AIR CANADA

Quarter 2 2007
Interim Unaudited
Consolidated Financial Statements and Notes

August 9, 2007

Consolidated Statement of Operations

Unaudited (Canadian dollars in millions except per share figures)		Three Months Ended June 30 2007*	Three Months Ended June 30 2006	Six Months Ended June 30 2007*	Six Months Ended June 30 2006
			(note 1)		(note 1)
Operating revenues					
Passenger		$ 2,336	$ 2,262	$ 4,473	$ 4,264
Cargo		135	154	276	305
Other		151	143	383	366
		2,622	2,559	5,132	4,935
Operating expenses					
Wages, salaries and benefits		531	526	1,113	1,063
Aircraft fuel		637	631	1,222	1,200
Aircraft rent		91	114	195	227
Airport and navigation fees		256	245	499	475
Aircraft maintenance, materials and supplies		222	211	471	435
Communications and information technology		69	66	140	141
Food, beverages and supplies		81	81	164	161
Depreciation, amortization and obsolescence		140	125	273	244
Commissions		51	59	110	127
Capacity purchase with Jazz	note 8	76	-	76	-
Special charge for labour restructuring	note 5	-	-	-	28
Other		354	352	797	773
		2,508	2,410	5,060	4,874
Operating income		**114**	**149**	**72**	**61**
Non-operating income (expense)					
Interest income		24	21	51	38
Interest expense		(87)	(78)	(180)	(150)
Interest capitalized		28	13	64	22
Gain on disposal of assets	note 2	14	1	21	3
Gain (loss) on financial instruments recorded at fair value	note 6	(6)	(1)	28	(3)
Other		(5)	(2)	(9)	1
		(32)	(46)	(25)	(89)
Income (loss) before the following items		82	103	47	(28)
Non-controlling interest		(31)	(39)	(68)	(76)
Foreign exchange gain		160	108	193	121
Recovery of (provision for) income taxes					
Current		-	-	(6)	-
Future		(56)	(20)	(45)	9
Income for the period		**$ 155**	**$ 152**	**$ 121**	**$ 26**
Earnings per share					
Basic and diluted		$ 1.55	$ 1.72	$ 1.21	$ 0.29

** Effective May 24, 2007, the results and financial position of Jazz are not consolidated within Air Canada (Note 1).*

The accompanying notes are an integral part of the interim consolidated financial statements.

Consolidated Statement of Financial Position

Unaudited (Canadian dollars in millions)		June 30 2007*	December 31 2006
ASSETS			
Current			
Cash and cash equivalents		$ 871	$ 1,447
Short-term investments		880	798
		1,751	2,245
Restricted cash		33	109
Accounts receivable		952	688
Spare parts, materials and supplies		101	148
Prepaid expenses and other current assets		135	124
Prepaid maintenance to ACTS		221	535
Future income taxes	note 1	-	345
		3,193	4,194
Property and equipment	note 2	6,597	5,946
Deferred charges		56	103
Intangible assets		1,125	1,194
Deposits and other assets		275	312
		$ 11,246	**$ 11,749**
LIABILITIES			
Current			
Accounts payable and accrued liabilities		$ 1,403	$ 1,521
Advance ticket sales		1,370	1,019
Aeroplan Miles obligation		59	58
Current portion of long-term debt and capital leases		440	367
Note payable to ACTS		221	535
Current taxes payable	note 1	-	345
		3,493	3,845
Long-term debt and capital leases		3,172	3,196
Future income taxes		125	134
Pension and other benefit liabilities		1,887	1,876
Other long-term liabilities		321	472
		8,998	9,523
Non-controlling interest		181	374
SHAREHOLDERS' EQUITY			
Share capital		274	274
Contributed surplus		1,781	1,693
Retained earnings (deficit)		14	(115)
Accumulated other comprehensive income (loss)	note 1	(2)	-
		2,067	1,852
		$ 11,246	**$ 11,749**

** Effective May 24, 2007, the results and financial position of Jazz are not consolidated within Air Canada (Note 1).*

The accompanying notes are an integral part of the interim consolidated financial statements.

Consolidated Statement of Changes in Shareholders' Equity

Unaudited (Canadian dollars in millions)		Six Months Ended June 30 2007	Six Months Ended June 30 2006 (note 1)
Share capital			
Common shares (beginning and end of period)		$ 562	$ -
Special common shares (beginning and end of period)		-	325
Adjustment to shareholders' equity (beginning and end of period)		(288)	(303)
Total share capital		274	22
Contributed surplus			
Balance, beginning of period		1,693	1,037
Fair value of stock options issued to Corporation employees recognized as compensation expense		6	1
Contribution from ACE on transfer of investments		-	483
Allocation of corporate costs		-	9
Allocation of reduction to intangible assets		-	(59)
Deconsolidation of Jazz	note 1	82	-
Total contributed surplus		1,781	1,471
Retained earnings (deficit)			
Balance, beginning of period		(115)	(41)
Cumulative effect of adopting new accounting policies	note 1	8	-
		(107)	(41)
Net income for the period		121	26
		14	(15)
Accumulated other comprehensive income (loss)			
Balance, beginning of period		-	-
Cumulative effect of adopting new accounting policies	note 1	(26)	-
Other comprehensive income		24	-
		(2)	-
Total deficit and accumulated other comprehensive income (loss)		12	(15)
Total shareholders' equity		**$ 2,067**	**$ 1,478**

Consolidated Statement of Comprehensive Income

Unaudited (Canadian dollars in millions)		Three Months Ended June 30 2007*	Three Months Ended June 30 2006	Six Months Ended June 30 2007*	Six Months Ended June 30 2006
Comprehensive income (loss)					
Net income for the period		$ 155	$ 152	$ 121	$ 26
Other comprehensive income, net of taxes:					
Net change in unrealized gains on fuel derivatives under hedge accounting	note 6	8	-	14	-
Reclassification of net realized losses on fuel derivatives to income	note 6	2	-	10	-
		10	-	24	-
Total comprehensive income (loss)		**$ 165**	**$ 152**	**$ 145**	**$ 26**

** Effective May 24, 2007, the results and financial position of Jazz are not consolidated within Air Canada (Note 1).*

The accompanying notes are an integral part of the interim consolidated financial statements.

Consolidated Statement of Cash Flows

Unaudited (Canadian dollars in millions)		Three Months Ended June 30 2007*	Three Months Ended June 30 2006 (note 1)	Six Months Ended June 30 2007*	Six Months Ended June 30 2006 (note 1)
Cash flows from (used for)					
Operating					
Income for the period		$ 155	$ 152	$ 121	$ 26
Adjustments to reconcile to net cash from operations					
Depreciation, amortization and obsolescence		140	125	273	244
Gain on disposal of and provisions on assets		(14)	(1)	(21)	(3)
Foreign exchange gain		(154)	(133)	(187)	(130)
Future income taxes		56	20	45	(9)
Employee future benefit funding more than expense		(69)	(45)	(138)	(68)
Decrease (increase) in accounts receivable		(150)	(130)	(200)	(136)
Decrease (increase) in spare parts, materials and supplies		(17)	(20)	16	43
Increase (decrease) in accounts payable and accrued liabilities		(64)	(27)	59	58
Increase (decrease) in advance ticket sales, net of restricted cash		195	178	426	400
Decrease in Aeroplan Miles obligation		(21)	(26)	(46)	(57)
Non-controlling interest		31	39	68	76
Allocation of corporate expenses	note 1	-	6	-	9
Aircraft lease payments (in excess of) less than rent expense		(2)	(3)	(9)	(8)
Unrealized period change in fair value of derivatives	note 6	9	4	(32)	4
Capitalized interest		(28)	(14)	(64)	(23)
Other		49	18	49	41
		116	**143**	**360**	**467**
Financing					
Issue of Jazz units		-	-	-	218
Transfer of Jazz investment to ACE	note 1	-	-	-	400
Promissory note paid by Jazz to ACE		-	-	-	(424)
Jazz – Credit facility borrowings		-	-	-	113
Aircraft related borrowings	note 3	532	98	644	222
Distributions paid to non-controlling interest		(21)	(37)	(54)	(45)
Reduction of long-term debt and capital lease obligations		(89)	(61)	(167)	(149)
Reduction of non-controlling interest	note 3	-	-	(36)	-
Other		-	2	-	-
		422	**2**	**387**	**335**
Investing					
Short-term investments		44	(19)	(83)	(166)
Additions to capital assets		(707)	(192)	(1,104)	(466)
Proceeds from sale of assets		1	-	45	-
Deconsolidation of Jazz cash		(138)	-	(138)	-
Cash management with related parties		(21)	7	(34)	(1)
Other		(22)	-	(9)	(4)
		(843)	**(204)**	**(1,323)**	**(637)**
Increase (decrease) in cash and cash equivalents		**(305)**	**(59)**	**(576)**	**165**
Cash and cash equivalents, beginning of period		1,176	1,258	1,447	1,034
Cash and cash equivalents, end of period		**$ 871**	**$ 1,199**	**$ 871**	**$ 1,199**
Cash payments of interest		**$ 64**	**$ 67**	**$ 120**	**$ 122**
Cash payments of income taxes		**$ 3**	**$ -**	**$ 3**	**$ -**

** Effective May 24, 2007, the results and financial position of Jazz are not consolidated within Air Canada (Note 1).*

Cash and cash equivalents exclude Short-term investments of $880 as at June 30, 2007 ($468 as at June 30, 2006).
The accompanying notes are an integral part of the interim consolidated financial statements.

Notes to the Interim Consolidated Financial Statements (unaudited)
(currencies in millions – Canadian dollars)

1. BASIS OF PRESENTATION AND NATURE OF OPERATIONS

The accompanying consolidated financial statements are of Air Canada (the "Corporation"), a majority-owned subsidiary of ACE Aviation Holdings Inc. ("ACE").

A) BASIS OF PRESENTATION

The unaudited interim consolidated financial statements for the Corporation are based on the accounting policies consistent with those disclosed in Note 2 to the 2006 annual combined consolidated financial statements of Air Canada, with the exception of the changes in accounting policies described below in part B) Changes in Accounting Policies.

As described in Note 1 to the 2006 annual combined consolidated financial statements of Air Canada, for periods prior to the initial public offering of shares of Air Canada, which closed on November 24, 2006 (the "Air Canada IPO"), the financial statements of Air Canada are combined to include the financial position, results of operations and cash flows of a number of entities that subsequently became subsidiaries of Air Canada in conjunction with the Air Canada IPO.

In accordance with Canadian generally accepted accounting principles ("GAAP"), these interim financial statements do not include all of the financial statement disclosures required for annual financial statements and should be read in conjunction with the 2006 annual combined consolidated financial statements of Air Canada. In management's opinion, the financial statements reflect all adjustments that are necessary for a fair presentation of the results for the interim periods presented.

The Corporation has historically experienced greater demand for its services in the second and third quarters of the calendar year and lower demand in the first and fourth quarters of the calendar year. This demand pattern is principally a result of the high number of leisure travelers and their preference for travel during the spring and summer months. The Corporation has substantial fixed costs in its cost structure that do not meaningfully fluctuate with passenger demand in the short-term.

Allocation of Corporate Expenses

For the period prior to November 24, 2006, these consolidated financial statements include an allocation of the general corporate expenses incurred by ACE based upon the proportion of the Corporation's consolidated revenues compared to ACE's consolidated revenues. The allocation of general corporate expenses to the Corporation includes its proportionate share of general corporate expenses incurred by ACE, including executive management, legal, investor relations, treasury, finance, financial reporting, tax, internal audit and human resources services as well as costs of governance, professional fees and regulatory filings, all of which amounted to $6 for Quarter 2 2006 ($9 for the six months ended June 30, 2006). This allocation of corporate expenses was recorded within the Air Canada Services segment and is recorded as a credit to contributed surplus. The allocation of general corporate expenses ceased on November 24, 2006.

Excluded Inter-company Investments

Prior to the Air Canada IPO, Air Canada held, for tax planning purposes, certain investments in limited partnerships of which ACE owned directly or indirectly all of the limited partner units. These investments and related income and income tax effects have been excluded from these consolidated statements of financial positions and operations of the Corporation, as these activities did not relate to the operations of the Corporation. These investments were transferred to ACE during 2005 and 2006 in exchange for cash and a note receivable. For purposes of these consolidated financial statements, these exchanges of the investments for cash and a note receivable were recorded as related party transactions resulting in a contribution of cash and notes receivable to the Corporation. These contributions of cash have been reflected as financing activities in the consolidated statement of cash flows.

During Quarter 1 2006 the Corporation received cash from ACE of $400 and a note receivable of $83 for the investments in Jazz Air LP ("Jazz") and during Quarter 4 2006 the Corporation received cash of $673 for the investments in ACTS LP ("ACTS") and $83 related to the settlement of the note receivable.

Income Taxes

As part of a tax loss utilization strategy that was planned in conjunction with the Air Canada IPO 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 during Quarter 1 2007. The Corporation recorded interest expense of $6, which was due on the tax balance prior to its recovery during Quarter 1 2007, in Current income taxes on the consolidated statement of operations.

Accounting for Jazz

As a result of ACE's distribution of units of Jazz Air Income Fund ("JAIF") on May 24, 2007 ACE's ownership interest in JAIF was reduced from 58.8% to 49.0%. JAIF holds all of the outstanding units of Jazz. This distribution by ACE gave rise to a reconsideration of who should consolidate Jazz, and as a result, JAIF was deemed to be the primary beneficiary of Jazz under AcG-15 Consolidation of Variable Interest Entities. As of the distribution date, Air Canada therefore no longer consolidates Jazz. Prospective from the date of deconsolidation, Air Canada has one reportable segment.

The consolidated statement of financial position as at June 30, 2007 does not include the financial position of Jazz. The comparative December 31, 2006 consolidated statement of financial position included the following items of Jazz:

- Cash and cash equivalents of $135 and Other current assets of $109;
- Long-lived assets of $239;
- Current liabilities of $213;
- Long-term debt of $115;
- Non-controlling interest of $162; and
- Other long-term liabilities of $71.

Consolidation adjustments recorded by Air Canada relating to accounting for income taxes and other items amounting to an aggregate adjustment of $82, has been recorded in contributed surplus as a result of the deconsolidation.

The Quarter 2 cash flow impact of Air Canada's deconsolidation of Jazz of $138 reflects the Jazz cash being removed from the consolidated statement of financial position of Air Canada and is classified as a cash outflow from investing activities.

Also refer to Note 8 Related Party Transactions for a description of the transactions between Air Canada and Jazz and the related accounting presentation in Air Canada.

B) CHANGES IN ACCOUNTING POLICIES

On January 1, 2007, the Corporation adopted CICA accounting handbook section 3855, *Financial Instruments – Recognition and Measurement*, section 3861, *Financial Instruments – Disclosure and Presentation,* section 3865, *Hedges*, section 1530, *Comprehensive Income*, and section 3251, *Equity.*

Financial Instruments

Section 3855 establishes standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. It requires that financial assets and financial liabilities, including derivatives, be 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. Under this standard, 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. An asset can be classified as available-for-sale when it has not been classified as trading or held-to-maturity. Transaction costs are expensed as incurred for financial instruments classified or designated as held-for-trading. For other financial instruments, transaction costs are capitalized on initial recognition.

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. 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.

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 (loss) with the exception of derivatives designated in effective cash flow hedges, as further described below.

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 remeasure the fair value of the financial guarantee unless it qualifies as a derivative.

The Corporation has implemented the following classifications:

- Cash and cash equivalents are classified as held-for-trading and any period change in fair value is recorded through net income.
- Accounts receivable are classified as loans and receivables and are measured at amortized cost using the effective interest rate method.
- Accounts payable, credit facilities, and bank loans are classified as other financial liabilities and are measured at amortized cost using the effective interest rate method.

Section 3861 establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them. The purpose of the section is to enhance financial statement users' understanding of the significance of financial instruments to an entity's financial position, performance and cash flows.

<u>Hedges</u>

Section 3865 specifies the criteria that must be satisfied in order for hedge accounting to be applied. 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 Corporation has designated 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. Upon maturity of the fuel derivatives, the effective gains and losses previously recognized in Accumulated OCI ("AOCI") are recorded in Fuel expense.

When hedge accounting is discontinued, the amounts previously recognized in AOCI are reclassified to non-operating income (loss) during the periods when the variability in the cash flows of the hedged item affects net income. Gains and losses on derivative hedging items are reclassified to non-operating income (loss) immediately when the hedged item is sold or terminated early.

Comprehensive Income

Section 1530 introduces Comprehensive Income, which consists of Net Income and OCI. OCI represents changes in Shareholders' equity during a period arising from transactions and other events with non-owner sources that are recognized in Comprehensive income, but excluded from net income. Period changes in the fair value of the effective portion of cash flow hedging instruments are recorded in OCI. These interim consolidated financial statements include the consolidated statement of comprehensive income for Quarter 2 2007; items affecting OCI are recorded prospectively commencing from January 1, 2007 including the transition adjustments noted below. Cumulative changes in OCI are included in AOCI, which is presented as a new category within Shareholders' equity on the consolidated statement of financial position. OCI and AOCI are presented net of tax.

Equity

Section 3251 establishes standards for the presentation of equity and the changes in equity during the period.

Impact Upon Adoption

In accordance with the transitional provisions of the standards, prior periods have not been restated for the adoption of these new accounting standards.

The transition adjustments attributable to the remeasurement of financial assets and financial liabilities at fair value, other than financial assets classified as available-for-sale and hedging instruments designated as cash flow hedges, were recognized in the opening Deficit of the Corporation as at January 1, 2007.

For the Corporation's fuel-hedging relationship classified as a cash flow hedge, which qualifies for hedge accounting under the new standard, the effective portion of any gain or loss on the hedging instruments was recognized in AOCI and the cumulative ineffective portion was included in the opening Deficit of the Corporation as at January 1, 2007.

Upon adoption the Corporation recorded the following adjustments to the consolidated statement of financial position:

Increase (decrease)		
Deferred charges	$	(14)
Future income taxes ($6, net of valuation allowance $6)		-
Accounts payable and accrued liabilities		18
Long-term debt and capital leases		(14)
Deficit, net of nil tax		(8)
Accumulated other comprehensive income (loss), net of nil tax		(26)

Future Accounting Changes

Capital Disclosures and Financial Instruments – Presentation and Disclosure

The CICA issued three new accounting standards: section 1535, *Capital Disclosures*, section 3862, *Financial Instruments – Disclosures*, and section 3863, *Financial Instruments – Presentation*. These new standards will be effective for fiscal years beginning on or after October 1, 2007 and the Corporation will adopt them on January 1, 2008. The Corporation is in the process of evaluating all of the consequences of the new standards, which may have a material impact on the Corporation's financial statements.

Section 1535 establishes disclosure requirements about an entity's capital and how it is managed. The purpose will be to enable users of the financial statements to evaluate the entity's objectives, policies and processes for managing capital.

Sections 3862 and 3863 will replace section 3861, *Financial Instruments – Disclosure and Presentation*, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections will place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

2. DISPOSAL OF PROPERTY

During Quarter 2 2007, a CRJ-100 aircraft owned by Air Canada and leased to Jazz was damaged beyond repair. Given estimated insurance proceeds, Air Canada has recorded a gain on disposal of $14 in Quarter 2 2007.

During Quarter 1 2007 the Corporation sold one of its commercial real estate properties for net proceeds of $42 with a carrying value of $37. The gain on sale of $5 ($4 net of tax) has been recorded in the Air Canada Services segment for Quarter 1 2007.

Also during Quarter 1 2007 the Corporation sold 18 parked aircraft for proceeds of $2 with a nil book value. The gain on sale of $2 ($1 net of tax) has been recorded in the Air Canada Services segment for Quarter 1 2007.

3. LONG-TERM DEBT AND CAPITAL LEASES

Boeing Aircraft Financing

On April 19, 2007, Air Canada received a commitment for loan guarantee support, subject to the fulfillment of certain terms and conditions, from the Export-Import Bank of the United States ("EXIM") covering seven Boeing 777 aircraft to be delivered in 2007. During the six months ended June 30, 2007 Air Canada took delivery of 5 Boeing 777 aircraft, one of which was delivered during Quarter 1 2007. One of the aircraft was delivered under an operating lease agreement with ILFC. The remaining four were financed under the loan guarantee support provided by EXIM.

The following table summarizes the loans, which are secured by the delivered aircraft, related to the acquisition of Boeing aircraft financed under the loan guarantee support provided by EXIM:

	Number of Aircraft	Interest Rate	Maturity	Original US$ Loan Amount	Original CDN$ Loan Amount
Quarter 2 2007					
Boeing 777	4	5.435%	2019	415	441

The interest rate above represents the weighted average fixed interest rate on the loans.

The following table summarizes the principal repayment requirements (in CDN$) of the Boeing aircraft financing obtained during Quarter 2 2007:

	Remainder of 2007	2008	2009	2010	2011	2012
Boeing aircraft financing	$ 18	$ 37	$ 37	$ 37	$ 37	$ 37

Embraer Aircraft Financing

The following table summarizes the loans, secured by the delivered aircraft, that Air Canada drew during the six month period ended June 30, 2007 to finance the acquisition of Embraer aircraft:

	Number of Aircraft	Interest Rate	Maturity	Original US$ Loan Amount	Original CDN$ Loan Amount
Quarter 2 2007					
Embraer 190	4	7.161%	2019	$ 90	$ 96
Quarter 1 2007					
Embraer 190	4	6.813%	2019	$ 90	$ 105
Total	**8**			**$ 180**	**$ 201**

The interest rates above represent the weighted average fixed interest rate on the loans.

The following table summarizes the principal repayment requirements (in CDN$) of the Embraer aircraft financing obtained during the six month period ended June 30, 2007:

	Remainder of 2007	2008	2009	2010	2011	2012
Embraer aircraft financing	$ 4	$ 9	$ 9	$ 10	$ 10	$ 15

Reduction in Non-controlling Interest

During Quarter 1 2007 the Corporation refinanced five CRJ aircraft and the refinancing included a payment of the non-controlling interest portion of the leasing arrangement to third parties of $36.

4. POST-EMPLOYMENT EXPENSES

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

	Three Months Ended		Six Months Ended	
	June 30 2007*	**June 30 2006**	**June 30 2007***	**June 30 2006**
Pension benefit expense	$ 37	$ 46	$ 75	$ 91
Other employee future benefit expense	23	27	53	55
	60	**73**	**128**	**146**
Amount charged to affiliates	(10)	(14)	(20)	(26)
Net pension benefit and other employee benefits expense	**$ 50**	**$ 59**	**$ 108**	**$ 120**

** Effective May 24, 2007, the results and financial position of Jazz are not consolidated within Air Canada (Note 1).*

5. LABOUR RELATED PROVISIONS

The following table outlines the changes to labour related provisions which are included in long-term employee liabilities for balances that existed upon the implementation of fresh start reporting on September 30, 2004 (current portion included in Accounts payable and accrued liabilities):

	Three Months Ended		Six Months Ended	
	June 30 2007	**June 30 2006**	**June 30 2007**	**June 30 2006**
Beginning of period	$ 67	$ 110	$ 77	$ 121
Interest accretion	2	3	3	5
Amounts disbursed	(12)	(14)	(23)	(27)
Deconsolidation of Jazz (note 1)	(4)	-	(4)	-
End of period	53	99	53	99
Current portion	(27)	(33)	(27)	(33)
	$ 26	**$ 66**	**$ 26**	**$ 66**

The following table outlines the changes to labour related provisions which are included in long-term employee liabilities for balances that have been created subsequent to the implementation of fresh start reporting on September 30, 2004 (current portion included in Accounts payable and accrued liabilities):

	Three Months Ended		Six Months Ended	
	June 30 2007	**June 30 2006**	**June 30 2007**	**June 30 2006**
Beginning of period	$ 28	$ 39	$ 29	$ 13
Special charge for labour restructuring:				
2006 non-unionized reduction	-	-	-	28
Charges recorded in wages, salaries and benefits	9	3	11	3
Amounts disbursed	(3)	(3)	(6)	(5)
End of period	34	39	34	39
Current portion	(18)	(31)	(18)	(31)
	$ 16	**$ 8**	**$ 16**	**$ 8**

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

During Quarter 1 2006 a workforce reduction plan was announced to reduce non-unionized employee levels by 20 percent. A special charge of $28 was recorded in the Air Canada Services segment in Quarter 1 2006 relating to this program. During Quarter 4 2006, the estimated cost of this plan to the Air Canada Services segment was revised due to the favourable impact of attrition and other factors which reduced the cost of achieving the target. As a result, the Air Canada Services segment recorded a reduction of $8 in Quarter 4 2006 to the special charge for labour restructuring.

6. DERIVATIVE AND FINANCIAL INSTRUMENTS

Fuel Price Risk Management

The financial results of the Corporation are impacted by changes in jet fuel prices as a result of the Corporation's inherent dependence on energy for its operations. To manage its exposure to jet fuel prices, the Corporation enters into derivative contracts with financial intermediaries for the purpose of managing volatility in operating cash flows. The Corporation uses derivative contracts on jet fuel and also on other crude oil based commodities, such as heating oil and crude oil, due to the relative limited liquidity of jet fuel derivative instruments on a medium to longer term horizon, since jet fuel is not traded on an organized futures exchange. The Corporation does not purchase or hold any derivative financial instruments for trading purposes.

The Corporation designates its fuel derivatives as 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).

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. The Corporation'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 the Corporation's weighted average price). As the Corporation'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 the Corporation 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 the Corporation, 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. 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.

The following table provides the changes in fair value of designated hedging items before the impact of tax during the six month period ended June 30, 2007:

Increase (decrease)	Fair value of outstanding fuel derivatives	OCI / AOCI	Fuel expense	Non-operating income (loss)	Retained earnings	Cash on settlement
January 1, 2007	$ (18)	$ (26)	$ -	$ -	$ 8	$ -
Unrealized period change in fair value	39	9	-	30	-	-
Realized loss on maturing contracts	14	8	8	-	-	(14)
March 31, 2007	$ 35	$ (9)	$ 8	$ 30	$ 8	$ (14)
Unrealized period change in fair value	6	13	-	(7)	-	-
Realized gain on maturing contracts	(5)	3	(3)	(7)	-	4
June 30, 2007	$ 36	7	$ 5	$ 16	$ 8	$ (10)

OCI amounts for the three months ended June 30, 2007 are presented net of tax expense of $6 in the Consolidated Statement of Comprehensive Income ($9 for the six months ended June 30, 2007).

Foreign Exchange Risk Management

The Corporation enters into certain foreign exchange forward contracts or currency swaps to manage the risks associated with foreign currency exchange rates. As at June 30, 2007, the Corporation had entered into foreign currency forward contracts and option agreements on US$1,574 of future purchases in 2007 and 2008. The fair value of these foreign currency contracts as at June 30, 2007 is $73 in favour of the counterparty (December 31, 2006 - $25 in favour of the Corporation on $503 of future purchases in 2007). These derivative instruments have not been designated as hedges for accounting purposes. The unrealized loss has been recorded in foreign exchange.

During Quarter 1 2007, currency swaps for five CRJ leases with third parties were settled at their fair value of $10 (which was equal to carrying value) upon the expiry of the lease term.

7. SEGMENT INFORMATION

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

	Three Months Ended June 30, 2007*				Three Months Ended June 30, 2006			
	Air Canada Segment	Jazz	Elimination	Consolidated Total	Air Canada Segment	Jazz	Elimination	Consolidated Total
Passenger revenue	$ 2,336	$ -	$ -	$ 2,336	$ 2,262	$ -	$ -	$ 2,262
Cargo revenue	135	-	-	135	154	-	-	154
Other revenue	150	1	-	151	141	2	-	143
External revenue	2,621	1	-	2,622	2,557	2	-	2,559
Inter-segment revenue	14	248	(262)	-	19	338	(357)	-
Total revenues	**2,635**	**249**	**(262)**	**2,622**	**2,576**	**340**	**(357)**	**2,559**
Wages, salaries and benefits	475	56	-	531	449	77	-	526
Aircraft fuel	636	54	(53)	637	631	71	(71)	631
Aircraft rent	71	22	(2)	91	83	33	(2)	114
Airport and navigation fees	257	33	(34)	256	245	43	(43)	245
Aircraft maintenance, materials and supplies	205	20	(3)	222	189	22	-	211
Communications and information technology	67	1	1	69	64	2	-	66
Food, beverages and supplies	78	2	1	81	79	4	(2)	81
Depreciation of property and equipment	126	4	-	130	105	7	-	112
Amortization of intangible assets	10	-	-	10	13	-	-	13
Obsolescence provisions	-	-	-	-	-	-	-	-
Commissions	51	-	-	51	59	-	-	59
Capacity purchase with Jazz	232	-	(156)	76	215	-	(215)	-
Special charge for labour restructuring	-	-	-	-	-	-	-	-
Other operating expenses	339	31	(16)	354	331	45	(24)	352
Total operating expenses	**2,547**	**223**	**(262)**	**2,508**	**2,463**	**304**	**(357)**	**2,410**
Operating income (loss)	**88**	**26**	**-**	**114**	**113**	**36**	**-**	**149**
Interest income	23	1	-	24	20	1	-	21
Interest expense	(86)	(1)	-	(87)	(76)	(2)	-	(78)
Interest capitalized	28	-	-	28	13	-	-	13
Gain on sale of assets	14	-	-	14	1	-	-	1
Gain (loss) on financial instruments recorded at fair value	(6)	-	-	(6)	(1)	-	-	(1)
Other non-operating income (expense)	(6)	1	-	(5)	(3)	-	1	(2)
Non-controlling interest	(4)	-	(27)	(31)	(3)	-	(36)	(39)
Foreign exchange gain	160	-	-	160	108	-	-	108
Recovery of (provision for) income taxes	(56)	-	-	(56)	(20)	-	-	(20)
	67	1	(27)	41	39	(1)	(35)	3
Segment income (loss)	**$ 155**	**$ 27**	**$ (27)**	**$ 155**	**$ 152**	**$ 35**	**$ (35)**	**$ 152**

* Effective May 24, 2007, the results and financial position of Jazz are not consolidated within Air Canada (Note 1).

	Six Months Ended June 30, 2007*				Six Months Ended June 30, 2006			
	Air Canada Segment	Jazz	Elimination	Consolidated Total	Air Canada Segment	Jazz	Elimination	Consolidated Total
Passenger revenue	$ 4,473	$ -	$ -	$ 4,473	$ 4,264	$ -	$ -	$ 4,264
Cargo revenue	276	-	-	276	305	-	-	305
Other revenue	380	3	-	383	362	4	-	366
External revenue	5,129	3	-	5,132	4,931	4	-	4,935
Inter-segment revenue	40	610	(650)	-	39	656	(695)	-
Total revenues	**5,169**	**613**	**(650)**	**5,132**	**4,970**	**660**	**(695)**	**4,935**
Wages, salaries and benefits	974	139	-	1,113	912	151	-	1,063
Aircraft fuel	1,221	125	(124)	1,222	1,200	130	(130)	1,200
Aircraft rent	144	57	(6)	195	166	65	(4)	227
Airport and navigation fees	500	80	(81)	499	475	83	(83)	475
Aircraft maintenance, materials and supplies	429	50	(8)	471	396	45	(6)	435
Communications and information technology	138	2	-	140	138	4	(1)	141
Food, beverages and supplies	158	6	-	164	155	7	(1)	161
Depreciation of property and equipment	244	9	-	253	206	11	-	217
Amortization of intangible assets	19	-	-	19	26	-	-	26
Obsolescence provisions	1	-	-	1	1	-	-	1
Commissions	110	-	-	110	127	-	-	127
Capacity purchase with Jazz	462	-	(386)	76	421	-	(421)	-
Special charges for labour restructuring	-	-	-	-	28	-	-	28
Other operating expenses	759	83	(45)	797	730	92	(49)	773
Total operating expenses	**5,159**	**551**	**(650)**	**5,060**	**4,981**	**588**	**(695)**	**4,874**
Operating income (loss)	**10**	**62**	**-**	**72**	**(11)**	**72**	**-**	**61**
Interest income	49	2	-	51	37	2	(1)	38
Interest expense	(177)	(3)	-	(180)	(147)	(4)	1	(150)
Interest capitalized	64	-	-	64	23	(1)	-	22
Gain on sale of assets	21	-	-	21	3	-	-	3
Gain (loss) on financial instruments recorded at fair value	28	-	-	28	(3)	-	-	(3)
Other non-operating income (expense)	(10)	1	-	(9)	1	-	-	1
Non-controlling interest	(6)	-	(62)	(68)	(7)	-	(69)	(76)
Foreign exchange gain	193	-	-	193	121	-	-	121
Recovery of (provision for) income taxes	(51)	-	-	(51)	9	-	-	9
	111	-	(62)	49	37	(3)	(69)	(35)
Segment income (loss)	**$ 121**	**$ 62**	**$ (62)**	**$ 121**	**$ 26**	**$ 69**	**$ (69)**	**$ 26**

* Effective May 24, 2007, the results and financial position of Jazz are not consolidated within Air Canada (Note 1).

Geographic Information

Passenger revenues	Three Months Ended June 30 2007	Three Months Ended June 30 2006	Six Months Ended June 30 2007	Six Months Ended June 30 2006
Canada	$ 1,011	$ 960	$ 1,859	$ 1,740
US Transborder	469	469	958	938
Atlantic	477	474	835	809
Pacific	236	224	448	420
Other	143	135	373	357
	$ 2,336	**$ 2,262**	**$ 4,473**	**$ 4,264**

Cargo revenues	Three Months Ended June 30 2007	Three Months Ended June 30 2006	Six Months Ended June 30 2007	Six Months Ended June 30 2006
Canada	$ 26	$ 29	$ 52	$ 57
US Transborder	6	7	13	15
Atlantic	50	52	107	107
Pacific	44	56	84	105
Other	9	10	20	21
	$ 135	**$ 154**	**$ 276**	**$ 305**

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

Segment Asset Information

	December 31 2006			
	Air Canada Segment	Jazz	Elimination	Consolidated Total
Cash and cash equivalents	$ 1,312	$ 135	$ -	$ 1,447
Short-term investments	798	-	-	798
	$ 2,110	$ 135	$ -	$ 2,245
Total assets	**$ 11,388**	**$ 483**	**$ (122)**	**$ 11,749**

The Corporation is a domestic and international carrier and for the purposes of segment reporting, flight equipment is attributed to Canada. As a result, substantially all of the Corporation's property and equipment are related to operations in Canada.

The Air Canada segment is comprised of the passenger and cargo transportation services business operated by Air Canada and related ancillary services.

The Jazz segment included up to May 24, 2007 is operating under the capacity purchase agreement ("Jazz CPA") with Air Canada.

The accounting policies for these two segments are as described in Note 2 of the 2006 annual combined consolidated financial statements of Air Canada. In addition, Jazz recognizes its revenue under the Jazz CPA as the services are provided to the Air Canada Services segment.

Pass-through costs which are not marked-up charged to Air Canada from Jazz include fuel, airport and user fees and other; these expenses are recorded in the applicable category within the operating expenses in the results of Air Canada Services.

Also refer to Note 8 *Related Party Transactions*.

8. RELATED PARTY TRANSACTIONS

As at June 30, 2007 ACE has a 75% ownership interest in Air Canada. The Corporation has various related party transactions with ACE and other ACE related entities, including Aeroplan LP ("Aeroplan"), Jazz, and ACTS. These transactions are recorded at the exchange amount.

Related party trade balances arise from the provision of services, as outlined in the table below, the allocation of employee related costs, and centralized cash management activities as described below.

The related party balances resulting from the application of the commercial and contractual practices were as follows:

	June 30 2007*	December 31 2006
Accounts receivable		
ACE	$ 15	$ -
Aeroplan	-	6
ACTS	124	97
Jazz	95	-
	$ 234	**$ 103**
Accounts payable and accrued liabilities		
ACE	$ -	$ 12
ACTS	127	111
Jazz	74	-
	$ 201	**$ 123**

* Effective May 24, 2007, the results and financial position of Jazz are not consolidated within Air Canada (Note 1).

Revenues and expenses with related parties are summarized as follows:

	Three Months Ended		Six Months Ended	
	June 30 2007*	June 30 2006	June 30 2007*	June 30 2006
Revenues				
Revenues from Aeroplan related to Aeroplan rewards	$ 91	$ 83	$ 188	$ 160
Revenue offset from purchase of Aeroplan miles	(62)	(63)	(126)	(124)
Property rental revenues from related parties	13	13	23	25
Revenues from information technology services to related parties	8	6	14	13
Revenues from corporate services and other	11	3	17	7
Cargo revenues from related parties	-	1	1	2
	$ 61	**$ 43**	**$ 117**	**$ 83**
Expenses				
Maintenance expenses for services from ACTS	$ 187	$ 159	$ 375	$ 320
Expense from Capacity Purchase Agreement with Jazz	76	-	76	-
Pass through fuel expense from Jazz	29	-	29	-
Pass through airport expense from Jazz	17	-	17	-
Pass through other expenses from Jazz	2	-	2	-
Call centre management and marketing fees for services from Aeroplan	1	2	5	5
Other expenses	-	13	-	22
Recovery of wages, salary and benefit expense for employees assigned to Aeroplan and ACTS	(123)	(118)	(222)	(207)
	$ 189	**$ 56**	**$ 282**	**$ 140**
Net interest expense from related parties	**$ -**	**$ 2**	**$ -**	**$ 4**

* Effective May 24, 2007, the results and financial position of Jazz are not consolidated within Air Canada (Note 1). The related party transactions above are for the period from May 24, 2007.

Prior to 2007, Air Canada held certain investments in Aeroplan, Jazz and ACTS. During 2006, as described in Note 1, certain cash payments and notes received from ACE on transfer of these investments to ACE have been included in these consolidated financial statements as a contribution from ACE to Shareholders' Equity.

Summary of significant related party agreements

The Relationship between the Corporation and Aeroplan

Aeroplan operates a loyalty program which provides loyalty marketing services to its customers.

The transactions between Air Canada and Aeroplan described below are recorded at the exchange amount and are settled by netting amounts payable against amounts receivable in accordance with the inter-company agreements with any outstanding balance paid in the subsequent period. Accordingly, the amounts have been presented in these consolidated financial statements on a net basis as the parties intend to settle on a net basis.

Aeroplan Commercial Participation and Services Agreement (CPSA)

Pursuant to the Aeroplan CPSA, last amended on October 13, 2006, Air Canada continues to allocate 8% of the seat capacity to Aeroplan on the flights operated by Air Canada and Jazz and certain other air carriers under the Air Canada code (collectively, the "AC Flights") at a fixed redemption cost. In addition, Aeroplan can purchase an unlimited number of available seats based on published fares with a variable discount depending on the fare product. Any adjustment to this variable discount is based on an identified set of parameters. The Aeroplan CPSA also provides that Aeroplan will be charged the lowest fares charged to any other loyalty program taking into account Aeroplan's volume purchase of Air Canada's seat inventory. The rates charged for the allocated 8% of the seat capacity on AC Flights are fixed through the end of 2007. Thereafter, any upward or downward adjustments to such rates must maintain aggregate discounts at least as favourable to Aeroplan as those set out in the current rates.

Air Canada is one of Aeroplan's leading partners and it pays a fee to participate in the Aeroplan program, which fee is based on the Aeroplan miles awarded to Air Canada customers who travel on AC Flights. Aeroplan is required to purchase a minimum number of reward travel seats on AC Flights annually, which number is a function of Aeroplan's consumption of seats in the three preceding calendar years (2006 – $170). Moreover, Air Canada is required to purchase a minimum number of Aeroplan miles annually.

The Aeroplan CPSA also provides that Aeroplan shall, in return for a service fee, manage Air Canada's frequent flyer tier membership program for Air Canada Super Elite®, Elite® and Prestige® customers, as well as perform certain marketing and promotion services for Air Canada, including call centre services for the frequent flyer tier membership program. These amounts are included in the above table summarizing related party revenue and expenses under call centre management and marketing fees for services from Aeroplan.

Unless otherwise agreed to between Air Canada and Aeroplan, all amounts due and owing by either party to the other pursuant to the CPSA are payable within thirty days of the invoice date.

Aeroplan Database Agreement

Pursuant to the Aeroplan Database Agreement, Aeroplan manages Air Canada's passenger information database. The Aeroplan Database Agreement allows Aeroplan to access and use the Air Canada database information for statistical purposes, as well as for revenue generating and general marketing purposes by using such information to conduct market research for other Aeroplan partners who are not in direct competition with Air Canada. Air Canada is entitled to access and use the Aeroplan database information for certain purposes, including pre-approved targeted marketing activities. The access and usage by each of Aeroplan and Air Canada is subject to adherence with any applicable confidentiality and privacy restrictions and is subject to pre-established fees based on the information access or use, which fees are invoiced on a quarterly basis and are subject to revision annually.

Aeroplan Master Services Agreement (MSA)

Pursuant to the Aeroplan MSA, Air Canada has agreed to provide certain administrative services to Aeroplan in return for a fee based on Air Canada's fully allocated cost of providing such services to Aeroplan plus a mark-up to reflect overhead and administrative costs. Amounts related to the MSA are included in the above table summarizing related party revenues and expenses under Revenues from corporate services and other.

Aeroplan General Services Agreement (GSA)

Pursuant to the Aeroplan GSA, Air Canada provides Aeroplan with the services of a group of call centre employees of Air Canada. Aeroplan must reimburse Air Canada for all costs, including salary and benefits, related to the call centre employees on a fully allocated basis. With regard to the shortfall in the pension plan maintained by Air Canada which covers, among others, these call centre employees, Aeroplan has agreed to pay an amount not to exceed $16.1 million over the next eight years to compensate Air Canada for call centre employees' share of the unfunded Air Canada pension liability. Amounts related to the GSA are recorded in the above table summarizing related party revenues and expenses under Recovery of wages, salary and benefit expense for employees assigned to Aeroplan, ACTS, and ACE.

Trademark License Agreement

Air Canada and Aeroplan LP have granted each other reciprocal royalty-free, non-exclusive, non-sublicensable, non-assignable rights to use certain of each other's trademarks around the world which incorporate their names or logos, solely in association with the Aeroplan Program.

The Relationship between the Corporation and ACTS

ACTS provides full-service maintenance, repair and overhaul services to a wide range of customers.

ACTS Maintenance Agreements

Pursuant to general terms and related services agreements between ACTS and Air Canada (the "ACTS Maintenance Agreements") as well as other maintenance agreements with Jazz, ACTS has agreed to provide the following services to Air Canada and Jazz: 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, training services, supply chain management services and other ancillary services. ACTS serves as Air Canada's exclusive repair agency to provide certain of these services and Jazz's exclusive repair agency related to component repair and overall work on parts which can be removed from Jazz aircraft. Jazz performs certain of its own aircraft heavy maintenance. The amounts related to the ACTS Maintenance Agreements and other maintenance agreements with Jazz are recorded in the above table summarizing related party revenues and expenses under Maintenance expense for services from ACTS.

ACTS Master Services Agreement (MSA)

Pursuant to the master services agreement between Air Canada and ACTS (the "ACTS MSA"), Air Canada has agreed to provide ACTS with services including infrastructure support and services which are mostly administrative in nature, including information technology, human resources, finance and accounting, and legal services in return for fees to be paid by ACTS to Air Canada.

These amounts are recorded in the above table summarizing related party revenues and expenses under Revenues from corporate services and other.

ACTS Trademark License Agreement

Air Canada has granted ACTS a royalty-free, non-exclusive, non-assignable right to use certain trademarks registered by Air Canada which incorporate the Air Canada name, and/or Air Canada's roundel design, solely in association with the provision of heavy maintenance, component maintenance and supply chain business services in Canada and the United States.

General Services Agreements

Pursuant to general services agreements between Air Canada and ACTS (the "ACTS GSAs"), Air Canada provides ACTS with the services of a group of unionized and non-unionized employees of certain departments/divisions of Air Canada. ACTS must reimburse Air Canada for all costs, including salary and benefits, related to these employees on a fully allocated basis. These amounts are recorded in the above table summarizing related party revenues and expenses under Recovery of wages, salary and benefits expense for employees assigned to ACTS.

Unless otherwise agreed to between Air Canada and ACTS, all amounts due and owing by either party to the other are payable within thirty days of the invoice date.

<u>*Building Sale to ACTS*</u>

During Quarter 4 2006 Air Canada recorded an impairment loss on the building that is being sold to ACTS. Upon execution of the sale agreement, the building will be sold to ACTS at the carrying value of $28. Air Canada and ACTS are finalizing the sale of the building from Air Canada to ACTS that is expected to be executed in 2007.

The Relationship between the Corporation and Jazz

Air Canada has no ownership interest in Jazz. Jazz is consolidated in these consolidated financial statements under AcG-15 up to May 24, 2007 (refer to note 1). Air Canada and Jazz negotiate transactions between each other as if they were unrelated parties on an arm's length basis.

<u>*Jazz CPA*</u>

Under the Jazz CPA, Air Canada pays Jazz fees based on a variety of metrics and an estimate of various costs and expenses (marked-up by a specified percentage) to be incurred and paid by Jazz for the applicable period for flights operated by Jazz pursuant to the Jazz CPA and other services to aircraft. The fees include both a variable component that is dependent on Jazz aircraft utilization and a fixed component. Air Canada also reimburses Jazz for pass-through costs specified in the Jazz CPA. These pass-through costs, which are not marked-up, include fuel, airport and navigation fees.

<u>*Jazz MSA*</u>

Air Canada and Jazz are parties to the Jazz MSA pursuant to which Air Canada provides certain services to Jazz in return for a fee based on the fair market value of the services provided by Air Canada to Jazz. Pursuant to the Jazz MSA, Air Canada provides Jazz with infrastructure support consisting principally of administrative services in relation with information technology, corporate real estate, environmental affairs and legal services. Jazz benefits from the information technology available to Air Canada from third parties and from Air Canada's internal information technology resources.

Air Canada and Jazz may elect to terminate any services under the Jazz MSA (without terminating the whole Jazz MSA) or the entire Jazz MSA upon one year's prior written notice. The Jazz MSA shall terminate upon the termination of the Jazz CPA.

<u>*Jazz Trademark Agreements*</u>

Pursuant to the Jazz Trademark License Agreement, Air Canada has granted Jazz a royalty-free, non-exclusive, non-sublicensable, non-assignable right to use certain trademarks owned or registered by Air Canada around the world including Jazz and those which incorporate the Air Canada name, and/or Air Canada's roundel design, solely in association with the Jazz business. The Jazz Trademark License Agreement can be terminated in the event that the Jazz CPA is terminated. However, Air Canada and Jazz have also entered into a Jazz Special Trademark Agreement which would grant all of Air Canada's rights to the Jazz trademark to Jazz (and preclude Air Canada from using the Jazz trademark or licensing the Jazz trademark to third parties) upon the occurrence of certain events involving (i) the expiration or termination of the Jazz CPA if, at such time, Jazz is no longer an affiliate of Air Canada; (ii) the occurrence of a change of control pursuant to which Jazz ceases to be an affiliate of Air Canada if, at or prior to such time, the Jazz CPA has expired or has been terminated; or (iii) the sale or transfer of all or substantially all of the assets or business of Jazz to a third party that is not an affiliate of Air Canada if, at or prior to such time, the Jazz CPA has expired or has been terminated.

The Relationship between the Corporation and ACE

<u>*ACE Master Services Agreement*</u>

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.

Cash Management System

Air Canada manages (or managed, as the case may be) the cash for certain related parties, including Aeroplan up to June 2005, Jazz up to February 2006 and ACTS during all periods presented in these consolidated financial statements. All cash collected from billings and sources other than Air Canada is recorded by Air

Canada on a daily basis. Any payments to pay obligations related to operating and financing costs and capital expenditures other than obligations to Air Canada and other ACE affiliates were made through the Air Canada cash management system. In addition, certain inter-company transactions for services were not settled within the terms set out in the above noted agreements. Inter-company accounts receivable and payable include any excess cash, (cash proceeds greater than cash expenditures), cash deficiencies (cash expenditures greater than proceeds) or deferrals of receipts of payments. The consolidated statement of cash flows reflects the receipt and repayment of excess cash as a financing activity and the disbursement and repayment of cash deficiencies as investing activities.

9. COMMITMENTS

During Quarter 2 2007, the Corporation amended agreements with Boeing to cancel orders for two Boeing 777 aircraft scheduled for delivery in 2009. In addition, the Corporation increased its order for Boeing 787 aircraft by 23, bringing its total firm orders to 37 Boeing 787 aircraft. Following the amendment, Air Canada has options to acquire an additional 23 Boeing 787 aircraft. The deliveries of the 37 Boeing 787 aircraft committed to by the Corporation are scheduled to be completed by 2014.

In conjunction with the amended agreements, the Corporation received additional financing commitments from Boeing for seven of the additional Boeing 787 aircraft (21 Boeing 787 aircraft in total) on the same terms and conditions as described in Note 15 – Commitments in the 2006 annual combined consolidated financial statements. Should the Corporation not utilize any of the financing commitments on the 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.

Based on June 30, 2007 exchange rates, the impact by year on the previously disclosed committed capital expenditures as described in Note 15 – commitments in the 2006 annual combined consolidated financial statements of Air Canada are as follows:

Change in capital commitments **Increase (decrease)**		**CDN**
Year ending December 31, 2007	$	28
Year ending December 31, 2008		(9)
Year ending December 31, 2009		(293)
Year ending December 31, 2010		72
Year ending December 31, 2011		263
Thereafter		2,815
	$	**2,876**

Final aircraft delivery prices include estimated escalation and deferred price delivery payment interest calculated based on the 90-day USD LIBOR rate at June 30, 2007.

10. CONTINGENCIES

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 the Corporation. Competition authorities have sought or requested information from the Corporation as part of their investigations. The Corporation is cooperating with these investigations which may lead to proceedings against the Corporation and a number of airlines and other cargo operators. The Corporation 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. It is not possible at this time to predict with any degree of certainty the outcome of these proceedings, but these proceedings may result in liability to the Corporation which may be material. It is the Corporation's policy to conduct its business in full compliance with all applicable competition laws.