AIR CANADA

Third Quarter 2008
Interim Unaudited
Consolidated Financial Statements and Notes

November 7, 2008

Consolidated Statement of Operations

Unaudited (Canadian dollars in millions except per share figures)		Three Months Ended September 30 2008	2007	Nine Months Ended September 30 2008	2007*
Operating revenues					
Passenger		$ 2,766	$ 2,660	$ 7,531	$ 7,133
Cargo		139	132	402	408
Other		170	162	651	545
		3,075	2,954	8,584	8,086
Operating expenses					
Wages, salaries and benefits		472	478	1,433	1,591
Aircraft fuel		1,064	716	2,627	1,938
Aircraft rent		67	66	199	261
Airport and navigation fees		275	284	771	783
Aircraft maintenance		127	155	502	626
Communications and information technology		69	70	214	210
Food, beverages and supplies		86	88	244	252
Depreciation and amortization	Note 6	176	144	520	417
Commissions		54	54	154	164
Capacity purchase with Jazz	Note 11	243	234	711	310
Other		330	314	1,102	1,111
		2,963	2,603	8,477	7,663
Operating income before under-noted item		**112**	**351**	**107**	**423**
Provision for cargo investigations	Note 9	-	-	(125)	-
Operating income (loss)		**112**	**351**	**(18)**	**423**
Non-operating income (expense)					
Interest income		13	21	46	72
Interest expense		(72)	(82)	(231)	(262)
Interest capitalized		6	24	31	88
Gain (loss) on capital assets	Note 2	-	(2)	(29)	19
Gain (loss) on financial instruments recorded at fair value	Note 5	(93)	(2)	60	26
Other		(1)	(4)	(3)	(13)
		(147)	(45)	(126)	(70)
Income (loss) before the following items		**(35)**	**306**	**(144)**	**353**
Non-controlling interest		(2)	-	(8)	(68)
Foreign exchange gain (loss)		(87)	104	(128)	297
Provision for income taxes					
Current		(1)	(10)	(1)	(16)
Future		(7)	(127)	(17)	(172)
Income (loss) for the period		**$ (132)**	**$ 273**	**$ (298)**	**$ 394**
Income (loss) per share					
Basic and Diluted		$ (1.32)	$ 2.73	$ (2.98)	$ 3.94

**Up until May 24, 2007, the results of Jazz are 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)		September 30 2008	December 31 2007
ASSETS			
Current			
Cash and cash equivalents		$ 497	$ 527
Short-term investments		617	712
		1,114	1,239
Restricted cash		82	124
Accounts receivable		994	750
Aircraft fuel inventory		94	98
Fuel derivatives	Note 5	12	68
Prepaid expenses and other current assets		134	182
		2,430	2,461
Property and equipment	Note 2	7,457	7,919
Intangible assets		968	952
Deposits and other assets		484	488
		$ **11,339**	**$ 11,820**
LIABILITIES			
Current			
Accounts payable and accrued liabilities		$ 1,364	$ 1,226
Advance ticket sales		1,452	1,300
Current portion of long-term debt and capital leases		408	413
		3,224	2,939
Long-term debt and capital leases		3,962	4,006
Future income taxes		88	88
Pension and other benefit liabilities		1,460	1,824
Other long-term liabilities		364	336
		9,098	9,193
Non-controlling interest		192	184
SHAREHOLDERS' EQUITY			
Share capital		274	274
Contributed surplus		1,795	1,791
Retained earnings		24	322
Accumulated other comprehensive income (loss)		(44)	56
		2,049	2,443
		$ 11,339	**$ 11,820**

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)		Nine Months Ended September 30 2008	2007*
Share capital			
Common shares		$ 274	$ 274
Total share capital		274	274
Contributed surplus			
Balance, beginning of period		1,791	1,693
Fair value of stock options issued to Corporation employees recognized as compensation expense	Note 1	(4)	8
Proceeds from intercompany agreements	Note 7	8	-
Purchase of Air Canada Vacations	Note 1	-	(10)
Deconsolidation of Jazz		-	82
Total contributed surplus		1,795	1,773
Retained earnings			
Balance, beginning of period		322	(107)
Net income (loss) for the period		(298)	394
Total retained earnings		24	287
Accumulated other comprehensive income (loss)			
Balance, beginning of period		56	(26)
Other comprehensive income (loss)		(100)	32
Total accumulated other comprehensive income (loss)		(44)	6
Total retained earnings and accumulated other comprehensive income (loss)		(20)	293
Total shareholders' equity		**$ 2,049**	**$ 2,340**

**Up until May 24, 2007, the results of Jazz are consolidated within Air Canada (Note 1).*
The accompanying notes are an integral part of the interim consolidated financial statements.

Consolidated Statement of Comprehensive Income

Unaudited (Canadian dollars in millions)		Three Months Ended September 30 2008	2007	Nine Months Ended September 30 2008	2007*
Comprehensive income					
Income (loss) for the period		$ (132)	$ 273	$ (298)	$ 394
Other comprehensive income, net of taxes:					
Net gains (losses) on fuel derivatives under hedge accounting	Note 5	(244)	11	29	25
Reclassification of net realized (gains) losses on fuel derivatives to income	Note 5	(44)	(3)	(129)	7
		(288)	8	(100)	32
Total comprehensive income (loss)		**$ (420)**	**$ 281**	**$ (398)**	**$ 426**

**Up until May 24, 2007, the results of Jazz are consolidated within Air Canada (Note 1).*
The accompanying notes are an integral part of the interim consolidated financial statements.

Consolidated Statement of Cash Flow

Unaudited (Canadian dollars in millions)		Three Months Ended September 30 2008	Three Months Ended September 30 2007	Nine Months Ended September 30 2008	Nine Months Ended September 30 2007*
Cash flows from (used for)					
Operating					
Income (loss) for the period		$ (132)	$ 273	$ (298)	$ 394
Adjustments to reconcile to net cash from operations					
Depreciation and amortization		176	144	520	417
Loss (gain) on disposal of assets		-	2	29	(19)
Foreign exchange (gain) loss		102	(139)	103	(326)
Future income taxes		7	127	17	172
Excess of employee future benefit funding over expense		(150)	(32)	(232)	(170)
Provision for cargo investigations	Note 9	-	-	125	-
Non-controlling interest		2	-	8	68
Changes in non-cash working capital balances		(390)	(323)	(18)	(54)
Financial instruments and other		117	18	(78)	5
		(268)	**70**	**176**	**487**
Financing					
Aircraft related borrowings		-	449	313	1,093
Distributions paid to non-controlling interest		-	-	-	(54)
Reduction of long-term debt and capital lease obligations		(67)	(138)	(708)	(305)
Reduction of non-controlling interest		-	-	-	(36)
Other		8	-	8	-
		(59)	**311**	**(387)**	**698**
Investing					
Short-term investments		161	171	95	88
Additions to capital assets		(105)	(604)	(733)	(1,772)
Proceeds from sale of assets		-	16	27	61
Deconsolidation of Jazz cash		-	-	-	(138)
Proceeds from sale-leaseback transactions	Note 2	-	-	708	-
Cash management with related parties		-	11	-	(23)
Other		49	(54)	84	(56)
		105	**(460)**	**181**	**(1,840)**
Decrease in cash and cash equivalents		**(222)**	**(79)**	**(30)**	**(655)**
Cash and cash equivalents, beginning of period		719	871	527	1,447
Cash and cash equivalents, end of period		**$ 497**	**$ 792**	**$ 497**	**$ 792**
Cash payments of interest		$ 68	$ 60	$ 215	$ 179
Cash payments of income taxes		$ -	$ 3	$ -	$ 6

**Up until May 24, 2007, the results of Jazz are consolidated within Air Canada (Note 1).*
The accompanying notes are an integral part of the interim consolidated financial statements.
Cash and cash equivalents exclude Short-term investments of $617 as at September 30, 2008 ($710 as at September 30, 2007).

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"). The term "Corporation" refers to, as the context may require, Air Canada and / or one or more of Air Canada's subsidiaries.

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 2007 annual consolidated financial statements of the Corporation, with the exception of the changes in accounting policies described below in part B) Changes in Accounting Policies.

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 2007 annual consolidated financial statements of the Corporation. 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.

Certain comparative figures have been reclassified to conform to the financial statement presentation adopted in the current period.

Purchase of ACE's Interest in Air Canada Vacations

During the third quarter of 2007, the Corporation purchased from ACE its 49% interest in Air Canada Vacations causing Air Canada Vacations to be wholly owned by the Corporation. Consideration for the units was $10 and was accounted for within contributed surplus. Air Canada Vacations still remains consolidated within the results of the Corporation.

Stock-based Compensation

In the third quarter of 2008, Air Canada reversed previously recorded stock-based compensation expense of $8.

Accounting for Jazz

Air Canada is party to a capacity purchase agreement (the "Jazz CPA") with Jazz Air LP ("Jazz"). The Corporation does not hold any partnership units of Jazz. Due to the terms of the Jazz CPA, Jazz is deemed to be a variable interest entity. The Corporation was deemed to be the primary beneficiary of Jazz up until May 24, 2007. As a result of ACE's distribution of units of Jazz Air Income Fund on May 24, 2007, the Corporation no longer consolidates Jazz. Prospective from the date of deconsolidation, the Corporation has one reportable segment. Refer to Note 1 of the 2007 annual consolidated financial statements of the Corporation.

B) CHANGES IN ACCOUNTING POLICIES

Capital Disclosures and Financial Instruments – Presentation and Disclosure

Effective January 1, 2008 Air Canada adopted three new Canadian Institute of Chartered Accountants ("CICA") accounting standards: section 1535, *Capital Disclosures*, section 3862, *Financial Instruments – Disclosures*, and section 3863, *Financial Instruments – Presentation*.

Section 1535 establishes disclosure requirements about an entity's capital and how it is managed. The purpose is to enable users of the financial statements to evaluate the entity's objectives, policies and processes for managing capital. Refer to Note 10 for the Corporation's section 1535 disclosures.

Sections 3862 and 3863 replace section 3861, *Financial Instruments – Disclosure and Presentation*, revising and enhancing its disclosure requirements in certain areas, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. Refer to Note 5 for the Corporation's financial instruments disclosures. Where the disclosure requirements of the new standards did not change from the previous standard and where there have been no significant updates from the disclosures in Note 17 of the 2007 annual consolidated financial statements of the Corporation, no additional disclosure has been provided.

Inventories

Effective January 1, 2008, the Corporation adopted CICA section 3031, *Inventories*, which replaced section 3030, *Inventories*. Section 3031 provides more extensive guidance on measurement, and expands disclosure requirements to increase transparency. The Corporation's accounting policy for aircraft fuel inventory is consistent with measurement requirements in the new standard and as a result, no adjustment was recorded on transition; however, additional disclosures are required. The additional disclosure requirements will be applied as described below.

The main features of the new standard, which impact the Corporation, include:

- Measurement of inventories at the lower of cost and net realizable value, with guidance on the determination of costs.
- Consistent use of either a first-in first-out or weighted average formula to measure the cost of other inventories. The Corporation uses a weighted average formula to measure cost.
- Reversal of previous write-downs to net realizable value when there is a subsequent increase in the value of inventories.
- Disclosure of the accounting polices used, carrying amounts, amounts recognized as an expense, write-downs, and the amount of any reversal of any write-downs recognized as a reduction in expenses.

Future Accounting Standard Changes

In February 2008, the CICA issued section 3064, *Goodwill and Intangible Assets* which provides guidance on the recognition, measurement, presentation and disclosure for goodwill and intangible assets, other than the initial recognition of goodwill or intangible assets acquired in a business combination. The standard is effective for fiscal years beginning on or after October 1, 2008, and requires retroactive application to prior period financial statements. The Corporation has evaluated the impact of this new standard for adoption on January 1, 2009 and does not expect any significant impact on its consolidated financial statements.

In February 2008, the Canadian Accounting Standards Board confirmed January 1, 2011 as the changeover date for Canadian publicly accountable enterprises to start using International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board. IFRS uses a conceptual framework similar to Canadian GAAP, but there are significant differences in recognition, measurement and disclosures. The Corporation is currently evaluating the impact of the adoption of IFRS on its consolidated financial statements.

2. FINANCING AND INVESTING ACTIVITIES

Revolving Credit Facility

Though Air Canada has a secured revolving credit facility of $400, as further described in Note 8 to the 2007 annual consolidated financial statements of the Corporation, it is no longer available to the Corporation until and unless the Corporation and the lenders conclude amendments satisfactory to each of them relating to a financial covenant and other business terms. During the third quarter of 2008, the Corporation and the lenders entered into an amending agreement pursuant to which the parties undertake to negotiate such further amendments to the facility and the Corporation agrees not to request any funding under the facility until such further amendments are agreed. On October 30, 2008, the Corporation and the lenders entered into a further amendment agreement pursuant to which the commitment was reduced to $200 and the Corporation agreed to suspend the obligation of the lenders to consider any amendments in exchange for additional flexibility under the facility to permit the Corporation to seek alternative financing arrangements. Discussions with the lenders are not currently taking place and there can be no assurance that amendments satisfactory to the parties will be concluded, that amounts under the facility will ever be available to the Corporation, that the Corporation will not decide to terminate the facility, or that a replacement facility or alternative financing arrangements will be concluded.

Sale-Leaseback

During the second quarter of 2008 the Corporation received delivery of three Boeing 777 aircraft. One aircraft was financed with guarantee support from the Export-Import Bank of the United States ("EXIM"), as outlined below. Two of the aircraft were financed under sale and leaseback transactions with proceeds of $297. The resulting gain on sale of $30 has been deferred and will be recognized as a reduction to Aircraft rent expense over the term of the leases. The leases are accounted for as operating leases with 12 year terms, paid monthly.

During the first quarter of 2008 the Corporation received delivery of four Boeing 777 aircraft. One aircraft was financed with guarantee support from EXIM, as outlined below. Three of the aircraft were financed under sale and leaseback transactions with proceeds of $411. The resulting gain on sale of $47 has been deferred and will be recognized as a reduction to Aircraft rent expense over the term of the leases. The leases are accounted for as operating leases with 12 year terms, paid monthly.

Borrowings

Boeing Aircraft Financing

The following table summarizes the Japanese Yen (JPY) denominated loans, secured by the delivered aircraft, which have a carrying value of $249 as at September 30, 2008, that Air Canada drew during the nine month period ended September 30, 2008 to finance the acquisition of two Boeing aircraft:

	Number of Aircraft	Interest Rate	Maturity	Original JPY Loan Amount	Original CDN$ Loan Amount
Quarter 2 2008					
Boeing 777 - 300	1	1.05%	2020	11,199	$ 106
Quarter 1 2008					
Boeing 777 - 200	1	1.03%	2020	10,387	$ 98

During the second quarter of 2008, financing fees of $3 were recorded for these borrowings ($4 recorded during the first quarter of 2008). These fees are capitalized for periods preceding the dates that the assets are available for service.

The following table summarizes the principal repayment requirements (in CDN$) of the Boeing aircraft financing obtained during the nine month period ended September 30, 2008, based upon the foreign exchange rate as at September 30, 2008:

	Remainder of 2008	2009	2010	2011	2012	Thereafter	Total
Boeing aircraft financing	$ 4	$ 18	$ 18	$ 18	$ 18	$ 133	$ 209

Embraer Aircraft Financing

The following table summarizes the loans, secured by the delivered aircraft, which have a carrying value of $87 as at September 30, 2008, that Air Canada drew during the nine month period ended September 30, 2008 to finance the acquisition of three Embraer aircraft:

	Number of Aircraft	Interest Rate	Maturity	Original US$ Loan Amount	Original CDN$ Loan Amount
Quarter 1 2008					
Embraer 190	3	4.97 - 6.39%	2020	$ 68	$ 67

During the first quarter of 2008, financing fees of $1 were recorded for these borrowings. These fees are capitalized for periods preceding the dates that the assets are available for service.

The following table summarizes the principal repayment requirements (in CDN$) of the Embraer aircraft financing obtained during the nine month period ended September 30, 2008, based upon the foreign exchange rate as at September 30, 2008:

	Remainder of 2008	2009	2010	2011	2012	Thereafter	Total
Embraer aircraft financing	$ 1	$ 3	$ 3	$ 4	$ 4	$ 55	$ 70

Disposals of and Provisions for Assets

During the second and third quarters of 2008:

- There were no significant disposals or provisions during the quarters.

During the first quarter of 2008:

- The Corporation recorded an impairment charge of $38 on its fleet of B767-200 aircraft due to the revised retirement date of the aircraft.
- The Corporation sold an A319 aircraft for proceeds of $23 with a book value of $21, resulting in a gain on sale of $2.

During the third quarter of 2007:

- There were no significant disposals or provisions during the quarter.

During the second quarter of 2007:

- A CRJ-100 aircraft owned by Air Canada and leased to Jazz was damaged beyond repair. As a result of insurance proceeds of $21, Air Canada recorded a gain on disposal of $14 ($10 net of tax).

During the first quarter of 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) was recorded in the Air Canada segment.
- 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) was recorded in the Air Canada segment.

Predelivery Financing

The terms of the predelivery financing are described in Note 8 to the 2007 annual consolidated financial statements of the Corporation.

There were no draws or repayments under the predelivery financing during the third quarter of 2008.

During the second quarter of 2008, the Corporation drew an additional amount of $13 and made repayments of $197 on the predelivery financing.

During the first quarter of 2008, the Corporation drew an additional amount of $26 and made repayments of $238 on the predelivery financing.

Commitments

Refer to Note 8 for a discussion of the Corporation's aircraft commitments.

Subsequent Event

Refer to Note 12 – Subsequent Events for information regarding a new financing arranged by the Corporation.

3. PENSION AND OTHER EMPLOYEE FUTURE BENEFITS EXPENSE

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

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007*
Pension benefit expense	$ 22	$ 34	$ 67	$ 109
Other employee future benefits expense	26	26	78	79
	48	**60**	**145**	**188**
Amount charged to ACE, Aveos[(1)] and Aeroplan	(11)	(11)	(31)	(31)
Net pension benefit and other employee future benefits expense	**$ 37**	**$ 49**	**$ 114**	**$ 157**

** Up until May 24, 2007, the results of Jazz are consolidated within Air Canada (Note 1).*

(1) On September 23, 2008, ACTS Aero announced a name change to Aveos Fleet Performance Inc. ("Aveos"). Refer to Note 7 - Related party transactions.

Pension Funding Obligations

Based on the January 1, 2008 actuarial valuation, the Corporation's projected pension cash funding obligations for the remainder of 2008 and for the full year 2008 are as follows:

	Remainder of 2008	2008
Past service domestic registered plans	$ 60	$ 194
Current service domestic registered plans	45	170
Other pension arrangements	17	92
Projected pension funding obligations	$ **122**	$ **456**

Changes in the economic conditions, mainly the return on fund assets and the change in interest rates, will impact projected required contributions. The required contributions disclosed above assumes no future gains and losses on plan assets and liabilities over the projection period and does not reflect the economic experience of 2008 to date. If recent market conditions persist, the Corporation expects its January 1, 2009 valuation to result in significant increases in funding obligations starting in the second half of 2009.

4. LABOUR RELATED PROVISIONS

The following table outlines the changes to labour related provisions which are included in long-term employee liabilities (current portion included in Accounts payable and accrued liabilities):

		Three Months Ended September 30		Nine Months Ended September 30	
		2008	2007	2008	2007*
Beginning of period		$ 62	$ 87	$ 66	$ 106
Interest accretion		1	1	3	4
Charges recorded in wages, salaries, and benefits		7	5	20	16
Amounts disbursed		(8)	(12)	(27)	(41)
Deconsolidation of Jazz	Note 1	-	-	-	(4)
End of period		62	81	62	81
Current portion		(27)	(30)	(27)	(30)
		$ 35	**$ 51**	**$ 35**	**$ 51**

** Up until May 24, 2007, the results of Jazz are consolidated within Air Canada (Note 1).*

The Corporation offers certain severance programs to certain employees from time to time. The cost of these programs is recorded within Wages, salaries and benefits. During the third quarter of 2008, the Corporation recorded an expense of $7 ($12 for the nine months ending September 30, 2008) against these ongoing programs.

In response to record high fuel prices, on June 17, 2008, Air Canada announced a reduction in capacity which will impact fleet and staffing levels effective with the implementation of its fall and winter schedule. The expected reduction in flying will require fewer employees to operate the airline resulting in a decrease in staff levels of up to 2,000 positions across all levels of the organization. During the second quarter of 2008, Air Canada recorded an expense of $8 in Wages, salaries and benefits expense related to the reduction of non-unionized employees under this plan. The Corporation expects that the costs related to the planned unionized staff reduction will be determinable and recorded during the fourth quarter of 2008, but the costs are not expected to be significant due to the impact of attrition and leave of absence programs.

5. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

As described in Note 1, the Corporation adopted CICA Section 3862 and 3863 effective January 1, 2008. These new standards enhance disclosure with respect to financial instruments.

Summary of Financial Instruments

	Carrying Amounts					
	September 30, 2008					December 31, 2007
	Financial instruments classification					
	Held for trading	Held to maturity	Loans and receivables	Liabilities at amortized cost	Total	
Financial Assets						
Cash & cash equivalents	$ 497	$ -	$ -	$ -	$ 497	$ 527
Short-term investments	617	-	-	-	617	712
Restricted cash	82	-	-	-	82	124
Accounts receivable	-	-	944	-	944	750
Deposits and other assets						
Restricted cash	63	-	-	-	63	84
Asset backed commercial paper	29	-	-	-	29	29
Aircraft related and other deposits	-	320	-	-	320	309
Derivative instruments						
Fuel derivatives	-	-	-	-	-	10
Foreign exchange derivatives	56	-	-	-	56	-
Cross-currency interest rate swaps	5	-	-	-	5	-
Interest rate swaps	9	-	-	-	9	7
	$ 1,358	$ 320	$ 944	$ -	$ 2,622	$ 2,552
Financial Liabilities						
Accounts payable	$ -	$ -	$ -	$ 1,354	$ 1,354	$ 1,119
Current portion of long-term debt and capital leases	-	-	-	408	408	413
Long-term debt and capital leases	-	-	-	3,962	3,962	4,006
Derivative instruments						
Fuel derivatives (1)	10	-	-	-	10	-
Foreign exchange derivatives	-	-	-	-	-	124
Interest rate swaps	-	-	-	-	-	2
	$ 10	$ -	$ -	$ 5,724	$ 5,734	$ 5,664

(1) The fuel derivatives above relate to the current and long-term portion of fuel derivatives not designated under fuel hedge accounting. Fuel derivatives under hedge accounting have a fair value of $6 in favour of the counterparties ($67 in favour of the Corporation as at December 31, 2007) and are described further below.

There have been no changes in classification of financial instruments since December 31, 2007.

For cash flow purposes, the Corporation may settle, from time to time, certain short-term investments prior to their original maturity. For this reason, these financial instruments do not meet the criteria of held to maturity and are therefore designated as held for trading. They are recorded at fair value with changes in fair value recorded in interest income.

Collateral Held in Leasing Arrangements

The Corporation holds security deposits with a carrying value of $15, which approximates fair value, as security for certain aircraft leased and sub-leased to third parties. These deposits do not pay interest to the lessee or sub-lessee. Of these deposits, $9 has been assigned as collateral to secure the Corporation's obligations to the lessors of the aircraft, with the remaining cash held by Air Canada being unrestricted during the term of the lease. Any collateral held by the Corporation is returned to the lessee or sub-lessee, as the case may be, at the end of the lease or sub-lease term provided there have been no events of default under the leases or sub-leases.

Summary of Gains (Losses) on Financial Instruments Recorded at Fair Value

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Ineffective portion of fuel hedges	$ (58)	$ (8)	$ 24	$ 8
Fuel derivatives not under hedge accounting	(54)	8	31	12
Cross currency interest rate swaps	19	-	6	-
Other	-	(2)	(1)	6
Gain (loss) on financial instruments recorded at fair value [1]	**$ (93)**	**$ (2)**	**$ 60**	**$ 26**

(1) See Fuel Price Risk for a discussion of losses on fuel derivatives recorded in Other comprehensive income ("OCI").

Risk Management

The Corporation is exposed to the following risks as a result of holding financial instruments: interest rate risk, foreign exchange risk, liquidity risk, market risk, credit risk, and fuel price risk. The following is a description of these risks and how they are managed.

Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Corporation enters into both fixed and floating rate debt and also leases certain assets where the rental amount fluctuates based on changes in short term interest rates. The Corporation manages interest rate risk on a portfolio basis and seeks financing terms in individual arrangements that are most advantageous taking into account all relevant factors, including credit margin, term and basis. The risk management objective is to minimize the potential for changes in interest rates to cause adverse changes in cash flows to the Corporation. The temporary investment portfolio which earns a floating rate of return is an economic hedge for a portion of the floating rate debt.

The ratio of fixed to floating rate debt outstanding is designed to maintain flexibility in the Corporation's capital structure and is based upon a long term objective of 60% fixed and 40% floating. The ratio at September 30, 2008 is 56% fixed and 44% floating, including the effects of interest rate swap positions. The cross-currency interest rate swap positions were terminated October 1, 2008 with a fair value of $4 in favour of the Corporation. The adjusted ratio at October 1, 2008 is 61% fixed and 39% floating.

The following are the current derivatives employed in interest rate risk management activities and the adjustments recorded during the first nine months of 2008:

- As at September 30, 2008, the Corporation had entered into three cross-currency interest rate swap agreements with terms of March 2019, May 2019, and June 2019 respectively, relating to Boeing 777 financing with an aggregate notional value of $300 (US$283). These swaps convert US denominated debt principal and interest payments into Canadian denominated debt at a foreign exchange rate of par (US$1/CAD$1) and convert from a fixed rate of 5.208% to a floating rate. The fair value of these contracts as at September 30, 2008 was $5 in favour of Air Canada. These derivative instruments have not been designated as hedges for accounting purposes and are fair valued on a quarterly basis. During the three months ended September 30, 2008, a gain of $19 was recorded in Gain (loss) on financial instruments recorded at fair value related to these derivatives ($6 gain for the nine months ended September 30, 2008). As noted above, these swaps were terminated on October 1, 2008 with a fair value of $4 in favour of the Corporation.

- As at September 30, 2008, the Corporation had entered into two interest rate swap agreements with terms of July 2022 and January 2024 relating to two B767 aircraft financing agreements with an aggregate notional value of $103 (US$97). These swaps convert the lease payments on the two aircraft leases from fixed to floating rates. The fair value of these contracts as at September 30, 2008 was $9 in favour of the Corporation. These derivative instruments have not been designated as hedges for accounting purposes and are fair valued on a quarterly basis. During the three months ended September 30, 2008, a gain of $1 was recorded in Gain (loss) on financial instruments recorded at fair value related to these derivatives ($2 gain for the nine months ended September 30, 2008) ($3 gain for the three months ended September 30, 2007 and $1 loss for the nine months ended September 30, 2007).

- During the first quarter of 2008, the Corporation's one remaining Embraer 190 aircraft interest rate swap contract matured, with a fair value of $2 in favour of the counterparty. No gain or loss was recorded during the period.

Foreign Exchange Risk

Foreign exchange risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The majority of the Corporation's outstanding debt is denominated in US dollars. The US dollar debt acts as an economic hedge against the related aircraft, which is routinely purchased and sold by Air Canada in US dollars. The Corporation is also exposed to foreign exchange risk on foreign currency denominated trade receivables and foreign currency denominated net cash flows. The Corporation's risk management objective is to reduce cash flow risk related to foreign denominated cash flows.

The following are the current derivatives employed in foreign exchange risk management activities and the adjustments recorded during the first nine months of 2008:

- As at September 30, 2008, the Corporation had entered into foreign currency forward contracts and option agreements converting US dollars and Euros into Canadian dollars on $1,482 (US$1,398) and $4 (EUR 3) which mature in 2008, 2009, and 2010. The fair value of these foreign currency contracts as at September 30, 2008 was $56 in favour of the Corporation (December 31, 2007 - $124 in favour of third parties on $2,132 (US $2,158) and $26 (EUR 18) which mature in 2008 and 2009). These derivative instruments have not been designated as hedges for accounting purposes and are fair valued on a quarterly basis. During the three months ended September 30, 2008, a gain of $70 was recorded in Foreign exchange gain (loss) related to these derivatives (a gain of $153 for the nine months ended September 30, 2008) (a loss of $117 for the three months ended September 30, 2007 and a loss of $212 for the nine months ended September 30, 2007).

- The cross-currency swap as described above under interest rate risk management acts as an economic hedge of the foreign exchange risk on the financing related to two Boeing 777 aircraft with a principal amount of $300 (US$283) as at September 30, 2008.

- The Corporation had also entered into currency swap agreements for 11 CRJ aircraft. These agreements matured in January 2008 with a nominal fair value. No gain or loss was recorded during the period.

Liquidity risk

Liquidity risk is the risk that the Corporation will encounter difficulty in meeting obligations associated with its financial liabilities. The long-term debt issued by the Corporation generally has fixed principal and interest repayment requirements over the term of the instrument.

The Corporation monitors and manages liquidity risk by preparing rolling cash flow forecasts, monitoring the condition and value of assets available to be used as security in financing arrangements, and maintaining flexibility in financing arrangements. Refer to Section 6.3 of Management's Discussion and Analysis of Results for the third quarter of 2008 for a further discussion on liquidity.

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: foreign exchange risk; interest rate risk; and other price risk, which includes commodity price risk. Refer to the Asset-Backed Commercial Paper section below for information regarding these instruments held by the Corporation and the associated market risks.

The Corporation is exposed to market risks through the derivative instruments entered into. The Corporation uses derivative instruments only for risk management purposes and not for generating trading profit. As such, any change in cash flows associated with derivative instruments due to their exposure to market risks is designed to be offset by changes in cash flows related to the risk being hedged.

Sensitivity Analysis

The following table is a sensitivity analysis for each type of market risk relevant to the significant financial instruments recorded by the Corporation. The sensitivity analysis is based on a reasonably possible movement within the forecast period, being one year. These assumptions may not be representative of actual movements in these risks and should not be relied upon.

	Interest rate risk[1]	Foreign exchange rate risk [2]		Other price risk [3]		Other price risk [3]	
	Income	Income		Income	OCI, net	Income	OCI, net
	1% change	5% increase	5% decrease	10% decrease		10% increase	
Cash and cash equivalents	$ 4	$ -	$ -	$ -	$ -	$ -	$ -
Short-term investments	$ 6	$ -	$ -	$ -	$ -	$ -	$ -
Aircraft related deposits	$ -	$ (9)	$ 9	$ -	$ -	$ -	$ -
Long-term debt and capital leases	$ 15	$ 216	$ (216)	$ -	$ -	$ -	$ -
Foreign exchange derivatives	$ -	$ (76)	$ 64	$ -	$ -	$ -	$ -
Fuel derivatives	$ -	$ -	$ -	$ (67)	$ (26)	$ 64	$ 28

(1) Changes in interest rates will impact income favourably or unfavourably by approximately the same amount, based on current price levels and assumptions.

(2) Increase (decrease) in foreign exchange relates to a strengthening (weakening) of the Canadian dollar.

(3) Other price risk relates to the Corporation's fuel derivatives. The sensitivity analysis is based upon a 10% decrease or increase in the price of the underlying commodity. It also assumes that hedge accounting is 100% effective for the period and that changes in the fair value for derivatives that mature within one year are recorded in income whereas derivatives maturing beyond one year are recorded in OCI.

<u>Credit Risk</u>

In order to manage its exposure to credit risk, the Corporation reviews counterparty credit ratings on a regular basis. During the third quarter of 2008 a counterparty defaulted under a number of derivative agreements with the Corporation. As a result, the Corporation recorded a loss of $6 and $2 related to these foreign exchange and fuel derivatives, respectively. The loss is recorded in Non-operating income (expense).

<u>Fuel Price Risk</u>

In order to manage its exposure to jet fuel prices and to help mitigate volatility in operating cash flows, the Corporation enters into derivative contracts with financial intermediaries. 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 long 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.

Fuel derivatives include both derivatives designated and not designated under fuel hedge accounting. The current portion of the derivative asset of $12 is included in Fuel derivatives, the current liability of $30 is included in Accounts payable and accrued liabilities and the long term asset of the derivative of $2 is included in Deposits and other assets on the Consolidated statement of financial position.

The following information summarizes the financial statement impact of derivatives designated under fuel hedge accounting:

- The fair value of outstanding fuel derivatives under hedge accounting at September 30, 2008 was $6 in favour of the counterparties.

- The change in fair value of fuel derivatives under hedge accounting during the third quarter of 2008 was $(386) ($97 for the nine months ended September 30, 2008):

    - The unrealized effective change in the fair value of derivatives recorded in OCI during the third quarter of 2008 was a loss of $280 (gain of $67 for the nine months ended September 30, 2008). The realized effective change in the fair value of derivatives recorded in OCI during the third quarter of 2008 was a loss of $48 (gain of $6 for the nine months ended September 30, 2008). OCI amounts for the three and nine months ended September 30, 2008 of $(244) and $29, respectively, are presented net of tax expense on Air Canada's Consolidated Statement of Comprehensive Income.

    - The ineffective change in the fair value of derivatives recorded in non-operating income (expense) for the third quarter of 2008 was a loss of $58 (gain of $24 for the nine months ended September 30, 2008). The ineffective portion is calculated as the difference between the change in intrinsic value and change in fair market value of the derivatives as well as the difference between the Air Canada proxy derivative value and the counterparty derivative value. The loss in non-operating income (expense) is due to the decrease in fair market value of the derivatives being larger than the decrease in intrinsic value.

- During the third quarter of 2008, fuel derivative contracts matured with fair values in favour of the Corporation for $74.

- During the third quarter of 2008, the benefit to fuel expense was $64 ($190 for the nine months ended September 30, 2008). This benefit was recognized through the removal of the amount from AOCI, which is reported as a reclassification of net realized gains of $44 net of tax for the three months ended September 30, 2008 ($129 net of tax for the nine months ended September 30, 2008).

- During the third quarter of 2008, the net impact to AOCI was a decrease of $392 before tax of $104 ($117 before tax of $17 for the nine months ended September 30, 2008). As at September 30, 2008, the balance in AOCI was $(44). The estimated net amount of existing gains and losses reported in AOCI that is expected to be reclassified to net income (loss) during the following 12 months is $18 before tax.

The following information summarizes the financial statement impact of derivatives not designated under fuel hedge accounting, but held as economic hedges:

- During the third quarter of 2008, fuel derivative contracts matured in favour of the Corporation for $2 ($21 in favour of the Corporation for the nine months ended September 30, 2008).

- The fair value of outstanding fuel derivatives not under hedge accounting at September 30, 2008 was $10 in favour of the counterparties.

- The change in fair value of the derivative contracts for the period was a loss of $54 (gain of $31 for the nine months ended September 30, 2008) and was recorded in non-operating income (expense).

Asset-Backed Commercial Paper ("ABCP")

The Corporation has $37 ($29 net of a fair value adjustment) in non-bank sponsored ABCP which has been recorded in Deposits and other assets. The carrying value as at September 30, 2008 is based on a number of assumptions as to the fair value of the investments including factors such as estimated cash flow scenarios and risk adjusted discount rates. The assumptions used in estimating the fair value of the investments are subject to change, which may result in further adjustments to non-operating results in the future. No adjustments to the carrying value were recorded during the first nine months of 2008.

Maturity Analysis

The following is a maturity analysis, based on contractual undiscounted cash flows, for selected financial liabilities. The analysis includes both the principal and interest component of the payment obligations on long-term debt and is based on interest rates and the applicable foreign exchange rate effective as at September 30, 2008.

	Remainder of 2008	2009	2010	2011	2012	Thereafter	Total
Long-term debt obligations	$ 84	$ 310	$ 288	$ 294	$ 298	$ 2,091	$ 3,365
Debt consolidated under AcG-15	76	107	156	349	93	192	973
Capital lease obligations	93	167	163	157	200	625	1,405
	$ 253	**$ 584**	**$ 607**	**$ 800**	**$ 591**	**$ 2,908**	**$ 5,743**

Maturities also include Accounts payable and accrued liabilities of $1,364 which are expected to be settled within one year.

6. SEGMENT INFORMATION

Effective May 24, 2007, as described in Note 1, Air Canada has one reportable segment. Prior to the deconsolidation of Jazz, Air Canada had two business segments; Air Canada Services and Jazz. A reconciliation of the total amounts reported by each business segment and geographic region to the applicable amounts in the consolidated statements is as follows:

	Nine Months Ended September 30				
	2008				2007*
	Air Canada	Air Canada Segment	Jazz	Elimination	Consolidated Total
Operating revenues					
Passenger revenue	$ 7,531	$ 7,133	$ -	$ -	$ 7,133
Cargo revenue	402	408	-	-	408
Other revenue	651	542	3	-	545
External revenue	8,584	8,083	3	-	8,086
Inter-segment revenue	-	50	610	(660)	-
Total revenues	**8,584**	**8,133**	**613**	**(660)**	**8,086**
Operating expenses					
Wages, salaries and benefits	1,433	1,452	139	-	1,591
Aircraft fuel	2,627	1,937	125	(124)	1,938
Aircraft rent	199	220	57	(16)	261
Airport and navigation fees	771	784	80	(81)	783
Aircraft maintenance	502	584	50	(8)	626
Communications and information technology	214	208	2	-	210
Food, beverages and supplies	244	246	6	-	252
Depreciation and amortization	520	408	9	-	417
Commissions	154	164	-	-	164
Capacity purchase with Jazz	711	696	-	(386)	310
Other	1,102	1,073	83	(45)	1,111
Total operating expenses	**8,477**	**7,772**	**551**	**(660)**	**7,663**
Operating income before under noted item	**107**	**361**	**62**	**-**	**423**
Provision for cargo investigation	(125)	**-**	**-**	**-**	**-**
Operating income (loss)	**(18)**	**361**	**62**	**-**	**423**
Interest income	46	70	2	-	72
Interest expense	(231)	(259)	(3)	-	(262)
Interest capitalized	31	88	-	-	88
Gain (loss) on capital assets	(29)	19	-	-	19
Gain (loss) on financial instruments recorded at fair value	60	26	-	-	26
Other non-operating income (expense)	(3)	(14)	1	-	(13)
Non-controlling interest	(8)	(6)	-	(62)	(68)
Foreign exchange gain (loss)	(128)	297	-	-	297
Provision for income taxes	(18)	(188)	-	-	(188)
Segment income (loss)	**$ (298)**	**$ 394**	**$ 62**	**$ (62)**	**$ 394**

** Up until May 24, 2007, the results of Jazz are consolidated within Air Canada (Note 1).*

Included within Depreciation and amortization is depreciation of property and equipment for the three months ended September 30, 2008 of $163 (2007 - $132), $483 for the nine months ended September 30, 2008 (2007 - $385). For the nine months ended September 30, 2007, this was broken down as $376 Air Canada and $9 Jazz.

Geographic Information

Passenger revenues	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Canada	$ 1,150	$ 1,139	$ 3,148	$ 2,998
US Transborder	467	470	1,455	1,428
Atlantic	631	597	1,489	1,432
Pacific	328	310	775	758
Other	190	144	664	517
	$ 2,766	**$ 2,660**	**$ 7,531**	**$ 7,133**

Cargo revenues	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Canada	$ 27	$ 28	$ 77	$ 80
US Transborder	5	6	14	19
Atlantic	49	51	167	158
Pacific	46	38	110	122
Other	12	9	34	29
	$ 139	**$ 132**	**$ 402**	**$ 408**

Passenger and cargo revenues are based on the actual flown revenue for flights with an origin and destination in a specific country or region. Atlantic refers to flights that cross the Atlantic Ocean with origins and destinations principally in Europe. Pacific refers to flights that cross the Pacific Ocean with origins and destinations principally in Asia. Other passenger and cargo revenues refer to flights with origins and destinations principally in South America, South Pacific, and the Caribbean. Other operating revenues are principally derived from customers located in Canada. Passenger revenues includes revenues from Aeroplan related to Aeroplan rewards net of purchase of Aeroplan miles of $73 for the three months ended September 30, 2008 ($143 for the nine months ended September 30, 2008) and $61 for the three months ended September 30, 2007 ($123 for the nine months ended September 30, 2007).

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7. RELATED PARTY TRANSACTIONS

At September 30, 2008, ACE has a 75% ownership interest in Air Canada. Air Canada has various related party transactions with ACE and Aveos Fleet Performance Inc. (formerly called ACTS Aero Technical Support & Services Inc.) ("Aveos"). Aveos conducts the business previously operated by ACTS LP ("ACTS") prior to the sale of ACTS announced by ACE and completed on October 16, 2007. Refer to Note 20 of the 2007 annual consolidated financial statements of the Corporation for additional information on Aveos.

During the third quarter of 2008, ACTS LP settled certain contracts with Air Canada for $8, in relation to the monetization. These contracts were accounted for as equity transactions, resulting in an increase to Contributed surplus of $8.

Trade balances between the related parties have trade terms which generally require payment 30 days after receipt of invoice.

The related party balances resulting from the application of the related party agreements were as follows:

	September 30 2008	December 31 2007
Accounts receivable		
ACE	$ 9	$ 9
Aveos	88	75
	$ 97	**$ 84**
Prepaid Maintenance		
Aveos	$ 7	$ 24
	$ 7	**$ 24**
Accounts payable and accrued liabilities		
Aveos	$ 45	$ 88
	$ 45	**$ 88**

Revenues and expenses with related parties are summarized as follows:

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	**2007**	**2008**	**2007**
Revenues				
Property rental revenues from ACE and Aveos	$ 4	$ 10	$ 22	$ 31
Revenues from information technology services to Aveos	4	4	11	11
Revenues from corporate services and other to ACE and Aveos	3	6	22	16
Cargo revenues from Aveos	-	-	-	1
	$ 11	**$ 20**	**$ 55**	**$ 59**
Expenses				
Maintenance expense for services from Aveos	$ 93	$ 130	$ 368	$ 505
Recovery of wages, salary and benefit expense for employees assigned to ACE and Aveos	(64)	(80)	(219)	(276)
	$ 29	**$ 50**	**$ 149**	**$ 229**

Refer to Note 12 – Subsequent Events for information regarding a new agreement with Aveos.

8. COMMITMENTS

The table below provides Air Canada's current contractual obligations as at September 30, 2008 related to operating lease obligations and committed capital expenditures.

	Remainder of 2008	2009	2010	2011	2012	Thereafter	Total
Operating lease commitments	$ 78	$ 317	$ 307	$ 240	$ 221	$ 774	$ 1,937
Committed capital expenditures	51	149	86	87	471	3,897	4,741
	$ 129	**$ 466**	**$ 393**	**$ 327**	**$ 692**	**$ 4,671**	**$ 6,678**

Boeing 777

The Corporation expects that the delivery of two Boeing 777 aircraft originally scheduled for delivery during the third quarter of 2008 will be delayed to 2009 by Boeing. Air Canada's capital expenditure projections have been amended to reflect this expected delay.

Boeing 787

Boeing has notified Air Canada that its first Boeing 787 aircraft originally scheduled for delivery in February 2010 is scheduled for delivery in January 2012, with additional deliveries, originally scheduled for completion between 2010 and 2014, being delayed by approximately two to two and a half years. Air Canada's capital expenditure projections, including the predelivery payments, have been amended to reflect this delay.

9. CONTINGENCIES

Investigations by Competition Authorities Relating to Cargo

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, a number of whom, including the Corporation, have received a statement of objections from the European Commission that sets out the European Commission's preliminary assessment in relation to such matter. Air Canada has provided its reply to the statement of objections. Competition authorities have sought or requested information from the Corporation as part of their investigations. The Corporation is cooperating with these investigations, which are likely to lead to proceedings against the Corporation and a number of airlines and other cargo operators in certain jurisdictions. 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.

During the first quarter of 2008, the Corporation recorded a provision of $125 as a preliminary estimate. This estimate is based upon the current status of the investigations and proceedings and the Corporation's assessment as to the potential outcome for certain of them. This provision does not address the proceedings in all jurisdictions, but only where there is sufficient information to do so. Management has determined it is not possible at this time to predict with any degree of certainty the outcome of all proceedings. Additional material provisions may be required.

10. CAPITAL DISCLOSURES

The Corporation views capital as the sum of long-term debt, non-controlling interest, capitalized operating leases and shareholders' equity. The Corporation currently has predelivery financing arranged, which is related to future deliveries, and, as the aircraft have not yet been delivered, this debt is excluded from the capital base. The Company includes capitalized operating leases, which is a measure commonly used in the industry ascribing a value to obligations under operating leases. The value is based on annualized aircraft rent expense multiplied by 7.5, which is a factor commonly used in the airline industry. The measure used may not necessarily reflect the fair value or net present value related to the future minimum lease payments as the measure is not based on the remaining contractual payments and the factor may not recognize discount rates implicit in the actual leases or current rates for similar obligations with similar terms and risks. This definition of capital is used by management and may not be comparable to measures presented by other public companies.

The Corporation also monitors its ratio of adjusted net debt to net debt plus shareholders' equity. Adjusted net debt is calculated as the sum of long-term debt, non-controlling interest and capitalized operating leases less cash, cash equivalents and short-term investments.

The Corporation's main objectives when managing capital are:

- to structure repayment obligations in line with the expected life of the Corporation's principal revenue generating assets;
- to ensure the Corporation has access to capital to fund the Corporation's fleet renewal and refurbishment program and to ensure adequate cash levels to withstand deteriorating economic conditions that may arise;
- to maintain an appropriate balance between debt supplied capital versus investor supplied capital as measured by the adjusted net debt to net debt plus equity ratio; and
- to maintain the Corporation's credit ratings to facilitate access to capital markets at competitive interest rates.

In order to maintain or adjust the capital structure, the Corporation may adjust the type of capital utilized, including purchase versus lease decisions, defer or cancel aircraft expenditures by not exercising available options or selling current aircraft options, and issuing debt or equity securities, all subject to market conditions and the terms of the underlying third party agreements.

The total capital as at September 30, 2008 and December 31, 2007 is calculated as follows:

	September 30 2008	December 31 2007
Long-term debt and capital lease obligations	$ 3,962	$ 4,006
Current portion of long-term debt and capital lease obligations	408	413
	4,370	4,419
Non-controlling interest	192	184
Capitalized operating leases	1,958	2,115
Less predelivery financing included in long-term debt	(140)	(521)
Adjusted debt and non-controlling interest	6,380	6,197
Shareholders' equity	2,049	2,443
Total Capital	**$ 8,429**	**$ 8,640**
Adjusted debt and non-controlling interest	**$ 6,380**	**$ 6,197**
Less cash, cash equivalents and short-term investments	(1,114)	(1,239)
Adjusted net debt and non-controlling interest	**$ 5,266**	**$ 4,958**
Adjusted net debt to adjusted net debt plus shareholders' equity ratio	**72.0%**	**67.0%**

The deterioration from December 31, 2007 in the ratio is attributable mainly to the decrease in shareholders' equity recorded during the nine months ended September 30, 2008.

11. JAZZ CAPACITY PURCHASE AGREEMENT

Air Canada and Jazz are parties to the Jazz CPA pursuant to which Air Canada purchases substantially all of Jazz's fleet capacity based on predetermined rates, in addition to reimbursing Jazz, without mark-up, for certain pass-through costs as defined in the Jazz CPA which include fuel, airport and user fees and other. The fees include both a variable component that is dependent on Jazz aircraft utilization and a fixed component and are recorded in the applicable category within the operating expenses in the results of Air Canada. Refer to Note 19 – Related Party Transactions in the 2007 annual consolidated financial statements of the Corporation for further details regarding the Jazz CPA. Up until May 24, 2007, the results of Jazz are consolidated within Air Canada (Note 1).

The following table outlines CPA and pass-through costs for the period:

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	**2007**	**2008**	**2007**
Expenses from CPA with Jazz	$ 243	$ 234	$ 711	$ 696
Pass through fuel expense from Jazz	131	84	339	236
Pass through airport expense from Jazz	53	54	153	153
Pass through other expense from Jazz	4	5	25	25
	$ 431	**$ 377**	**$ 1,228**	**$ 1,110**

12. SUBSEQUENT EVENTS

New Financing Arrangement

On October 28, 2008, the Corporation arranged for and received financing amounting to $92 (US$75). This financing has a term to December 15, 2009 and is repayable prior to then provided the Corporation has received certain additional alternate financing. The financing bears interest at one month LIBOR plus 5.98% (currently 9.10%) and is secured by a security interest and a movable hypothec in the principal amount of $200. The financing can be repaid at any time prior to maturity, in whole or in part, without penalty.

Agreement with Aveos on Revised Payment Terms

Air Canada and Aveos entered into an agreement dated October 28, 2008 pursuant to which Air Canada has agreed to temporarily extend payment terms to Aveos under certain related party agreements. In exchange for the extended payment terms, certain letters of credit related to the Pension and Benefits Agreement, as described in Note 20 of the 2007 annual consolidated financial statements of the Corporation, were canceled. The cancellation of the letters of credit will provide cash to Air Canada of approximately $40 and is offset by the impact of extended payment terms to Aveos of $22, for a net cash flow benefit of $18 to the Corporation.

The extended payment terms to Aveos are reduced over the course of one year, with the first reduction starting approximately six months from the date of the agreement, and with a corresponding return of the letters of credit to Aveos, such that by October 2009 the letters of credit would be re-instated to the levels then required under the Pension and Benefits Agreement between the two parties.