

**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 FIFTH REPORT OF THE MONITOR
DATED APRIL 30, 2004**

1. On April 1, 2003, Air Canada and certain of its subsidiaries (collectively the "Applicants" or 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, as amended (the "Amended and Restated Initial Order"). Pursuant to the Amended and Restated 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 (as defined below) are as defined in the Amended and Restated Initial Order or the First through the Twenty Fourth Reports of the Monitor. All references to dollars are in Canadian currency unless otherwise noted.
3. The purpose of this Twenty Fifth Report of the Monitor (the "Report") is to provide this Honourable Court and Air Canada stakeholders with:
 - An update on efforts to raise equity (the "Equity Process") required by the Applicants to successfully emerge from CCAA protection;

- A summary of an expanded creditor rights offering (“Rights Offering”) and the terms of an amended and restated standby purchase agreement (the “Restated DB Standby Agreement”) which will continue to be backstopped by Deutsche Bank Securities Inc. (“DB”). The Rights Offering and Restated DB Standby Agreement will become the cornerstone of the Equity Process, subject to approval of this Honourable Court;
- An outline of a private equity solicitation process (the “Private Equity Process”) to be commenced on May 5, 2004 to raise a possible additional \$250 million, subject to approval of this Honourable Court;
- Details on the extension of the global restructuring agreement (“GRA”) executed by the Company and GECAS; and
- Details of an agreement with the GTAA.

TERMS OF REFERENCE

4. In preparing this Report, the Monitor has relied upon unaudited Company prepared financial information, Company records and discussions with management (“Management”), and the financial and legal advisors to the Company. The Monitor has not performed an audit, a review or other verification of such information. An examination of the financial forecast as outlined in the Canadian Institute of Chartered Accountants 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 EFFORTS TO RAISE EQUITY

5. Since Trinity’s announcement on April 2, 2004 of its intention to not seek an extension of the Amended Trinity Investment Agreement upon its expiry on April 30, 2004 and that Trinity released Air Canada from its exclusivity obligations effective immediately, the

Monitor and the Company have held numerous discussions with the Company's stakeholders, including Labour unions, GECC and GECAS, and the advisors to the Unsecured Creditors' Committee ("UCC"). At the request of the Ad Hoc Committee of Senior Financial Creditors, a conference call was hosted by the Monitor for the purpose of listening to the issues and concerns of certain financial creditors.

6. Those discussions allowed the stakeholders to advise the Monitor and the Company of issues and concerns that each the various stakeholders believed should be considered in connection with the design and execution of a court-supervised Equity Process.
7. The Company and the Monitor received a wide range of views on particular issues given the large number of stakeholders involved in these proceedings. Certain stakeholder views reflected that the following elements of a court-supervised Equity Process would be integral to a successful outcome for the Company:
 - Certain stakeholders expressed a strong desire for an opportunity to participate in providing additional capital in the Equity Process through an expanded Rights Offering to creditors.
 - The certainty of closing any new equity proposal which would be brought forward for court approval was paramount. This would require the new Private Equity Process to provide that equity investment proposals have few conditions. Additionally, any conditionality related to the remaining restructuring initiatives, such as pension funding, should be satisfied at the commencement of the Private Equity Process so that there would be no uncertainty at the conclusion of the Private Equity Process that a successful equity investor would close.
 - A short Private Equity Process was seen as essential to enable the Company to restore confidence in the likelihood of a successful restructuring and to provide confidence in the marketplace following the departure of Trinity. Many stakeholders provided the Monitor with their views on the appropriate timetable to be built into a court-approved Private Equity Process and adhered to by equity

participants to remove any uncertainty and delay in the Private Equity Process and overall emergence from CCAA.

- Stakeholders wish there to be guidelines around the Private Equity Process by which investment proposals are to be solicited and evaluated, including the supervision and approval of the Court and with an expanded role for the Monitor to supervise, facilitate and oversee the Private Equity Process.
8. In general, the views of the Company's Labour unions reflected a desire for a longer Private Equity Process for a larger private equity component with more inclusive participation by Labour in the process.
9. With the assistance of the Company's financial and legal advisors and based upon input from various stakeholders, the Monitor and the Company have developed an Equity Process which in the Monitor's view, responds to the many of the issues and concerns expressed by the stakeholders and is commercially achievable. The Equity Process described below consists of two major elements:
- The expansion of the existing Rights Offering to creditors from \$450 million to \$850 million with the continued support of DB; and
 - The design of an Private Equity Process to raise a potential additional \$250 million with a 45 day due diligence period and low conditionality provisions to be imposed on potential equity investors to mitigate closing risk.

RESTATED DB STANDBY AGREEMENT AND RIGHTS OFFERING

10. Following Trinity's notification that it would not seek an extension to its investment agreement with the Company, DB indicated its willingness to continue to support the Company through a possible expansion of its commitment to back-stop a larger creditor Rights Offering.
11. In the Monitor's view, DB's willingness to reaffirm and increase its financial commitment to Air Canada was a very positive step for the Company in restoring marketplace

confidence in the restructuring process and in the ability of Air Canada to successfully emerge from protection under the CCAA with necessary equity capital.

12. It became apparent that a larger Rights Offering backstopped by DB could become the cornerstone for an Equity Process that addresses many of the concerns expressed by the stakeholders. With a substantial amount of equity committed to Air Canada through an expanded DB commitment, a Private Equity Process could then be designed.
13. The Company, with the substantial and direct involvement of the Monitor, commenced intensive negotiations with DB in connection with finalizing amendments to the original standby agreement that had already received approval of this Honourable Court.
14. Due to the significant increase in its financial commitment to Air Canada, DB reasonably requested greater assurances and protection through additional conditions and due diligence requirements. During the negotiations, each of DB, the Monitor and Air Canada were cognizant of certain of the views of stakeholders as expressed above.
15. Notwithstanding a substantial equity commitment was to be made by DB through a creditor Rights Offering, it was the shared view of the Monitor, DB, the Company and many stakeholders that a successful post-emergence Air Canada will benefit from the stewardship, governance and strategic direction that a private equity investor can provide. DB indicated that additional funding should be sought from a private equity investor in addition to the \$850 million to be obtained through the Restated DB Standby Agreement. It was the Monitor's view that in light of the stakeholder concerns noted above, and the desire to conclude the restructuring as quickly as possible, potential additional private equity should not be obtained at any cost or at any substantial increase in the risk to the successful conclusion of the restructuring.
16. In the equity solicitation process concluded in January 2004, Air Canada identified an aggregate equity requirement of \$1.1 billion composed of \$650 million from Trinity and a standby commitment of \$450 million from DB. Of the \$1.1 billion of equity capital to be raised, approximately \$150 million was to be used to retire the GECC convertible note

provided for in the GRA, thus leaving approximately \$950 million of cash at the restructured Air Canada.

17. Under the Restated DB Standby Agreement discussed below, the Applicants continue to target \$1.1 billion of equity financing (\$850 million from DB and \$250 million from a private equity investor). However, in the event the Private Equity Process is unsuccessful in raising \$250 million, DB will still fund \$850 million without the requirement that the GECC convertible note be repurchased, leaving \$850 million of cash in the restructured Air Canada.
18. Consequently, DB and the Company, with the concurrence of the Monitor, agreed that the Rights Offering and standby funding commitment to be extended by DB should not be conditional upon the raising \$250 million in the Private Equity Process. Consequently, Air Canada is assured of raising the minimum necessary equity capital required to successfully emerge from protection under CCAA without the closing risk associated with a private equity investment.
19. Attached as Exhibit “A” is a copy of the Restated DB Standby Agreement that has been approved by the Board of Air Canada and executed by the Company and DB and subject to approval of this Honourable Court.

20. A summary of key terms of the Restated DB Standby Agreement is as follows:

- | | |
|-------------------|---|
| Commitment | <ul style="list-style-type: none">• \$850 million back stop to a creditor Rights Offering to close on or before September 30, 2004.• There is no restriction on DB’s ability to syndicate its rights under the agreement. DB shall consult with the Company with respect to syndication. |
| Pricing | <ul style="list-style-type: none">• Creditors – can purchase Rights Offering Shares at the same price as Trinity at Trinity’s pre-money valuation of \$925 million.• DB - as standby purchaser, will pay a premium of 7.5% over the price paid by creditors. |

- Rights Offering**
- To be offered to all creditors pro-rata on a creditor's claim relative to total creditor claims.
 - No over-allotment provision to allow creditors to receive additional rights in addition to their pro-rata allocation.
 - Creditors holding disputed claims are allowed to participate under certain conditions.
- Fees and Expenses**
- Partial expense reimbursement of \$2 million payable upon court approval plus \$500,000 per month commencing May 1, 2004 until Closing.
 - Arrangement fee of \$12.75 million (1.5% of \$850 million commitment).
- Private Equity Solicitation Process**
- Raise approximately \$250 million.
 - Part of the proceeds to be used to repay GECC warrants and retire the GECC convertible note.
 - Private Equity Process and private equity investor to be reasonably satisfactory to DB.
- Material Conditions**
- By May 15, 2004:
- Applicants must achieve cost reductions of \$200 million of the \$330 million labour cost shortfall set forth in the April 8, 2004 management presentation to Labour. (refer to s. 6.1(iii) of the agreement)
 - Labour agreeing to "clean slate" requirements in connection with grievances and claims under Collective Agreements.
 - Funding obligations of pension and benefit plans shall have been resolved with OSFI on terms not less favourable to Air Canada than the terms contained in the February 2004 agreement between Air Canada and the Pension Beneficiary Groups.
- Other material conditions:
- DB shall receive assurances from the Government of Canada in connection with the modification, amendment or repeal of certain provisions of legislation so as to ensure Air Canada is permitted to compete on a fair and equitable basis with all air carriers.
 - Court approval of the extension of GECAS agreements, if necessary.

- Stability for the restructuring process to be maintained through arrangements to be made to retain senior management. R. Milton shall not have resigned or been terminated prior to Closing.
 - Aggregate amount of Disputed Claims in respect of creditors electing to participate in the Rights Offering shall be less than \$1 billion.
- Timetable**
- May 15 => 3 major conditions satisfied (identified above).
- June 30 => Plan of Arrangement filed in Court.
- Aug. 15 => Creditors' meeting to be held.
- Sept 30 => Closing of Rights Offering and Emergence from CCAA.
- Exclusivity**
- Air Canada cannot solicit a Competing Transaction (as defined)
- Governance**
- The CEO shall be one of 11 directors.
 - The Plan of Arrangement will provide for a process to designate the remaining 10 directors, of which, DB has the right, but not the obligation, to nominate 4.
- Break-Fee**
- \$25.5 million (3% of \$850 million commitment)
 - Payable if:
 - Air Canada consummates a Competing Transaction (as defined) within 24 months.
 - Air Canada terminates the agreement in the event that Closing does not occur by Sept 30, 2004.
 - The Court terminates the agreement.

21. Seabury and the Company have prepared a preliminary analysis, reviewed by the Monitor, estimating the potential equity allocations that may result from the closing of the Restated DB Standby Agreement and a \$250 million private equity investor pursuant to the Private Equity Process described below. The following table summarizes the estimated equity allocations based on the assumptions disclosed below:

TABLE 1 – Air Canada’s Preliminary Estimates of Equity Allocations⁽⁶⁾
(Assuming 50% Rights Offering Take-up)

Stakeholder	Restated DB Standby Agmt	Trinity Dec 19
Equity Plan Sponsor ⁽¹⁾	11.97%	31.13%
GE ⁽²⁾	0.00%	0.00%
Creditors – Claims	44.30%	44.30%
Creditors – Rights Offering ⁽³⁾⁽⁴⁾	20.36%	16.17%
Total Creditors	64.66%	60.47%
DB – standby purchaser & syndication	20.36%	5.39%
Management options (added to improve comparability) ⁽⁵⁾	3.00%	3.00%
Existing Shareholders (added to improve comparability) ⁽⁵⁾	0.01%	0.01%

(1) Assumes \$250 million is raised from a new equity plan sponsor at the same pricing as the Rights Offering Shares to be made available to creditors pursuant to the Restated DB Standby Agreement.

(2) Assumes GECC warrants and GECC convertible note are redeemed under the same terms disclosed in the Trinity December 19 agreement and related transactions described in the Eighteenth Report.

(3) Assumes 50% of creditors exercise their Rights (with no provision for over-allotment) pursuant to the Restated DB Standby Agreement at the same pricing as Trinity. Under the Trinity Dec 19 agreement, it was assumed that 50% of the creditors would exercise their rights to purchase equity at the same pricing as Trinity plus an over-allotment exercise of Rights for a further 25% of the Rights Offering Shares at a premium of 15% over Trinity’s price.

(4) If 100% of the Rights Offering shares are subscribed by creditors, the estimated equity allocations under the two scenarios above would be amended as follows: Total Creditors under the Restated DB Standby Agmt – 85.01%; Total Creditors under the Trinity Dec 19 Agmts – 65.85% (see Table 2 below). As the percentage of creditors exercising their Rights increases, creditors in the aggregate will receive substantially more equity in the restructured Air Canada under the Restated DB Standby Agreement.

(5) The Restated DB Standby Agreement does not require equity to be made available to management of the restructured Air Canada under an options program or existing Air Canada shareholders. Equity allocations may be addressed by private equity investors during the Private Equity Process described below. However, to increase the usefulness of this analysis and to improve the comparability of the Trinity Dec 19 agreement to the Restated DB Standby Agreement, the Monitor has assumed the identical equity allocations to management options and existing Air Canada shareholders under the Restated DB Standby Agreement.

(6) The pricing and equity allocations proposed by private equity investors pursuant to the Private Equity Process cannot be forecast or determined at this time. Therefore, the analysis contained in Table 1 should be viewed as a preliminary estimate only, which is subject to change once a private equity investment agreement has been selected and approved by court.

22. The Monitor has taken the results from Table 1 above and estimated the effect on equity allocations assuming 100% of Rights Offering Shares are taken up by creditors.

TABLE 2 – Monitor’s Preliminary Estimates of Equity Allocations⁽⁵⁾
(Assuming 100% Rights Offering Take-up)

Stakeholder	Restated DB Standby Agmt	Trinity Dec 19
Equity Plan Sponsor ⁽¹⁾	11.97%	31.13%
GE ⁽²⁾	0.00%	0.00%
Creditors – Claims	44.30%	44.30%
Creditors – Rights Offering ⁽³⁾	40.72%	21.56%
Total Creditors	85.01%	65.85%
Management options (added to improve comparability) ⁽⁴⁾	3.00%	3.00%
Existing Shareholders (added to improve comparability) ⁽⁴⁾	0.01%	0.01%

(1) Assumes \$250 million is raised from a new equity plan sponsor at the same pricing as the Rights Offering Shares to be made available to creditors pursuant to the Restated DB Standby Agreement.

(2) Assumes GECC warrants and GECC convertible note are redeemed under the same terms disclosed in the Trinity December 19 agreement and related transactions described in the Eighteenth Report.

(3) Assumes 100% of creditors exercise their Rights pursuant to the Restated DB Standby Agreement at the same pricing as Trinity. Under the Trinity December 19 agreement, it is assumed that 100% of the creditors would exercise their rights to purchase equity at the same pricing as Trinity.

(4) The Restated DB Standby Agreement does not require equity to be made available to management of the restructured Air Canada under an options program or existing Air Canada shareholders. Equity allocations may be addressed by private equity investors during the Private Equity Process described below. However, to increase the usefulness of this analysis and to improve the comparability of the Trinity December 19 agreement to the Restated DB Standby Agreement, the Monitor has assumed the identical equity allocations to management options and existing Air Canada shareholders under the Restated DB Standby Agreement.

(5) The pricing and equity allocations proposed by private equity investors pursuant to the Private Equity Process cannot be forecast or determined at this time. Therefore, the analysis contained in Table 1 should be viewed as a preliminary estimate only, which is subject to change once a private equity investment agreement has been selected and approved by this Honourable Court.

PRIVATE EQUITY SOLICITATION PROCESS

23. Having the cornerstone of \$850 million of equity capital committed at the commencement of the Equity Process assists the Company in seeking private equity for the following reasons:

- Since the Restated DB Standby Agreement does not require as a condition any further private equity investment, the Private Equity Process can be designed to mitigate closing risk through limiting the number and nature of conditions acceptable to the Company;
- Major restructuring conditions can be addressed at the commencement of the process, therefore, eliminating the need for private equity investors to require material conditions; and
- The establishment of court-approved parameters around the terms and conditions which are acceptable in the Private Equity Process increases the comparability of the investment agreements submitted in the Private Equity Process.

24. Attached as Exhibit “B” is the protocol for the Private Equity Process designed by the Monitor and the Company after receiving input from stakeholders and reflecting the flexibility provided by the Restated DB Standby Agreement.

25. The major elements of the protocol are:

- The Monitor will supervise, facilitate and oversee the Private Equity Process undertaken by the Company;
- Stakeholders will be provided with appropriate periodic updates respecting the confidentiality requirements of the potential equity investors;
- Proposed equity investment agreements must be submitted by June 18, 2004, the conclusion of the due diligence phase; and
- The Monitor will provide its recommendation to the Company and to the Court at the conclusion of the Private Equity Process.

26. Based upon the input received from stakeholders, the protocol stipulates that any proposed investment agreement shall contain no condition requiring:

- The renegotiation of any material contract which has received approval of the Court during the restructuring;
- The renegotiation of any collective bargaining agreement;
- Any changes to the design of pension plans; and
- Funding of the pension and benefit plans on a basis that is less favourable to Air Canada than the terms of the February 2004 agreement reached by Air Canada and the pension beneficiary groups.

27. If approved by this Honourable Court, the protocol will become the structure for the Private Equity Process to be supervised by the Monitor.

EXTENSION OF THE GLOBAL RESTRUCTURING AGREEMENT

28. In the Twenty Second Report, the Monitor provided an overview of the GRA executed by the Company and GECAS which provides several benefits to Air Canada including:

- The restructuring of owned and managed aircraft leases;
- New exit financing of US\$585 million to be available for use upon emergence from CCAA (the “Exit Facility”); and
- Aircraft financing to a maximum of US\$950 million to be used for the future acquisition of approximately 43 new regional aircraft (the “RJ Financing”).

29. In return, the GRA provides, amongst other things, for:

- The delivery of notes refinancing existing obligations to GECC in connection with two B747-400 cross-collateralized leases;

- The delivery of stock purchase warrants for the purchase of an additional 4% of common stock of the restructured Air Canada at a strike price equal to the price paid by any private equity plan sponsor; and
 - The cross-collateralization of all GECC and affiliate obligations (the “Interfacility Collateralization Agreement”) on Air Canada’s emergence from CCAA proceedings for a certain period of time.
30. The Exit Facility and the Interfacility Collateralization Agreement were in the form of term sheets attached to the GRA. Since the execution of the GRA, the Company and GECAS continue to negotiate the form of definitive agreements.
31. The RJ Financing was in the form of a commitment to provide financing on terms and conditions to be subsequently agreed amongst the parties. The Company and GECAS continue to negotiate a mutually acceptable term sheet.
32. The GRA as amended on January 5, 2004 provides that the Company must emerge from CCAA protection on or before April 30, 2004. On April 29, 2004, the Applicants and GECAS reached an agreement on the terms of an extension of the GRA from April 30, 2004 to September 30, 2004 subject to the following conditions:
- Court approval of the Restated DB Standby Agreement to be received by May 7, 2004;
 - Satisfactory resolution of the major conditions in the Restated DB Standby Agreement by May 15, 2004 (as identified above);
 - The filing of the Plan of Arrangement with the Court by June 30, 2004;
 - Creditor approval of the Plan of Arrangement by August 15, 2004; and
 - Emergence from these CCAA proceedings on or before September 30, 2004.
33. The GRA extension agreement provides that GECAS shall have the right to terminate the GRA prior to September 30, 2004 in the event that the Applicants do not meet any one of the five milestone conditions outlined above.

DETAILS OF AN AGREEMENT WITH GTAA

34. A dispute arose between Air Canada and the GTAA with respect to the use of contact gates at the new Terminal 1 (“TINew”) and the existing Terminal 2. On February 4, 2004, this Honourable Court granted an order requiring the GTAA to provide Air Canada with the fixed preferential use of the 14 contact gates at the opening of TINew. Leave to appeal the February 22, 2004 order was denied on March 19, 2004.
35. An issue arose between the GTAA and Air Canada, arising out of the February 22 order, relating to the number of Terminal 2 gates to be vacated by Air Canada. The GTAA then brought a motion for an order requiring Air Canada to deliver up vacant possession of three gates in Terminal 2. That motion was returnable on April 30, 2004.
36. Late on April 29, 2004, Air Canada and the GTAA reached agreement on a number of operational issues at Terminal 2 including the use of the three gates which were the subject of the pending motion. With respect to the three gates in issue, in general terms, they will become common use gates administered by the GTAA subject to certain agreed grandfathered use by Air Canada.
37. It is the view of the Monitor that the agreement reached represents a practical resolution of various operational disputes which had separated Air Canada and the GTAA. By letter dated April 30, 2004, Air Canada and the GTAA advised the Court of their commitment to continuing to work together to enhance the relationship going forward in accordance with the suggestion made in the February 24, 2004 Reasons of The Honourable Mr. Justice Farley.

MONITOR'S CONCLUSIONS AND RECOMMENDATIONS

38. The Restated DB Standby Agreement:

- a) Provides immediate certainty to Air Canada and the stakeholders that the Company will have sufficient equity financing required by the business plan in order to emerge from CCAA on an accelerated timeline;
- b) Provides immediate stability to the Company and assurance to the travelling public on the eve of the Company's peak operating season. ;
- c) Assists the Company in meeting its business plan objectives in the upcoming critical period as private equity investors consider a potential \$250 million investment; and
- d) Allows for the continued availability of the GRA to Air Canada, an essential element of the equity component of Air Canada's exit strategy, as it provides the Company with necessary exit debt financing and approximately one third of its aircraft fleet.

39. The Private Equity Process described above and the protocol attached as Exhibit "B" provide Air Canada and its stakeholders with a court supervised Private Equity Process designed to meet the GRA extension agreement milestones which will provide the certainty and speed to facilitate Air Canada's exit from CCAA proceedings.

40. The Restated DB Standby Agreement, the Private Equity Process and the financing arrangements within the GRA should provide Air Canada with the necessary financing to successfully emerge from CCAA protection.

41. The Monitor notes, however that:

- a) Certain key conditions to the Restated DB Standby Agreement must be met by May 15, 2004; and
- b) Five milestones must be met to ensure the continued availability of the GRAs.

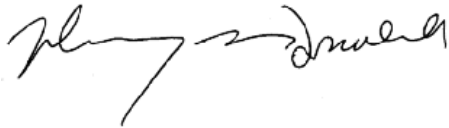
42. The Monitor recommends that this Honourable Court approve the Company's motion seeking approval of the Restated DB Standby Agreement and the Private Equity Process described herein.

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:

A handwritten signature in black ink, appearing to read 'Murray A. McDonald', written in a cursive style.

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.