

**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-THIRD REPORT OF THE MONITOR
DATED APRIL 2, 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, 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 are as defined in the Amended and Restated Initial Order or the First through Twenty-Second Reports of the Monitor. All references to dollars are in Canadian currency unless otherwise noted.
3. The purpose of this Twenty-Third Report of the Monitor (the "Report") is to provide this Honourable Court with an update on:
 - a. The status of the Amended Trinity Investment Agreement;
 - b. The Company's 2003 audited financial statements;
 - c. The Company's current financial position; and

- d. Conclusions.

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 THE AMENDED TRINITY INVESTMENT AGREEMENT

5. On December 8, 2003, this Honourable Court approved an investment agreement entered into between the Company and Trinity pursuant to which Trinity is to make a \$650 million equity investment in Air Canada. This agreement was later revised and the Amended Trinity Investment Agreement was approved by the Board of Directors of Air Canada on December 21, 2003 and by this Honourable Court on January 16, 2004.
6. In the Twenty-Second Report, the Monitor reported on the status of a number of conditions precedent to closing pursuant to the Amended Trinity Investment Agreement. Certain of the more significant conditions which had yet to be satisfied or waived by Trinity as at the date of the Twenty-Second Report include:

Pension and benefit plans, including the related design and funding obligations are to be satisfactory to Trinity;

The funding of any pension plan deficit shall have been resolved with the Office of the Superintendent of Financial Institutions ("OSFI"), the Company's labour unions, retirees and other applicable employee representatives, and the Company

shall have received any necessary regulatory approvals, all to the satisfaction of Trinity; and

The Company must achieve the cost savings and labour productivity targets as well as have EBITDAR for the period October 1, 2003 through to closing of not less than the target amounts all as set out in the Amended Trinity Investment.

7. The Amended Trinity Investment Agreement provides that the equity financing commitment ends on April 30, 2004 unless extended. Pursuant to an extension agreement negotiated by the Applicants and Trinity, Trinity could, at its option, terminate the Amended Trinity Investment Agreement in the event that certain conditions, including the resolution of the pension plan deficit funding settlement and pension plan design, were not satisfied or waived by May 1, 2004.
8. As reported in the Twenty-Second Report, an agreement was reached on February 18, 2004 between the Applicants and representatives of its Canadian labour unions, non-unionized employees and retirees (the "Pension Beneficiaries Group") with respect to a schedule for funding the pension deficit over a ten year period. This agreement was documented in a term sheet (the "Pension Funding Term Sheet"). The Pension Funding Term Sheet, as it related to the funding commitment only, was approved by Trinity.
9. Subsequent to the execution of the Pension Funding Term Sheet, the Company, the Pension Beneficiaries Group and the Monitor met with representatives of the Office of the Superintendent of Financial Institutions ("OSFI") to present the Pension Funding Term Sheet, with a view to obtaining the necessary regulatory approval. Discussions were held between representatives of the Applicants, the Monitor and representatives of OSFI concerning the adequacy of the funding and the treatment of a deemed trust asserted by OSFI. However, on March 26, 2004, OSFI issued a letter to the Applicants advising that the pension funding set out in the Pension Funding Term Sheet was inadequate. To date, these issues with respect to the pension funding and the deemed trust remain unresolved.

10. With respect to Trinity's proposal to restructure Air Canada's pension plans, the Monitor reported in its Twenty Second Report that no further discussions had taken place between Trinity and the Pension Beneficiaries Group and that Trinity had indicated that as a result of unwillingness of the unions to discuss the restructuring of the pension plans, it was conducting a full review of its investment including examining the actual level of concessions achieved from the renegotiation of the collective agreements in May, 2003 (in relation to the estimated savings of \$850 million from the wage and benefit reductions and productivity enhancements agreed to by the labour unions) as well as the financial impact of the unions' refusal to allow for a transition of the current defined benefit plans to defined contribution plans.
11. Since the date of the Twenty-Second Report, discussions between Management and representatives of the Company's labour unions have continued with a view to trying to break the impasse on the pension design issue. In particular, discussions were held between Management and representatives of District Lodge 140 of the International Association of Machinists and Aerospace Workers (the "IAMAW"), representing 11,500 technical operations, airport ground service, clerical and finance branch personnel. These discussions resulted in an announcement on March 31, 2004 by the Applicants and the IAMAW that a tentative agreement had been reached to allow all active and inactive current employees represented by District 140 of the IAMAW the freedom to choose between a defined benefit ("DB") and a defined contribution ("DC") pension plan. Under this agreement, all current employees who opt to enrol in the DC plan would receive a bonus, concurrently with an Initial Public Offering (IPO) of a restructured Air Canada, equal to 10% of base salary provided that the aggregate pool did not exceed 10% of the IPO. Any new employees hired after the ratification of the agreement would automatically be enrolled in a DC plan. The agreement is subject to membership ratification and to approval by Trinity Time Investment.
12. Also on March 31, 2004, the Company was advised by the national office of the IAMAW (the "IAMAW National") that it took the position that the IAMAW National had responsibility for pension issues and that the agreement entered into between District Lodge 140 of the IAMAW (the "IAMAW Local") was done without the authority of the

IAMAW National and hence, that the IAMAW was not bound by the terms of the tentative agreement. Subsequently, the IAMAW National requested an expedited hearing on Saturday, April 4, 2004 before the Canadian Industrial Relations Board (the "CIRB") seeking a declaration that the IAMAW Local had no authority to enter into the tentative agreement and that it was of no force or effect. On April 2, 2004, the Applicants attended before this Honourable Court to schedule the hearing of a motion for an order that all hearings before the CIRB are stayed. This motion is scheduled to be heard on April 8, 2004. It is unclear whether in the face of this pending motion, the CIRB will hear the motion of the IAMAW National on April 4, 2004.

13. No further progress has been made on the pension design issues since the date of the Monitor's Twenty-Second Report with respect to the remainder of the Company's labour unions.
14. In the late evening of April 1, 2004, Trinity advised Air Canada that it would not be seeking an extension of the Amended Trinity Investment Agreement upon its expiry on April 30, 2004 and that it released Air Canada from its exclusivity obligations effective immediately. This was confirmed in a press release issued by Trinity dated April 2, 2004.
15. Trinity also confirmed to General Electric Capital Corporation and Deutsche Bank Securities Inc. that it would not seek to extend agreements with them which expire concurrently with the Trinity Agreement. Trinity indicated in its press release that notwithstanding progress in the restructuring and other initiatives, the Company's financial performance was somewhat weaker than Trinity had expected, labour cost and productivity savings promised by Air Canada's unions were not being fully achieved, and that the Company's organized labour structures and all time high fuel costs were impairing its ability to succeed.
16. Trinity did not rule out continued participation if the circumstances change sufficiently. However, given the recent announcement by Trinity, it appears unlikely that the remaining conditions precedent to closing of the Amended Trinity Investment Agreement will be satisfied or waived by Trinity allowing for completion of the transaction by April 30, 2004. Accordingly, the Applicants will likely have to commence a process for

identifying another equity plan sponsor or alternative sources for post-emergence equity financing. It is expected that this will result in a significant delay in the Company's emergence from CCAA protection.

THE 2003 YEAR-END FINANCIAL STATEMENTS

17. On April 2, 2004, the Company released its 2003 year-end audited financial statements. For the fiscal year ended December 31, 2003, the Company recorded a net loss of \$1.867 billion. Included in this net loss were certain reorganization and restructuring items totalling approximately \$1.05 billion. These items, most of which are non-cash items, are mainly a result of the CCAA and do not reflect the normal operating results of the airline. Accordingly, the net loss for 2003 before reorganization and restructuring items was approximately \$684 million. Management estimates this is largely due to the effects of the Iraq war, the Severe Acute Respiratory Syndrome outbreak and the rapid expansion of Westjet and other low cost carriers. Combined, Management estimates that these factors caused revenues to decline approximately \$1.3 billion over 2002.
18. In a press released dated April 2, 2004 issued by the Company, Management notes that while the operating loss is significant, 2004 revenues to date have been tracking in line with the Company's business plan and unit costs have reflected a decline of approximately 14% from 2002.

FINANCIAL POSITION

19. In light of the expected delay in the Company's ability to exit from CCAA protection, the Monitor has reviewed the company's current financial position and cash flow forecasts to assess its short-term liquidity position. In this regard, the Monitor notes the following:

The Applicants' unrestricted cash balance in its combined Canadian and US dollar bank accounts as at April 1, 2004 was approximately \$957.2 million. In addition, a further US \$457 million was available to be drawn under the DIP financing facility;

The Applicants are entering the summer travel season, which is traditionally their strongest seasonal period with respect to passenger traffic and bookings. For example, passenger revenue for the five months from May to September 2002 represented more than 47% of the total 2002 passenger revenue. (2003 figures are not considered representative due to the impact of SARS and the Iraq war on these particular months); and

The forecast cash flow projection prepared by the Applicants with the assistance of the Monitor for the period of March 20 to June 18, 2004 (the "Cash Flow Projection") and included in the Monitor's Twenty-Second Report reflected a forecast cash position as at June 18, 2004 of approximately \$1,027.6 million.

20. As a result, the Company has advised the Monitor that it expects its cash resources to remain stable over the next several months. Accordingly, the Monitor is of the view that the Applicants should be allowed a period of time to further pursue its restructuring efforts and to commence a process for identifying an alternate equity investor or source of post emergence financing. In this regard, the Monitor proposes that it work with the Applicants and its advisors to develop an equity solicitation process in consultation with the Applicants' stakeholders for subsequent consideration and approval of this Honourable Court.
21. Based on the recent discussions the Monitor had with certain of the stakeholders concerning the adverse development concerning the Amended Trinity Investment Agreement, together with the Monitor's general knowledge of the stakeholders ongoing objectives to see Air Canada emerge successfully from these CCAA proceedings, a continuation of the stay of proceedings is appropriate and will assist the Applicants in stabilizing its operations and the restructuring process overall.

CONCLUSIONS

22. The Monitor believes the Company will benefit from a sufficiently long extension of the stay of proceedings in order to stabilize the restructuring process and allow for the development of an alternative equity process. The Monitor will provide its further views on the exact extension of the stay as and when the applicants seek, as is anticipated, a further stay extension.

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 long horizontal stroke extending to the right.

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.