ACE AVIATION

Consolidated Financial Statements and Notes 2008

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

August 7, 2009

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August 6, 2009

Auditors' Report

To the Shareholders of
ACE Aviation Holdings Inc.

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

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

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

PricewaterhouseCoopers LLP[1]

[1] Chartered accountant auditor permit No. 18144

Consolidated Statement of Operations

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

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

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

Consolidated Statement of Financial Position

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

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

On behalf of the Board of Directors:

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

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

Consolidated Statement of Changes in Shareholders' Equity

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

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

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

Consolidated Statement of Comprehensive Income (Loss)

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

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

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

Consolidated Statement of Cash Flow

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

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

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

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

A) BASIS OF PRESENTATION

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

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

As at December 31, 2008, ACE holds:

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

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

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

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

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

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

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

B) NATURE OF OPERATIONS

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

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

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

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

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

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

C) SIGNIFICANT EVENTS

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

During July 2009

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

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

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

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

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

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

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

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

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

During the second quarter of 2009

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

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

During the first quarter of 2009

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

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

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

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

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

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

D) AIR CANADA LIQUIDITY RISK

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

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

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

Pension Funding Obligations

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

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

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

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

Covenants in Credit Card Agreements

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

Cargo Investigations and Proceedings

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

E) DISPOSITION OF AVIATION INTERESTS

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

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A) PRINCIPLES OF CONSOLIDATION

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

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

B) USE OF ESTIMATES

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

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

C) PASSENGER AND CARGO REVENUES

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

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

D) CAPACITY PURCHASE AGREEMENTS – JAZZ AND TIER III CARRIERS

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

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

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

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

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

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

E) AEROPLAN LOYALTY PROGRAM

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

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

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

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

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

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

F) OTHER REVENUES

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

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

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

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

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

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

G) EMPLOYEE FUTURE BENEFITS

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

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

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

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

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

H) EMPLOYEE PROFIT SHARING PLAN

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

I) STOCK-BASED COMPENSATION PLANS

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

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

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

J) MAINTENANCE AND REPAIRS

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

K) OTHER OPERATING EXPENSES

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

L) FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING

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

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

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

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

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

The Corporation has implemented the following classifications:

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

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

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

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

Fuel Derivatives Under Hedge Accounting

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

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

M) FOREIGN CURRENCY TRANSLATION

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

N) INCOME TAXES

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

O) CASH AND CASH EQUIVALENTS

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

P) SHORT-TERM INVESTMENTS

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

Q) RESTRICTED CASH

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

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

R) AIRCRAFT FUEL INVENTORY

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

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

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

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

S) PROPERTY AND EQUIPMENT

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

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

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

T) INTEREST CAPITALIZED

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

U) INTANGIBLE ASSETS

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

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

V) IMPAIRMENT OF LONG-LIVED ASSETS

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

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

W) EQUITY INVESTMENTS

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

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

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

Y) ASSET RETIREMENT OBLIGATIONS

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

Z) RELATED PARTY TRANSACTIONS

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

AA) VARIABLE INTEREST ENTITIES

Aircraft Leasing Transactions

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

Fuel Facilities Arrangements

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

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

AB) FUTURE ACCOUNTING STANDARD CHANGES

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

Goodwill and Intangible Assets

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

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

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

Business Combinations, Consolidated Financial Statements and Non-controlling Interests

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

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

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

3. AEROPLAN

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

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

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

Distributions

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

Distributions to Common Shareholders

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

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

Distributions to Preferred Shareholders

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

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

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

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

The distributions described above had no cash tax consequences.

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

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

Accounting resulting from distributions

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

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

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

Sales of units

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

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

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

4. JAZZ

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

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

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

Initial Public Offering

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

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

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

Distributions

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

Distributions to Common Shareholders

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

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

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

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

Distributions to Preferred Shareholders

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

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

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

The distributions described above had no cash tax consequences.

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

Accounting resulting from the distributions

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

Sales of units

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

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

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

5. ACTS AERO

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

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

Monetization

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

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

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

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

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

Acquisition of Aeroman

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

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

Impairment of ACTS Aero

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

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6. PROPERTY AND EQUIPMENT

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

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

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

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

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

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

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

During 2008:

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

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

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

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

During 2007:

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

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

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

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

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

7. INTANGIBLE ASSETS

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

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

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

8. DEPOSITS AND OTHER ASSETS

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

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

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

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

9. LONG-TERM DEBT AND CAPITAL LEASES

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

10. FUTURE INCOME TAXES

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

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

a) FUTURE INCOME TAX ASSETS

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

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

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

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

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

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

b) TAXES PAYABLE AND FUTURE INCOME TAX LIABILITY

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

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

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

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

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

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

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

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

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

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

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

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

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

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

11. PENSION AND OTHER BENEFIT LIABILITIES

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

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

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

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

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

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

Discount Rate

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

Expected Return on Assets Assumption

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

Benefit Obligation and Plan Assets

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

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

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

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

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

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

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

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

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

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

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

Pension and Other Employee Future Benefit Expense

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

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

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

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

Other Benefits — Sensitivity Analysis

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

Pension Plan Cash Funding Obligations

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

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

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

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

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

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

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

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

Air Canada Pension Plan Solvency Deficiency Funding Regulations - 2004

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

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

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

Domestic Registered Plans

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

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

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

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

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

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

Defined Contribution Plans

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

12. OTHER LONG-TERM LIABILITIES

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

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

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

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

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

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

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

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

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

13. STOCK-BASED COMPENSATION

ACE Stock Option Plan

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

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

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

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

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

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

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

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

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

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

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

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

Air Canada Long-Term Incentive Plan

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

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

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

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

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

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

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

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

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

Performance Share Units

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

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

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

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

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

Employee Share Purchase Plans

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

14. SHAREHOLDERS' EQUITY

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

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

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

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

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

Share capital and other equity are comprised of:

(a) Common shares

Class A Variable Voting Shares

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

Class B Voting Shares

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

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

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

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

(b) Convertible Preferred Shares

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

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

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

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

Mandatory Conversion

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

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

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

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

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

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

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

(c) Convertible Notes

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

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

(d) Substantial Issuer Bid – January 2008

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

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

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

(e) Substantial Issuer Bid – June 2008

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

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

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

Accumulated Other Comprehensive Income (Loss)

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

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

15. EARNINGS PER SHARE

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

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

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

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

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

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

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

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

16. SEGMENT INFORMATION

Composition of Business Segments

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

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

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

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

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

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

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

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

Geographic Information

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

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

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

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

Segment Asset Information

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

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

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

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

17. COMMITMENTS

Boeing

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

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

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

Embraer

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

Aircraft Interior Refurbishment Program

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

Capital Commitments

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

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

Operating Lease Commitments

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

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

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

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

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

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

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

Maturity Analysis

ACE

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

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

Air Canada

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

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

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

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

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

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

Minimum Committed Purchase of Aeroplan Miles

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

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

18. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Summary of Financial Instruments

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

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

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

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

Collateral Held in Leasing Arrangements

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

Summary of Gain on Financial Instruments Recorded at Fair Value

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

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

Risk Management

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

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

Interest Rate Risk

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

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

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

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

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

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

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

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

Foreign Exchange Risk

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

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

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

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

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

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

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

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

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

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

<u>Liquidity risk</u>

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

Refer to the maturity analysis in Note 17.

Credit Card Agreement

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

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

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

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

Market risk

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

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

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

Sensitivity Analysis

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

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

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

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

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

Credit Risk

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

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

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

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

Fuel Price Risk

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Financial Instrument Fair Values in the Consolidated Statement of Financial Position

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

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

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

Asset Backed Commercial Paper (“ABCP”)

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

19. CAPITAL DISCLOSURES

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

ACE

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

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

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

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

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

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

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

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

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

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

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

Air Canada

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

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

Air Canada's main objectives when managing capital are:

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

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

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

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

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

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

20. CONTINGENCIES, GUARANTEES AND INDEMNITIES

Contingencies

Investigations by Competition Authorities Relating to Cargo

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

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

Porter Airlines Inc.

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

Pay Equity

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

Other Contingencies

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

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

Guarantees

Guarantees in Fuel Facilities Arrangements

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

Indemnification Agreements

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

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

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

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

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

21. RELATED PARTY TRANSACTIONS

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

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

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

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

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

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

Summary of significant related party agreements

The Relationship between the Corporation and Aveos

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

Pension and Benefits Agreement

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

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

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

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

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

Non-Compete and Repair Schemes Transfer Agreement

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

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

- With respect to airframe heavy maintenance services and paint services, the non-compete period ends one year after the current heavy maintenance services agreement is terminated or expires (the current term of the heavy maintenance services agreement expires October 1, 2011);
- With respect to engine and APU overhaul maintenance services, the non-compete period ends on October 1, 2015; and
- With respect to component maintenance services, the non-compete period ends on October 1, 2016;

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

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

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

Agreement with Aveos on Revised Payment Terms

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

Refer to Note 22 for a description of subsequent events.

Maintenance Agreements

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

Master Services Agreement (MSA)

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

General Services Agreements

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

Real Estate Agreements

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

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

Non-recurring transactions

ACTS LP

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

Share purchase rights sold from Air Canada to ACE

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

Warrants purchased from ACE

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

Air Canada Vacations

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

Air Canada Credit Facility

Refer to Note 22 for a description of subsequent events.

22. SUBSEQUENT EVENTS

Term Credit Facility

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

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

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

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

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

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

Related Party Transactions

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

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

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

POLARIS

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

ACE AVIATION

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.

	2008		
(Canadian dollars in millions)	**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.

	2007					
(Canadian dollars in millions)	**Air Canada**	**Aeroplan[1]**	**Jazz [2]**	**ACTS [3]**	**CIE**	**ACE Total**
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.

	Quarter 4					
(Canadian dollars in millions)	**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:

(Canadian dollars in millions)	Quarter 4 2008	Quarter 4 2007	Quarter 4 $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.