

**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 FIRST REPORT OF THE MONITOR
DATED FEBRUARY 6, 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. ("EYT") 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 Twentieth Reports of the Monitor. All references to dollars are in Canadian currency unless otherwise noted.
3. The purpose of this Twenty First Report of the Monitor (the "Report") is to provide this Honourable Court and Air Canada stakeholders with:
 - An update on the current status of the aircraft lease renegotiation process; and,

- A recommendation of the Monitor with respect to the Applicants' motion to seek Court approval for the payment of non-refundable deposits up to an aggregate amount of US\$55 million pursuant to the Bombardier and Embraer aircraft purchase agreements.

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.

AIRCRAFT LEASE RESTRUCTURING PROCESS

5. In connection with its CCAA filing and in accordance with paragraph 25 of the Amended and Restated Initial Order, the Applicants declared a payment moratorium effective April 1, 2003 on all aircraft lease payments in order to preserve cash resources, complete a review of their existing fleet and assess future fleet requirements in light of the restructuring. The moratorium period was also intended to provide the Applicants with the necessary time to negotiate revised financial arrangements for the use of the aircraft with the various lessors or, alternatively, to make arrangements for the return of the aircraft to the lessors, all in accordance with the Applicants' new business plan, including the aircraft fleet reconfiguration that the Company believes must be completed to be competitive in the current environment.
6. Aircraft lessors were advised that the lease concessions required would include amendments to bring lease rates to market, make lease termination dates consistent with the Company's business plan, implement satisfactory aircraft return conditions and provide for the funding of substantial maintenance checks. In doing so, the Applicants also sought to maintain various complex leasing structures in place to preserve potential financial benefits due at lease term, where applicable. Monitor is advised by the Company that it has met or held discussions with all of its aircraft lessors and/or advisors individually to this effect since April 1, 2003.

7. The table below summarizes the status of the Company's fleet reduction / re-negotiation efforts as of February 4, 2004:

	<i>Air Canada</i>	<i>Jazz</i>
Total Number of Aircraft as at April 1, 2003	259	130
Less: owned and parked aircraft		
	(19)	(51)
Number of Aircraft subject to re-negotiation	<u>240</u>	<u>79</u>
 <i>Status of Re-Negotiations:</i>		
Repudiations	29	9
Consensual returns or lease expirations	13	2
Re-negotiated under the GECAS agreement (<i>note 1</i>)	64	10
Re-negotiated under the ECA agreement	34	n/a
Re-negotiated pursuant to other signed MOUs	87	29
Re-negotiated in principle, with MOUs pending	13	9
Other settled aircraft arrangements (<i>note 2</i>)	n/a	20
	<u>240</u>	<u>79</u>

Note 1 – The agreement entered into between Air Canada and GECAS covers an additional 3 Air Canada aircraft for which leases have expired and 20 Jazz aircraft that have been returned on consent (*Note 2*) as well as an additional 10 aircraft that are also covered by the ECA agreement for a total of 107 aircraft.

Note 2 - This represents 20 F-28 aircraft that were owned by Jazz and had been previously parked. Pursuant to a pre-filing agreement, GECAS was to take title to these aircraft. Under the terms of the Global Restructuring Agreement reached with Air Canada subsequent to its CCAA filing, GE has given up the right to take title to the F-28 aircraft.

Status of Fleet Reductions

8. As reflected in the table above, the Applicants have reduced their total fleet size by 73 aircraft since April 1, 2003, including repudiated and returned aircraft, as well as the 20 parked F-28 aircraft. Of these 73 aircraft, only 50 aircraft were actually in use by the Applicants as at April 1, 2003 with the remaining 23 aircraft comprised of:
- 3 aircraft already sub-leased to an external third party. The Applicants have since arranged for the third party to assume the lease obligation directly; and

- 20 F28s that were parked and not in use.
 - It should be noted that the effective date on many of the repudiated aircraft leases has not yet passed. Accordingly, the Applicants may continue to use the aircraft up until the effective repudiation date. To the extent that leasing agreements are arrived at subsequent to the issuance of repudiations, these may be retracted, with a resulting amendment to any proof of claim previously filed by the lessor.
9. The Applicants have accepted delivery of 3 new GECAS aircraft since April 1, 2003. The rental rates on these new aircraft reflect the Applicants' view of current fair market lease rates. Accordingly, after considering unused aircraft and newly delivered aircraft, the Applicants will have made a net reduction in their operating fleet of 47 aircraft, assuming all repudiations become effective. It is anticipated that further reductions will occur as certain re-negotiated leases provide for the early return of aircraft over the next 24 months.

Status of Lease Re-Negotiations

10. Since the Monitor last reported to this Court on the progress of the fleet restructuring process on December 15, 2003, and in light of the recently established final claims bar date of February 23, 2004 for Restructuring Claims, the Company has issued additional lease repudiations covering 12 aircraft and successfully renegotiated 44 aircraft leases to complete its fleet restructuring process, including 1 renegotiated agreement that is subject to Court approval. The Applicants have yet to come to a financial arrangement with the equity participant for 3 ECA related aircraft. Accordingly, those 3 aircraft leases, which were previously reported as having been completed pursuant to the ECA Agreement, were repudiated effective April 15, 2004.
11. With respect to the 13 remaining Air Canada aircraft leases, including 1 previously reported ECA aircraft, the Applicants and the lessors have agreed to allow the lessors to file proofs of claim as if the Applicants had repudiated the aircraft leases ("Deemed

Repudiations”), notwithstanding that no such repudiation has been issued. This agreement was completed for the following reasons:

- The constituency of these lessor groups is composed by a very broad syndicate of North American and European based financial institutions; and,
 - The lessors were concerned that the issuance of notices of repudiation would result in significant time consumed within the syndicates arising from the repudiations and the resultant impact on the structured leases rather than focusing on the completion of the lease negotiations.
12. In most of the cases involving Deemed Repudiations, renegotiated lease terms have been agreed on such critical items as leasing rates, the funding of substantial maintenance checks, return dates and return conditions.
13. The 9 outstanding Jazz leases consist of mortgage loans secured by the related aircraft, which are subject to ongoing negotiations.

NEW AIRCRAFT ORDERS AND PRE-DELIVERY DEPOSITS

14. As reported in the Monitor’s previous Reports to this Honourable Court, the Applicants undertook to reduce fleet size by approximately 40 aircraft to properly match current and anticipated capacity requirements and to re-negotiate aircraft leasing costs to reflect current market rates. Concurrently, the Applicants have also negotiated modified expiry dates for certain of their aircraft leases to properly reflect anticipated passenger capacity and planned aircraft acquisitions, in accordance with its new business plan.
15. In light of the proposed new aircraft lease expiry dates, it is currently estimated that the Applicants’ global aircraft fleet will be reduced by approximately 89 aircraft between April 1, 2003 and December 2007 through repudiations and expiries of leases, with the related capacity to be serviced by a proposed new fleet of 50 to 110 seat aircraft as required by the Applicants’ business plan.

16. On December 19, 2003, Air Canada announced that it had reached agreements in principle to purchase 45 Bombardier and 45 Embraer aircraft. These agreements were the result of a detailed analysis of the alternative products available in the 50, 70 and 100 seat aircraft categories from various aircraft manufacturers.
17. The Bombardier order consists of fifteen 50-seat CRJ200 and thirty 74-seat CRJ705 aircraft with deliveries scheduled to begin in September 2004 and May 2005, respectively. The Embraer order consists of forty-five 93-seat Embraer 190 aircraft, with deliveries scheduled to begin in November 2005. It is anticipated that all Bombardier and Embraer orders will be delivered by January 2008, subject to the usual limited acceleration and deferral clauses permitting the Company to adjust new aircraft receipts to reflect capacity demands.
18. These aircraft orders are conditional on certain pre-requisite conditions being fulfilled including i) obtaining satisfactory financing; ii) final documentation of the Definitive Aircraft Purchase Agreements; and iii) approval by the Monitor, GE Canada Finance Inc., and Trinity. The Applicants expect to finalize the financing and documentation prior to emergence from CCAA protection.
19. To date, the Applicants have made refundable deposit payments totalling approximately US \$5 million towards the Embraer aircraft order.
20. The aggregate purchase price for these aircraft approximates US \$2 billion. As is usual in such transactions, the Company will be required to make certain non-refundable pre-delivery payments once the financing condition has been satisfied and the Definitive Aircraft Purchase Agreements are signed. The Applicants estimate the non-refundable deposits to be approximately US\$55 million. The US \$55 million payment includes the US \$5 million refundable deposit noted above, which will become non-refundable once the documentation and financing conditions are satisfied.
21. The Applicants have advised the Monitor that the aircraft manufacturers will not confirm a delivery timetable without receipt of the non-refundable deposits. The Applicants have further advised that the manufacturers require strict confidentiality for their transactions and

will not consent to have their purchase agreement, if, as and when concluded, being publicly reviewed.

22. As the first delivery of the Bombardier and Embraer aircraft is scheduled in September 2004 and November 2005 respectively, it is essential that the Applicants be able to make the applicable deposits to ensure that the agreements' aircraft delivery schedules are adhered to.
23. In order to secure the scheduled delivery timetable required to meet the business plan and the conditions of the Trinity Agreement, the Applicants will be required to agree to pay the non-refundable deposits. In view of the position of the manufacturers, the Applicants do not intend to seek this Honourable Court's approval for the agreements in question. Instead, the Applicants propose to require the manufacturers to structure such agreements so as to ensure that the Applicants' obligations thereunder will be limited to the amount of the deposits made, until such time as the Applicants have emerged from CCAA protection.
24. These agreements have been structured to be effective only upon emergence from CCAA protection, thereby limiting the Applicants' exposure during the stay period exclusively to the non-refundable deposits.
25. In light of the repudiated aircraft leases, the modified lease expiry dates, the anticipated aircraft returns over the next four years and the requirements contained in the Applicants' business plan, the completion of these aircraft orders is essential to the Applicants' successful implementation of its business plan. In addition, the Trinity agreement approved by this Honourable Court is subject to the company having entered into agreements to purchase 105 narrow body jet aircraft having fewer than 110 seats, prior to emergence from CCAA.
26. The Monitor is of the view that the amount of the deposits are reasonable in comparison to the estimated purchase price of the fleet being acquired and are usual and customary in the industry. In view of the unwillingness of the manufacturers to commit to delivery slots without deposits or permit their agreements to be publicly disclosed, the proposal to limit the Applicants' exposure to the amount of the deposits prior to emergence appears to be a

reasonable balancing of interests given the requirement to confirm such purchases and deliveries in order to satisfy the conditions of the Trinity Agreement.

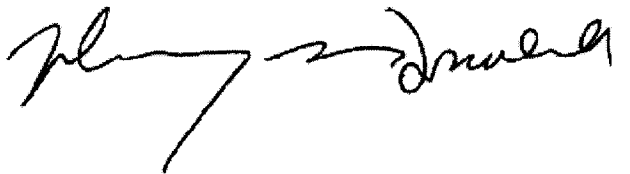
27. Accordingly, the Monitor recommends that the Applicants be permitted to fund the non-refundable pre-delivery payments in the amount of up to US\$ 55 million once the Applicants have obtained satisfactory financing.

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". The signature is written in a cursive style with a large, sweeping initial "M".

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.