future Legal proceedings
Airlines are susceptible to various claims and litigation in the course of operating their business. Future litigation, including an increase in class action claims, could also have a material adverse effect on Air Canada's business and results from operations.

Key Personnel
Air Canada is dependent on the experience and industry knowledge of its executive officers and other key employees to execute its business plan. If Air Canada were to experience a substantial turnover in its leadership or other key employees, Air Canada's business, results from operations and financial condition could be materially adversely affected. Additionally, Air Canada may be unable to attract and retain additional qualified key personnel as needed in the future.

Risks Relating to the Airline Industry

Terrorist Attacks and Security Measures
The September 11, 2001 terrorist attacks and subsequent terrorist activity, notably in the Middle East, Southeast Asia and Europe, caused uncertainty in the minds of the traveling public. The occurrence of a major terrorist attack (whether domestic or international and whether involving Air Canada or another carrier or no carrier at all) and increasingly restrictive security measures, such as the current restrictions on the content of carry-on baggage and current or proposed passenger identification document requirements, could have a material adverse effect on passenger demand for air travel and on the number of passengers traveling on Air Canada's flights. It could also lead to a substantial increase in insurance, airport security and other costs. Any resulting reduction in passenger revenues and/or increases in insurance, security or other costs could have a material adverse effect on Air Canada's business, results from operations and financial condition.

Epidemic Diseases (Severe Acute Respiratory Syndrome (SARS), Influenza or Other Epidemic Diseases)
As a result of the international outbreaks of Severe Acute Respiratory Syndrome (SARS) in 2003, the World Health Organization (the "WHO") issued on April 23, 2003 a travel advisory, which was subsequently lifted on April 30, 2003, against non-essential travel to Toronto, Canada. The seven-day WHO travel advisory relating to Toronto, the location of Air Canada's primary hub, and the international SARS outbreak had a significant adverse effect on passenger demand for air travel in Air Canada's markets and resulted in a major negative impact on traffic on the entire network. The WHO warns that there is a serious risk of an influenza pandemic.

An outbreak of influenza, SARS or of another epidemic disease (whether domestic or international) or a further WHO travel advisory (whether relating to Canadian cities or regions or other cities, regions or countries) could have a material adverse effect on passenger demand for air travel. Any resulting reduction in traffic in the markets served by Air Canada could have a material adverse effect on Air Canada's business, results from operations and financial condition.

Casualty Losses

Due to the nature of its core operating business, Air Canada may be subject to liability claims arising out of accidents or disasters involving aircraft on which Air Canada's customers are traveling or involving aircraft of other carriers maintained or repaired by Air Canada, including claims for serious personal injury or death. There can be no assurance that Air Canada's insurance coverage will be sufficient to cover one or more large claims and any shortfall may be material. Additionally, any accident or disaster involving one of Air Canada's aircraft or an aircraft of another carrier receiving line maintenance services from Air Canada may significantly harm Air Canada's reputation for safety, which would have a material adverse effect on Air Canada's business, results from operations and financial condition.

Seasonal Nature of the Business, Other Factors and Prior Performance

Air Canada has historically experienced considerably greater demand for its services in the second and third quarters of the calendar year and significantly lower demand in the first and fourth quarters of the calendar year. This demand pattern is principally a result of the preference of a high number of leisure travelers to travel during the spring and summer months. Air Canada has substantial fixed costs that do not meaningfully fluctuate with passenger demand in the short term.

As described elsewhere, demand for and cost of air travel is also affected by factors such as geopolitical and economic conditions, war or the threat of war or terrorist attacks, fare levels and weather conditions. Due to these and other factors, operating results for an interim period are not necessarily indicative of operating results for an entire year, and operating results for a historical period are not necessarily indicative of operating results for a future period.

Regulatory Matters

The airline industry is subject to extensive Canadian and foreign government regulations relating to, among other things, security, safety, licensing, competition, environment (including noise levels and carbon emissions) and, in some measure, pricing. Additional laws and regulations may be proposed, and decisions rendered, from time to time which could impose additional requirements or restrictions on airline operations. For example, new and proposed legislation have been considered or adopted concerning carbon emissions emanating from the aviation industry; such legislative initiatives include, for example, market-based mechanisms called emissions trading systems which are being proposed and implemented to reduce the amount of pollutants in the atmosphere through the trading of emissions credits. The implementation of additional regulations or decisions, including those relating to carbon emissions, and others, whether by Transport Canada, the Competition Bureau and/or the Competition Tribunal, the Canadian Transportation Agency or other domestic or foreign governmental entities, may have a material adverse effect on Air Canada's business, results from operations and financial condition. Air Canada cannot give any assurances that new regulations or revisions to the existing legislation, or decisions, will not be adopted or rendered. The adoption of such new laws and regulations or revisions, or the rendering of such decisions, could have a material adverse effect on Air Canada's business, results from operations and financial condition.

The availability of international routes to Canadian air carriers is regulated by agreements between Canada and foreign governments. Changes in Canadian or foreign government aviation policy could result in the alteration or termination of these agreements and could adversely affect Air Canada's international operations.

Air Canada is subject to domestic and foreign laws regarding privacy of passenger and employee data, including advance passenger information and access to airline reservation systems, which are not consistent in all countries in which Air Canada operates. The need to comply with these regulatory regimes is expected to result in additional operating costs and could have a material adverse effect on Air Canada's business, results from operations and financial condition.

Increased Insurance Costs

Since September 11, 2001 the aviation insurance industry has been continually reevaluating the terrorism risks that it covers, and this activity may adversely affect some of Air Canada's existing insurance carriers or Air Canada's ability to obtain future insurance coverage. To the extent that Air Canada's existing insurance carriers are unable or unwilling to provide it with insurance coverage, and in the absence of measures by the Government of Canada to provide the required coverage, Air Canada's insurance costs may increase further and may result in Air Canada being in breach of regulatory requirements or contractual arrangements requiring that specific insurance be maintained, which may have a material adverse effect on Air Canada's business, results from operations and financial condition.

Third Party War Risk Insurance

There is a risk that the Government of Canada may not continue to provide an indemnity for third party war risk liability coverage, which it currently provides to Air Canada and certain other carriers in Canada. In the event that the Government of Canada does not continue to provide such indemnity or amends such indemnity, Air Canada and other industry participants would have to turn to the commercial insurance market to seek such coverage. Air Canada estimates that such coverage would cost Air Canada approximately $10 million per year. Alternative solutions, such as those envisioned by the International Civil Aviation Organization ("ICAO") and the International Air Transport Association ("IATA"), have not developed as planned, due to actions taken by other countries and the recent availability of supplemental insurance products. ICAO and IATA are continuing their efforts in this area, however, the achievement of a global solution is not likely in the immediate or near future. The US federal government has set up its own facility to provide war risk coverage to US carriers, thus removing itself as a key component of any global plan.

Furthermore, the London aviation insurance market has introduced a new standard war and terrorism exclusion clause which is applicable to aircraft hull and spares war risk insurance, and intends to introduce similar exclusions to airline passenger and third party liability policies. Such clause excludes claims caused by the hostile use of a dirty bomb, electromagnetic pulse device, or biochemical materials. The Government of Canada indemnity program is designed to address these types of issues as they arise, but the Government of Canada has not yet decided to extend the existing indemnity to cover this exclusion. Unless and until the Government of Canada does so, the loss of coverage exposes Air Canada to this new uninsured risk and may result in Air Canada being in breach of certain regulatory requirements or contractual arrangements, which may have a material adverse effect on Air Canada's business, results from operations and financial condition.

15. Sensitivity of Results

Air Canada's financial results are subject to many different internal and external factors which can have a significant impact on operating results. In order to provide a general guideline, the following table describes, on an indicative basis, the financial impact that changes in certain assumptions would generally have had on Air Canada's operating results. These guidelines were derived from 2008 levels of activity and make use of management estimates. The impacts are not additive, do not reflect the interdependent relationship of the elements and may vary significantly from actual results due to factors beyond the control of Air Canada. Conversely, an opposite change in the sensitivity factor would have had the opposite effect on operating income.

($ millions) Key Variable		2008 Measure	Sensitivity Factor	Favourable/(Unfavourable) Estimated Operating Income Impact
Revenue Measures				
Passenger yield (cents)	System	19.2	1% increase in yield	$ 93
	Canada	25.2		$ 39
Traffic (RPMs) (millions)	System	50,519	1% increase in traffic	$ 84
	Canada	16,214		$ 36
Passenger load factor	System	81.4	1 percentage point increase	$ 103
RASM (cents)	System	15.6	1% increase in RASM	$ 89
Cost Measures				
Labour and benefits expenses ($ millions)		1,877	1% increase	$ (19)
Fuel – WTI price (US$/barrel) (1)		103.9	US$1/barrel increase to WTI	$ (25)
Fuel – jet fuel price (CAD cents/litre) (1)		92.5	1% increase	$ (35)
Cost per ASM (cents)		17.9	1% increase in CASM	$(111)
Currency Exchange				
C$ to US$	US$1 = C$1.23		1 cent increase (e.g. $1.23 to $1.24)	$ (30)

(1) Excludes the impact of fuel surcharges and fuel hedging. Refer to section 12 of this MD&A for information on Air Canada's fuel derivative instruments.

16. Quarterly Financial Information

The quarterly information presented below may not be directly comparable as a result of changes in accounting policies relating to Aeroplan, Jazz and ACTS.

($ millions, except per share amounts)	Q1 2007[(1)]	Q2 2007[(2)]	Q3 2007	Q4 2007[(3)]	Q1 2008	Q2 2008	Q3 2008	Q4 2008
Operating revenues	$ 2,625	$ 2,659	$ 3,022	$ 2,520	$ 2,726	$ 2,783	$ 3,075	$ 2,496
Operating expenses	(2,654)	(2,563)	(2,682)	(2,474)	(2,753)	(2,785)	(2,970)	(2,646)
Operating income (loss) before under-noted item[(4)]	**(29)**	**96**	**340**	**46**	**(27)**	**(2)**	**105**	**(150)**
Provision for cargo investigations[(5)]	-	-	-	-	(125)	-	-	-
Operating income (loss)	**(29)**	**96**	**340**	**46**	**(152)**	**(2)**	**105**	**(150)**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax[(6)]	(43)	22	(116)	1,082	(30)	832	(240)	(483)
Net income (loss)	**$ (72)**	**$ 118**	**$ 224**	**$ 1,128**	**$ (182)**	**$ 830**	**$ (135)**	**$ (633)**
Earnings (loss)[(7)]								
Per share – basic	**$ (0.70)**	**$ 1.14**	**$ 2.17**	**$ 10.81**	**$ (2.96)**	**$ 15.46**	**$ (3.86)**	**$ (18.12)**
Per share – diluted	**$ (0.70)**	**$ 0.98**	**$ 1.84**	**$ 8.88**	**$ (2.96)**	**$ 10.76**	**$ (3.86)**	**$ (18.12)**

(1) *ACE ceased consolidating Aeroplan's results effective March 14, 2007.*
(2) *ACE ceased consolidating Jazz's results effective May 24, 2007.*
(3) *ACE ceased consolidating ACTS' results effective October 16, 2007.*
(4) *Quarter 1 2007 and Quarter 2 2007 include special charges for labour restructuring of $9 million and $6 million, respectively.*
(5) *Air Canada recorded a provision for cargo investigations of $125 million in Quarter 1 2008.*
(6) *Quarter 2 2007 includes a gain of $4 million and a tax provision of $1 million relating to the sale of 0.249 million shares of its holdings in US Airways. Quarter 3 2007 includes a gain of $4 million and a tax provision of $1 million relating to the sale of 0.251 million shares of its holdings in US Airways. Quarter 4 2007 includes an aggregate gain on disposal of $1,339 million and a tax provision of $214 million mainly comprised of a gain on disposal of $565 million and a tax provision of $82 million related to the monetization of ACTS which was completed on October 16, 2007, a gain on disposal of $539 million and a tax provision of $91 million related to the secondary offering of 22,000,000 trust units of Aeroplan Income Fund and a gain on disposal of $233 million and a tax provision of $41 million related to the secondary offering of 35,500,000 trust units of Jazz Air Income Fund. Quarter 1 2008 includes a gain of $89 million ($71 million, net of tax) on ACE's sale of 13,000,000 units of Jazz Air Income Fund and an impairment provision of $38 million recorded by Air Canada related to its fleet of Boeing 767-200 aircraft. Quarter 2 2008 includes a gain of $413 million ($340 million, net of tax) on ACE's sale of 20,400,000 units of Aeroplan Income fund, a gain of $417 million ($344 million, net of tax) on ACE's sale of 19,892,088 units of Aeroplan Income Fund and a gain on of $78 million ($62 million, net of tax) on ACE's sale of 11,726,920 units of Jazz Air Income Fund.*
(7) *Earnings (loss) per share includes the impact of a substantial issuer bid completed by ACE on January 10, 2008 whereby 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 and a substantial issuer bid completed by ACE on June 18, 2008 whereby 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.*

17. Selected Annual Information

The following table provides selected annual information for ACE for the years 2008, 2007 and 2006. The information provided below may not be directly comparable as a result of changes in accounting policies relating to Aeroplan, Jazz and ACTS.

($ millions, except per share figures)	2008	2007 [(1)]	2006 [(2)]
Operating revenues	$ 11,080	$ 10,826	$ 10,657
Special charge for Aeroplan miles [(2)]	-	-	(102)
Operating revenues	11,080	10,826	10,555
Operating expenses [(1)] [(2)]	(11,154)	(10,373)	(10,160)
Operating income (loss) before the provision for cargo investigations [(3)]	**(74)**	**453**	**395**
Provision for cargo investigations	(125)	-	-
Operating income (loss)	**(199)**	**453**	**395**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax [(4)]	79	945	13
Net income (loss)	**$ (120)**	**$ 1,398**	**$ 408**
EBITDAR [(5)]	**$ 766**	**$ 1,358**	**$ 1,412**
EBITDAR excluding special charges [(5)]	**$ 891**	**$ 1,373**	**$ 1,539**
Earning (loss) per share			
- Basic	**$ (2.59)**	**$ 13.51**	**$ 4.01**
- Diluted	**$ (2.59)**	**$ 11.44**	**$ 3.80**
Cash, cash equivalents and short-term investments	**$ 1,813**	**$ 3,139**	**$ 3,178**
Total assets	**$ 11,871**	**$ 13,754**	**$ 13,441**
Total long-term liabilities [(6)]	**$ 7,626**	**$ 7,181**	**$ 7,452**

(1) The results and financial position of Aeroplan, Jazz and ACTS are not consolidated with ACE effective March 14, 2007, May 24, 2007 and October 16, 2007, respectively. Operating expenses in 2007 include special charges for labour restructuring totaling $15 million.

(2) 2006 includes a special charge of $102 million in connection with Air Canada's obligation for the redemption of pre-2002 Aeroplan miles. Operating expenses in 2006 include a special charge for labour restructuring of $25 million.

(3) Air Canada recorded a provision for cargo investigations of $125 million in 2008.

(4) Non-operating income (expense) includes gains on assets which amounted to $946 million in 2008, $1,366 million in 2007 and $393 million in 2006. Also included are net losses on foreign exchange of $655 million in 2008; net gains on foreign exchange of $313 million in 2007 and net gains on foreign exchange of $12 million in 2006.

(5) Refer to section 19 "Non-GAAP Financial Measures" in this MD&A for a reconciliation of EBITDAR to operating income (loss) and EBITDAR excluding special charges to operating income (loss).

(6) Total long-term liabilities include long-term debt (including current portion) and capital leases, convertible preferred shares, pension and other benefit liabilities and other long-term liabilities.

18. Controls and Procedures

Disclosure Controls and Procedures and Internal Controls over Financial Reporting
Disclosure controls and procedures within the Corporation have been designed to provide reasonable assurance that all relevant information is identified to its Disclosure Policy Committee to ensure appropriate and timely decisions are made regarding public disclosure.

Internal controls over financial reporting have been designed by management, with the participation of the Corporation's CEO and CFO, to provide reasonable assurance regarding the reliability of the Corporation's financial reporting and its preparation of financial statements for external purposes in accordance with Canadian Generally Accepted Accounting Principles ("GAAP").

The Corporation filed certifications, signed by the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"), with the Canadian Securities Administrators ("CSA") upon filing of the Corporation's 2008 annual filings. In those filings, the Corporation's CEO and CFO certify, as required by National Instrument 52-109, the appropriateness of the financial disclosure, the design and effectiveness of the Corporation's disclosure controls and procedures and the design and effectiveness of internal controls over financial reporting. The Corporation's CEO and CFO also certify the appropriateness of the financial disclosures in the Corporation's interim filings with securities regulators. In those interim filings, the Corporation's CEO and CFO also certify the design of the Corporation's disclosure controls and procedures and the design of internal controls over financial reporting.

Management's Report on Disclosure Controls and Procedures
Management, with the participation of the Corporation's CEO and CFO, assessed the effectiveness of the Corporation's disclosure controls and processes and concluded, as at December 31, 2008, that such disclosure controls and processes were effective to provide reasonable assurance that:

(i) material information relating to the Corporation was made known to its Disclosure Committee by others; and

(ii) information required to be disclosed by the Corporation in its annual filings, interim filings and other reports filed or submitted by the Corporation under securities legislations was recorded, processed, summarized and reported within the periods specified in securities legislation.

In addition, the evaluation covered the Corporation's processes, systems and capabilities relating to regulatory filings, public disclosures and the identification and communication of material information.

Management's Report on Internal Controls over Financial Reporting
Management, with the participation of the Corporation's CEO and CFO, assessed the effectiveness of the Corporation's internal controls over financial reporting. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control - Integrated Framework. Based on that evaluation, management and the CEO and CFO have concluded that, as at December 31, 2008, the Corporation's internal controls over financial reporting were effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. This evaluation took into consideration the Corporation's Corporate Disclosure Policy and the functioning of its Disclosure Policy Committee.

Changes in Internal Controls over Financial Reporting
There have been no changes to the Corporation's internal controls over financial reporting during the year ended December 31, 2008 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

19. Non-GAAP Financial Measures

EBITDAR/EBITDA

EBITDAR (earnings before interest, taxes, depreciation, amortization, obsolescence and aircraft rent) is a non-GAAP financial measure commonly used in the airline industry to view operating results before aircraft rent, depreciation, obsolescence and amortization, as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets. For businesses without aircraft rent, such as Aeroplan and ACTS, EBITDA (earnings before interest, taxes, depreciation, amortization and obsolescence) is used to view operating results before depreciation, amortization and obsolescence, as these costs can vary significantly among companies due to differences in the way companies finance their assets. The Corporation presents EBITDAR before and after the Provision for cargo investigations as this item could potentially distort the analysis of trends in business performance. EBITDAR and EBITDA are not recognized measures for financial statement presentation under GAAP and do not have a standardized meaning and are therefore not likely to be comparable to similar measures presented by other public companies.

ACE's EBITDAR for 2008 is not directly comparable to its EBITDAR for 2007 as a result of a dilution in ACE's ownership interest in Aeroplan, Jazz and ACTS.

EBITDAR and EBITDA and EBITDAR before the Provision for cargo investigations are reconciled to operating income (loss) as follows:

	Quarter 4					
(Canadian dollars in millions)	**2008**	**2007**	**$Change**	**2008**	**2007**	**$Change**
Air Canada						
GAAP operating income (loss) before the provision for cargo investigations	$ (146)	$ 72	$ (218)	$ (39)	$ 433	$ (472)
Add back:						
Aircraft rent	80	62	18	279	282	(3)
Depreciation and amortization	174	140	34	694	548	146
EBITDAR before the provision for cargo investigations	**108**	**274**	**(166)**	**934**	**1,263**	**(329)**
Provision for cargo investigations	-	-	-	(125)	-	(125)
EBITDAR	**$ 108**	**$ 274**	**$ (166)**	**$ 809**	**$ 1,263**	**$ (454)**
Aeroplan						
GAAP operating income	$ -	$ -	$ -	$ -	$ 40	$ (40)
Add back:						
Depreciation and amortization	-	-	-	-	3	(3)
EBITDA	**$ -**	**$ -**	**$ -**	**$ -**	**$ 43**	**$ (43)**
Jazz						
GAAP operating income	$ -	$ -	$ -	$ -	$ 62	$ (62)
Add back:						
Aircraft rent	-	-	-	-	57	(57)
Depreciation and amortization	-	-	-	-	9	(9)
EBITDAR	**$ -**	**$ -**	**$ -**	**$ -**	**$ 128**	**$ (128)**
ACTS						
GAAP operating income	$ -	$ 3	$ (3)	$ -	$ 20	$ (20)
Add back:						
Depreciation and amortization	-	1	(1)	-	31	(31)
EBITDA	**$ -**	**$ 4**	**$ (4)**	**$ -**	**$ 51**	**$ (51)**
ACE Consolidated (1)						
GAAP operating income (loss) before the provision for cargo investigations	$ (150)	$ 46	$ (196)	$ (74)	$ 453	$ (527)
Add back:						
Aircraft rent	80	62	18	279	323	(44)
Depreciation and amortization	172	140	32	686	582	104
EBITDAR before the provision for cargo investigations	**102**	**248**	**(146)**	**891**	**1,358**	**(467)**
Provision for cargo investigations	-	-	-	(125)	-	(125)
EBITDA/EBITDAR	**$ 102**	**$ 248**	**$ (146)**	**$ 766**	**$ 1,358**	**$ (592)**

(1) ACE ceased consolidating the results of Aeroplan, Jazz and ACTS effective March 14, 2007, May 24, 2007 and October 16, 2007, respectively.

20. Glossary of Terms

Available Seat Miles or ASMs — A measure of passenger capacity calculated by multiplying the total number of seats available for passengers by the miles flown.

CASM — Operating expense per ASM.

EBITDA — EBITDA is earnings before interest, taxes, depreciation, amortization and obsolescence and is a non-GAAP financial measure.

EBITDAR — EBITDAR is earnings before interest, taxes, depreciation, amortization, obsolescence and aircraft rent and is a non-GAAP financial measure.

Passenger Load Factor — A measure of passenger capacity utilization derived by expressing Revenue Passenger Miles as a percentage of Available Seat Miles.

Passenger Revenue per Available Seat Mile or RASM — Average passenger revenue per ASM.

Revenue Passenger Miles or RPMs — A measure of passenger traffic calculated by multiplying the total number of revenue passengers carried by the miles they are carried.

Yield — Average passenger revenue per RPM.