

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

**IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*,
R.S.C. 1985. c. C-36, AS AMENDED**

**IN THE MATTER OF SECTION 191 OF THE *CANADA BUSINESS
CORPORATIONS ACT*, R.S.C. 1985, C-44 AS AMENDED**

**IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF
AIR CANADA AND THE APPLICANTS SET OUT IN SCHEDULE "A"**

**TWENTY-EIGHTH REPORT OF THE MONITOR
DATED JUNE 28, 2004**

1. On April 1, 2003, Air Canada and certain of its subsidiaries (collectively the "Applicants" and the "Company") filed for and obtained protection from their creditors under the *Companies' Creditors Arrangement Act* R.S.C. 1985 c. C-36, *as amended* (the "CCAA"). The terms of this proceeding are governed by an order of this Court dated April 1, 2003 (the "Initial Order"). Pursuant to the Initial Order, Ernst & Young Inc. ("EYI") was appointed as monitor (the "Monitor") of the Applicants during these CCAA proceedings.
2. Capitalized terms not defined in this Report are as defined in the Initial Order or the First through Twenty-Seventh Reports of the Monitor. All references to dollars are in Canadian currency unless otherwise noted.
3. The purpose of this Twenty-Eighth Report of the Monitor (the "Report") is to provide this Honourable Court with:
 - An update on the status of the Private Equity Process;

- An analysis of the terms of an agreement reached between Cerberus ACE Investments, LLC, an affiliate of Cerberus Capital Management, L.P., (“Cerberus”) and Air Canada in connection with a private equity investment (“Investment Agreement”), which is subject to court approval;
- A brief summary of proposed amendments to the Initial Order; and
- The Monitor’s conclusions and recommendations.

TERMS OF REFERENCE

4. In developing this Report, the Monitor has relied upon unaudited company prepared financial information, company records, and discussions with management of the Applicants. The Monitor has not performed an audit or other verification of such information. An examination of the financial forecast as outlined in the Canadian Institute of Chartered Accountants (“CICA”) Handbook has not been performed. Future oriented financial information relied upon in this report is based on management’s assumptions regarding future events and actual results achieved will vary from this information and the variations may be material.

UPDATE ON PRIVATE EQUITY PROCESS

5. On May 4, 2004, this Honourable Court approved the Private Equity Process outlined in the Monitor’s Twenty-Fifth Report and Exhibit “B” thereto (the “Equity Protocol”), and directed the Company and the Monitor to commence the process immediately.
6. Pursuant to the Equity Protocol, the Company, its financial advisor, Seabury Securities LLC (“Seabury”), and the Monitor contacted 18 potential private equity investors with a view to soliciting interest in an equity investment in Air Canada. Potential equity investors were advised that Air Canada was seeking binding equity proposals on June 18, 2004 in connection with an investment of \$250 million for approximately 12% of the equity of the restructured Air Canada.

7. To ensure that any proposed investment agreement met Canadian ownership regulations, potential private equity investors were advised that their rights were limited to being represented on the Board of Air Canada, namely, to designate 3 of 11 directors.
8. The potential equity investors were provided with a copy of the Equity Protocol. They were advised that proposed equity investments to be submitted to the Monitor could not contain any condition requiring:
 - The renegotiation of any material contract that has received Court approval during the restructuring;
 - The renegotiation of any collective bargaining agreement;
 - Any change to the design of the pension plans;
 - Changes to the pension and benefit plan funding that are or would be more favourable to Air Canada than the terms of the February 2004 agreement between Air Canada and the pension beneficiary groups; and
 - Any matter that would be incompatible with any condition in the Amended and Restated Standby Purchase Agreement entered into between Air Canada and Deutsche Bank (“DB”).
9. Potential equity investors conducted detailed due diligence during May and June. In accordance with the Equity Protocol, all meetings and conference calls between the Company and the potential equity investors were conducted in the presence of the Monitor. A number of potential equity investors sought and received the consent of the Company and the Monitor to meet with DB, the standby purchaser for the \$850 million equity Rights Offering to creditors. A condition to the Amended and Restated Standby Purchase Agreement approved by this Honourable Court on May 5, 2004, required that DB, among other things, be reasonably satisfied with the selection of a private equity investor. The Company, its legal and financial advisors and the Monitor participated in a number of meetings between potential equity investors and DB.

10. A form of investment agreement was drafted by the Company with input from the Monitor and sent to the potential equity investors. The form of investment agreement was consistent with the requirements of the Equity Protocol.
11. While the form of the investment agreement ensured that any bid would comply with the minimum conditions and requirements summarized in this Report, the expectation was that the process and bid documentation would have to entertain some flexibility with respect to key business terms and the attributes of the equity being purchased. During the final stages of the Private Equity Process, a number of potential investors determined and advised the Company and the Monitor that their investment proposal would incorporate the terms of convertible preference shares.
12. Proposed binding investment agreements were received by the Monitor in the evening of June 18, 2004. The Monitor distributed the proposed investment agreements to the Company, its legal and financial advisors, DB, GECC and the financial advisors to the Unsecured Creditors' Committee ("UCC").
13. Seabury analyzed the investment proposals and reviewed their analysis with the Company and the Monitor. The Monitor conducted its own independent assessment of the investment proposals. Furthermore, the Company and the Monitor reviewed the investment proposals and received input from GECC, DB and the advisors to the UCC. The Monitor responded to enquiries from the Company's unions, and as discussed later in this Report, ensured that the issues of importance to them were addressed in the Equity Protocol and were reflected in the investment proposals received.
14. At a meeting of the Board of Directors on June 23, 2004, the Applicants' Board considered the input provided to the Company and the Monitor. The Board selected the investment proposal submitted by Cerberus, subject to refinement of some of the terms of the investment proposal that were subsequently accepted by Cerberus after short negotiations amongst Cerberus, the Company and the Monitor.

15. In the Monitor's view, the Private Equity Process was conducted pursuant to the terms of the Equity Protocol. The Monitor provided the Board with its own independent assessment of the investment proposals, which assessment was supportive of the views of the Company and its advisors, and the input received from many of the stakeholders.

PRIVATE EQUITY INVESTMENT AGREEMENT

16. Attached as Exhibit "A" is a copy of the executed Investment Agreement. A summary of the major terms of the Investment Agreements are as follows:

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|--------------------------|--|
| Pricing | <ul style="list-style-type: none">▪ \$250 million preference share investment for the equivalent of 9.16% of the fully diluted common share equity of Air Canada Enterprises ("ACE") on an as-converted basis upon exit from CCAA. The value of the ACE preference shares accrete as per below. |
| Capital Structure | <ul style="list-style-type: none">▪ Three classes of equity:<ul style="list-style-type: none">○ ACE Preference Shares – issued to Cerberus;○ ACE Variable Voting Common Shares – issued to non-Canadian creditors;○ ACE Voting Common Shares – issued to Canadian creditors. |
| Accretion | <ul style="list-style-type: none">▪ Non-cash accretion of 5.0% per annum compounded semi-annually. |
| Term | <ul style="list-style-type: none">▪ Seven years with up to six 6-month extension periods, in certain circumstances described below, to a maximum term of ten years. |
| Conversion | <ul style="list-style-type: none">▪ Convertible at the option of Cerberus at any time at a premium of 35% over the buy-in price, adjusted downward to a premium of 30% after one year.▪ Mandatory conversion at the option of ACE in the event that common stock trades above 200% of conversion price for 30 |

consecutive trading days during the first year.

- Mandatory conversion at the option of ACE in the event that common stock trades above 175% of conversion price for 30 consecutive trading days after the first year.

Mandatory Redemption

- Mandatory conversion into common shares after seven years unless stock price has been trading at less than the then accreted value, which would result in Cerberus not being required to convert and a reduction in the conversion price of 3.75%.
- After the seventh year anniversary, the evaluation process is repeated every 6 months - conversion is mandatory unless the common stock price has been trading at less than the then accreted value, which would result in Cerberus not being required to convert and a further reduction in the conversion price of 3.75% in each successive 6 month period up to 10 years.
- Cerberus has the right to require ACE to redeem preference shares in cash at the accreted value on the tenth anniversary.
- No redemption at the option of Air Canada.

Lock-Up Period

- Lock-up period of 24 months unless forced conversion takes place, which results in lock-up restriction remaining on 50% of the shares.

Governance

- A Board of Directors of 11 members, of which Cerberus has a non-transferrable right to designate 3.
- Board designation threshold reduced in the event Cerberus sells below 75% and 50% respectively of its initial stake after two years.

Material Conditions

- To be satisfied or waived by Closing:
 - GE Exit Financing and other GECC financing arrangements shall be completed on terms not materially inconsistent with the current terms;
 - DB shall not have terminated its obligations under the Amended and Restated Standby Purchase Agreement pursuant to the occurrence of a material adverse change;
 - All necessary regulatory approvals shall have been obtained

- Consummation of the rights offering shall take place contemporaneously; and
- All necessary approvals for the plan of reorganization, compromise and arrangement under CCAA shall have been obtained as necessary.

- Closing** ▪ Closing on the date of consummation of the Rights Offering.
- Termination** ▪ By either party, if parties are in mutual agreement or if Closing does not occur by December 31, 2004.
- By Cerberus, if Air Canada closing conditions cannot be fulfilled.
- By Air Canada, if Cerberus closing conditions cannot be fulfilled.
- Expenses and Fees** ▪ Monthly fees of \$250,000 from July 1, 2004 until Closing.
- The balance of all reasonable unpaid fees and expenses associated with Cerberus' investment in Air Canada.

17. Seabury has prepared an analysis of the approximate allocation of equity, on an as-converted basis, upon Air Canada's emergence from CCAA proceedings:

Stakeholder / Investor	Approximate Equity Allocation
Creditors (from claims)	45.8%
Rights Offering/DB Standby Agmt.	42.0%
Cerberus (initial)	9.2%
Management Options*	3.0%
Current Shareholders	0.01%

*An allocation of equity of 3% on Closing is to be made available to management in the form of stock options under an option plan to be described in the Plan of Arrangement and Information Circular to be filed on or about June 30, 2004.

PROPOSED AMENDMENTS TO INITIAL ORDER

18. At paragraph 14 of the Monitor's Twenty-Seventh Report, the Court was advised of Air Canada's intention to assign the New Aerogold Agreement to Aeroplan Limited Partnership in accordance with the requirements set out in the New Aerogold Agreement. As previously advised by Air Canada to the Court, the DIP Lender has requested the Initial Order be amended to clarify that its charge will extend to any property assigned among the affiliates of the Applicants. This is required in order to clarify the DIP Lender's rights in respect of the New Aerogold Agreement upon its assignment to Aeroplan Limited Partnership.
19. Air Canada has advised the Monitor that it will be seeking a further amendment to the Initial Order in connection with clarification that the Directors' Charge applies to directors of companies incorporated for purposes of the advancing the Plan of Reorganization. In particular, the Plan of Reorganization requires the incorporation of ACE Aviation Holdings Inc. ("ACE") to effect the corporate reorganization of Air Canada upon emergence from CCAA proceedings. Since ACE requires execution of certificates by its directors in order to advance the Plan of Reorganization and facilitate Air Canada's emergence from CCAA proceedings, it will be necessary to protect the directors through the clarification of the Directors' Charge.

MONITOR'S CONCLUSIONS

20. In the Monitor's view, the Private Equity Process was conducted in a fair and commercially reasonable manner under the supervision and facilitation of the Monitor in accordance with the Equity Protocol approved by this Honourable Court.
21. In the Monitor's view, the Investment Agreement described in this Report and subject to the approval of this Honourable Court does not contain any condition requiring the renegotiation or reopening of any material contract, collective bargaining agreement or pension plan design/funding agreement, thus meeting the material elements of the Equity Protocol.

22. From a financial perspective, the common equity ownership represented by the convertible preference shares to be issued upon Air Canada's exit from CCAA proceedings is approximately 9.2%, which is materially lower than the target 12% initially established under the Equity Protocol. Therefore, the initial conversion terms of the Investment Agreement are less dilutive (and hence, more favourable) to Air Canada's creditors than the target 12% equity ownership initially set under the Equity Protocol. However, based on the financial analysis prepared by Seabury and reviewed by the Monitor, the annual accretion in the value of the convertible preference shares (as described above) will increase the potential common equity ownership on an as converted basis to approximately 10.4% on the anniversary date at the end of the second year after issuance and approximately 12.9% on maturity at the end of the seventh year after issuance in the event the convertible preference shares are not otherwise converted under the terms of the Investment Agreement before that time.
23. DB has confirmed its satisfaction of the condition in the Amended and Restated Standby Agreement that the Private Equity Process and the private equity investor are satisfactory to it. DB has advised the Company and the Monitor that it is pleased with the outcome of the Private Equity Process and supports the selection of Cerberus as the private equity investor, which is subject to court approval.
24. The Company and the Monitor have been advised by the advisors to the UCC that the UCC is supportive of the selection of Cerberus as the private equity investor and the terms of the Investment Agreement disclosed to the UCC.
25. GECC continues to express its view that speed and certainty remain critical to Air Canada's successful emergence from CCAA proceedings. GECC has advised the Monitor of its concern that incorporating the proposed equity investment at this time may result in further delay and complication to the process, jeopardizing Air Canada's prospects for a successful emergence by September 30, 2004. GECC has further advised the Monitor that it has received assurances from Air Canada, Cerberus and DB that the selection of Cerberus as the private equity investor and the implementation of

the Investment Agreement, if approved by this Honourable Court, will not result in further delay.

26. In particular, GECC has advised the Monitor that it has received assurances that Cerberus will not request or support any steps by Air Canada to re-open settled arrangements with the unions or other parties. Further, GECC has been assured that the terms of the Cerberus investment proposal will in all respects be as set forth in the Investment Agreement and such equity investment will not cause Air Canada to miss the important milestone dates that Air Canada is required to meet under the GRA, including the requirement that Air Canada exit from CCAA proceedings by no later than September 30, 2004. In reliance upon such assurances, GECC has advised the Monitor that it has agreed to extend certain interim dates in the GRA in order to accommodate the Investment Agreement, however the exit deadline of September 30, 2004 remains firm.
27. The selection of Cerberus to provide an additional \$250 million of equity capital, if approved by this Honourable Court, in combination with the \$850 million of equity to be raised pursuant to the Rights Offering and backstop provided by DB, will provide Air Canada with \$1.1 billion of equity capital upon emergence from CCAA proceedings. The proceeds to be received from Cerberus, shall be used in part, to retire the GECC warrants and the GECC convertible note described in the Twenty-Sixth Report.
28. The \$1.1 billion of equity financing together with the financing provided under the GRA described in the Monitor's Twenty-Sixth Report, should provide Air Canada with the necessary financial capital to successfully emerge from CCAA proceedings and to execute its business plan.
29. The conclusion of the Private Equity Process and the selection and approval of Cerberus as the private equity investor is a critical step in the restructuring of Air Canada that will now allow Air Canada to direct its restructuring efforts to the resolution of disputed claims, the filing of the Plan of Arrangement/Information Circular and the creditors' meeting.

30. Consequently, the Company has advised the Monitor that it expects to file the Plan of Arrangement and Information Circular by June 30, 2004, and thereby, meet the next critical milestone condition under the terms of both the amended GRA with GECAS and the Amended and Restated Standby Purchase Agreement with DB.

MONITOR'S RECOMMENDATIONS

31. The Monitor recommends this Honourable Court approve the Applicants' motion seeking approval of the Investment Agreement.

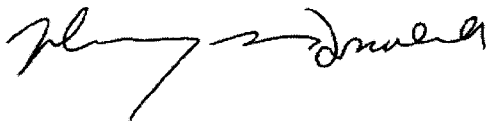
32. The Monitor recommends this Honourable Court approve the Applicants' motion seeking approval of amendments to the Initial Order as described in paragraphs 18 and 19 of the Report.

All of which is respectfully submitted by:

ERNST & YOUNG INC.

In its capacity as Court Appointed Monitor of Air Canada
and certain of its subsidiaries

Per:



Murray A. McDonald
President

SCHEDULE "A"

3838722 Canada Inc.

Air Canada Capital Ltd.

Jazz Air Inc.

Manoir Int'l Finance Inc.

Simco Leasing Ltd.

Wingco Leasing Inc.

Zip Air Inc.