AIR CANADA

Consolidated Financial Statements and Notes
2008

February 13, 2009

PRICEWATERHOUSECOOPERS

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February 12, 2009

Independent Auditors' Report

To the Shareholders of
Air Canada

We have audited the consolidated statements of financial position of **Air Canada** as at December 31, 2008 and December 31, 2007 and the consolidated statements of operations, changes in shareholders' equity, comprehensive income (loss) and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Corporation as at December 31, 2008 and December 31, 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

Consolidated Statement of Operations

For the year ended December 31 (Canadian dollars in millions except per share figures)		2008	2007*
Operating revenues			
Passenger		$ 9,713	$ 9,329
Cargo		515	550
Other		854	720
		11,082	10,599
Operating expenses			
Aircraft fuel		3,419	2,553
Wages, salaries and benefits		1,877	2,059
Airport and navigation fees		1,001	1,021
Capacity purchase with Jazz	Note 2d	948	537
Depreciation and amortization	Notes 3, 4, & 13	694	557
Aircraft maintenance		659	799
Food, beverages and supplies		314	319
Communications and information technology		286	277
Aircraft rent		279	323
Commissions		194	201
Other		1,450	1,458
		11,121	10,104
Operating income (loss) before under-noted item		**(39)**	**495**
Provision for cargo investigations	Note 17	(125)	-
Operating income (loss)		**(164)**	**495**
Non-operating income (expense)			
Interest income		57	94
Interest expense		(319)	(351)
Interest capitalized		37	108
Gain (loss) on capital assets	Note 3	(34)	19
Gain on financial instruments recorded at fair value	Note 15	92	26
Other		(3)	(18)
		(170)	(122)
Income (loss) before the following items		**(334)**	**373**
Non-controlling interest		(12)	(71)
Foreign exchange gain (loss)		(655)	317
Provision for income taxes			
Current	Note 7	(1)	(16)
Future	Note 7	(23)	(174)
Income (loss) for the year		**$ (1,025)**	**$ 429**
Income (loss) per share			
Basic	Note 12	$ (10.25)	$ 4.29
Diluted	Note 12	$ (10.25)	$ 4.27

** 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 consolidated financial statements.

Consolidated Statement of Financial Position

As at December 31 (Canadian dollars in millions)		2008	2007
ASSETS			
Current			
Cash and cash equivalents	Note 2o	$ 499	$ 527
Short-term investments	Note 2p	506	712
		1,005	1,239
Restricted cash	Note 2q	45	124
Accounts receivable	Note 18	702	750
Aircraft fuel inventory		97	98
Fuel derivatives	Note 15	-	68
Collateral deposits for fuel derivatives	Note 15	328	-
Prepaid expenses and other current assets	Note 18	226	182
		2,403	2,461
Property and equipment	Note 3	7,469	7,919
Intangible assets	Note 4	997	952
Deposits and other assets	Note 5	495	488
		$ 11,364	**$ 11,820**
LIABILITIES			
Current			
Accounts payable and accrued liabilities	Note 18	$ 1,440	$ 1,226
Fuel derivatives	Note 15	420	-
Advance ticket sales		1,333	1,300
Current portion of long-term debt and capital leases	Note 6	663	413
		3,856	2,939
Long-term debt and capital leases	Note 6	4,691	4,006
Future income taxes	Note 7	88	88
Pension and other benefit liabilities	Note 8	1,407	1,824
Other long-term liabilities	Note 9	370	336
		10,412	9,193
Non-controlling interest		190	184
SHAREHOLDERS' EQUITY			
Share capital	Note 11	274	274
Contributed surplus		1,797	1,791
Retained earnings (deficit)		(703)	322
Accumulated other comprehensive income (loss)	Notes 2l & 11	(606)	56
		762	2,443
		$ 11,364	**$ 11,820**

The accompanying notes are an integral part of the consolidated financial statements.
Commitments (Note 14); Contingencies, Guarantees, and Indemnities (Note 17)

On behalf of the Board of Directors:

(signed) David I. Richardson

David I. Richardson
Chairman

(signed) Robert G. Long

Robert G. Long
Chair of the Audit, Finance and Risk Committee

Consolidated Statement of Changes in Shareholders' Equity

For the year ended December 31 (Canadian dollars in millions)		2008	2007*
Share capital			
Common shares		$ 274	$ 274
Total share capital		274	274
Contributed surplus			
Balance, beginning of year		1,791	1,693
Fair value of stock options issued to Corporation employees recognized as compensation expense (recovery)	Note 10	(5)	15
Proceeds from intercompany agreements	Note 18	11	15
Purchase of Air Canada Vacations	Note 18	-	(14)
Deconsolidation of Jazz	Note 2d	-	82
Total contributed surplus		1,797	1,791
Retained earnings (deficit)			
Balance, beginning of year		322	(107)
Net income (loss) for the year		(1,025)	429
Total retained earnings (deficit)		(703)	322
Accumulated other comprehensive income (loss)			
Balance, beginning of year		56	(26)
Other comprehensive income (loss)		(662)	82
Total accumulated other comprehensive income (loss)		(606)	56
Total retained earnings (deficit) and accumulated other comprehensive income (loss)		(1,309)	378
Total shareholders' equity		**$ 762**	**$ 2,443**

** 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 consolidated financial statements.

Consolidated Statement of Comprehensive Income (Loss)

For the year ended December 31 (Canadian dollars in millions)		2008	2007
Comprehensive income (loss)			
Income (loss) for the year		$ (1,025)	$ 429
Other comprehensive income (loss), net of taxes:			
Net gains (losses) on fuel derivatives under hedge accounting net of taxes of 2008 - nil and 2007 - ($39)	Note 15	(605)	107
Reclassification of net realized gains on fuel derivatives to income net of taxes of 2008 - $22 and 2007 - $11	Note 15	(57)	(25)
		(662)	82
Total comprehensive income (loss)		**$ (1,687)**	**$ 511**

** 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 consolidated financial statements.

Consolidated Statement of Cash Flow

For the year ended December 31 (Canadian dollars in millions)		2008	2007*
Cash flows from (used for)			
Operating			
Income (loss) for the year		$ (1,025)	$ 429
Adjustments to reconcile to net cash from operations			
Depreciation and amortization		694	557
Loss (gain) on disposal of assets		34	(19)
Foreign exchange (gain) loss		822	(387)
Future income taxes		23	174
Excess of employee future benefit funding over expense		(316)	(205)
Provision for cargo investigations	Note 17	125	-
Non-controlling interest		12	71
Fuel and other derivatives	Note 15	(208)	(3)
Fuel hedge collateral deposits, net	Note 15	(322)	-
Changes in non-cash working capital balances		117	(85)
Other		(58)	5
		(102)	**537**
Financing			
Borrowings	Note 6	871	1,914
Distributions paid to non-controlling interest		-	(54)
Reduction of long-term debt and capital lease obligations		(992)	(504)
Other	Notes 6 & 18	5	(16)
		(116)	**1,340**
Investing			
Short-term investments		206	86
Additions to capital assets		(883)	(2,714)
Proceeds from sale of assets	Note 3	38	119
Proceeds from sale-leaseback transactions	Note 3	708	-
Funding of Aveos letter of credit	Note 5	59	(101)
Deconsolidation of Jazz cash	Note 2d	-	(138)
Other	Note 15	62	(49)
		190	**(2,797)**
Decrease in cash and cash equivalents		**(28)**	**(920)**
Cash and cash equivalents, beginning of year		527	1,447
Cash and cash equivalents, end of year		**$ 499**	**$ 527**

** 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 $506 as at December 31, 2008 (2007 - $712).
The accompanying notes are an integral part of the consolidated financial statements.

1. BASIS OF PRESENTATION, NATURE OF OPERATIONS, AND LIQUIDITY RISK

A) BASIS OF PRESENTATION

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.

These consolidated financial statements are expressed in millions of Canadian dollars and are prepared in accordance with generally accepted accounting principles ("GAAP") in Canada.

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

B) NATURE OF OPERATIONS

The consolidated financial statements of Air Canada include Air Canada's wholly owned subsidiaries of Air Canada Cargo Limited Partnership ("Air Canada Cargo"), ACGHS Limited Partnership ("Air Canada Ground Handling Services" or "ACGHS") and Touram Limited Partnership ("Air Canada Vacations"). These consolidated financial statements also include certain aircraft and engine leasing entities and fuel facility corporations, which are consolidated under Accounting Guideline 15 – Consolidation of Variable Interest Entities (Note 2z).

Jazz Air LP ("Jazz") is consolidated within Air Canada for the period to May 24, 2007 (Note 2d).

Air Canada is Canada's largest domestic and international airline and the largest provider of scheduled passenger services in the Canadian market, the Canada-US transborder market as well as the international markets to and from Canada. Certain of the scheduled passenger services offered on domestic and Canada-US transborder routes are provided by Jazz through the Jazz CPA. Through Air Canada's global route network, virtually every major market throughout the world is served either directly or through the Star Alliance network. In addition, Air Canada provides certain charter services.

Air Canada Cargo offers air cargo services on domestic and US transborder routes using cargo capacity on aircraft operated by Air Canada and Jazz in these markets. Air Canada offers international cargo services on routes between Canada and major markets in Europe, Asia, South America and Australia using cargo capacity on Boeing 777 and other wide body aircraft operated by Air Canada.

Air Canada Ground Handling Services provides passenger handling services to Air Canada, Jazz and other airlines with a primary focus on Canadian stations. Services covered include passenger check-in, gate management, baggage and cargo handling and processing, cabin cleaning, de-icing as well as aircraft ramp services.

Air Canada Vacations is one of Canada's leading tour operators. Based in Montreal and Toronto, it operates its business in the outgoing leisure travel market (Caribbean, Mexico, Europe, South America and USA) through developing, marketing and distributing vacation travel packages and services through a network of independent travel agencies in Canada as well as through the Air Canada Vacations website, aircanadavacations.com.

C) LIQUIDITY RISK

Along with many airline carriers globally, Air Canada faced a number of significant challenges in 2008 as a result of volatile fuel prices and the weakening demand for air travel. With the expectation of a continuing recession in 2009, the industry will continue to face significant challenges throughout 2009, including Air Canada. The recession is expected to put significant pressures on passenger and cargo revenues for many airlines, including Air Canada. At the same time, it is expected that lower fuel prices in 2009 and capacity adjustments made in 2008 as a result of the high fuel prices will provide some relief. Air Canada continues to be significantly leveraged requiring continuing interest payments and debt payments, which are largely denominated in foreign currencies. Further, the funding of employee benefit plans for many companies, including Air Canada, will be impacted during 2009 by the declines in the value of plan assets. In 2009, a number of the Corporation's collective agreements expire and uncertainties exist with respect to the outcome of these negotiations. In addition, the credit markets continued to be constrained throughout the latter part of 2008 raising concerns about available funding for a number of companies, including Air Canada. These factors have had an impact on the liquidity risk of Air Canada during 2008 and are continuing challenges for Air Canada as well as other airline industry companies.

Liquidity risk is the risk that the Corporation will encounter difficulty in meeting obligations associated with its financial liabilities and other contractual obligations. 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, seeking flexibility in financing arrangements, and establishing programs to monitor and maintain compliance with terms of financing agreements. A key component of managing liquidity risk is also ensuring that operating cash flows are optimized. The Corporation's principal objective in managing liquidity risk is to maintain a minimum Cash and cash equivalents and Short-term investments ("unrestricted cash") balance in excess of a target liquidity level of 15% of operating revenues. However, management expects there may be challenges to achieving its target unrestricted cash to operating revenue ratio of 15% in 2009.

During 2008 and continuing in 2009, management undertook various initiatives and developed a plan to manage its operating and liquidity risks taking into account the prevailing economic conditions including:

- Adjusted capacity by reducing the number of flights to various locations as a result of the effects of the high fuel prices. This reduction positioned the Corporation's capacity, in part, to better respond to the effects of the recession. The Corporation continues to monitor the market and its capacity with the objective of matching its capacity to passenger demand.

- Implemented cost containment initiatives including staffing level reductions, a company-wide fuel efficiency program, a supplier concession program and other cost reduction initiatives. Management continues to monitor staffing levels and costs and will make adjustments to reflect the capacity reductions and achieve further efficiencies. During the first quarter of 2009, the Corporation has announced further staff reductions to align its costs with the planned capacity.

- Entered into hedging programs to manage its exposure to jet fuel prices and help mitigate volatility in operating cash flows. With the drop in fuel prices in the latter half of the year, management undertook strategies to alleviate some of the effects of the hedges and related requirements to post collateral deposits as the fair values became unfavourable, including terminating certain hedging positions as disclosed in Note 15. These strategies have reduced some of the liquidity risk related to the derivatives however the Corporation is exposed to higher fuel costs as most of the current hedge positions are at much higher prices than today's WTI levels. Based on current fuel prices as at December 31, 2008, the Corporation has a liability of $420 for hedging losses offset by a deposit of $328. The difference between the amount extended and the fair value of fuel hedging contracts of $420 relates to credit lines extended by certain counterparties as well as foreign exchange contracts in favour of Air Canada.

- Continued its capital expenditure program to acquire more fuel efficient aircraft. The Corporation has also arranged to lease and sublease certain aircraft to third parties to further manage capacity. In response to current economic conditions, management has curtailed its capital expenditures program for 2009. Management continues to consider strategies to monetize its parked aircraft and aircraft leased to others.

- Entered into new financial arrangements which provided aggregate net proceeds of $641 during 2008 and, subject to fulfillment of certain conditions additional available credit of $50, as at December 31, 2008. The following summarizes the principal financing arrangements undertaken:

  - A series of agreements for secured financings with General Electric Capital Corporation ("GECC") and its affiliates providing up to US$195 (approximately $238), of which $99 was received in December and $92 was received in January 2009. This financing bears interest at 6.97% and matures in 2014. The remaining financing agreement with GECC pertains to the sale and leaseback of a Boeing 777 aircraft remains subject to certain conditions and is planned for completion in 2009.

  - A secured revolving credit facility of up to $100 with the Canadian Imperial Bank of Commerce ("CIBC") with draw downs being subject to certain conditions, of which $50 was drawn as at December 31, 2008 for net proceeds of $47. This facility, which has a one year term, contains a financial covenant requiring the Corporation to maintain, as of the last business day of each month, a minimum cash level of $900, which includes the unused and available commitment under the facility and an interest coverage ratio test determined as at the end of each fiscal quarter. As of February 12, 2009, no amounts were drawn under this facility.

- A secured financing transaction with Calyon New York Branch and Norddeutsche Landesbank Girozentrale for a $143 loan, of which $97 was received in December 2008 and the remaining received in January 2009, maturing in December 2013 bearing interest at 5.13%.

- An agreement with Aeroplan Limited Partnership ("Aeroplan") to accelerate payments for purchase of seats for the period from October 2008 to May 2009. Payments by Air Canada to Aeroplan for Miles earned by passengers continue based on the original terms of settlement. Under this arrangement cash flows from operations have been favourably impacted by $63 as at December 31, 2008. This impact will reverse in 2009 upon expiry of this agreement.

- Two secured financings amounting to proceeds of $92 and $99, respectively due in 2009 which bear interest at 6.45%.

- Sale and leaseback arrangements for five Boeing 777 aircraft which generated net proceeds of $144. Future lease payments required under these operating leases are disclosed in Note 14. Management will continue to consider other opportunities to enter into sale and leaseback arrangements to provide funding if and when necessary.

Refer to Note 6 for a description of debt financing arrangements.

At December 31, 2008, Air Canada had Cash and cash equivalents and Short-term investments of $1,005, which represents 9% of 2008 operating revenues. Management continues to closely monitor the cash flows to ensure the Corporation has adequate cash resources to meet its obligations and commitments when they become due.

The Corporation has equity in Boeing 777 aircraft and Embraer aircraft, based upon estimated fair value in excess of loan value, which would be available to support additional financings going forward. Management has developed estimates of the current value of these assets and identified potential opportunities. However, given the current and continuing instability of credit markets and economic conditions, there can be no assurance that the Corporation will be able, if needed, to conclude further transactions, including on acceptable terms or that the Corporation's assets will generate the expected proceeds.

A maturity analysis of the Corporation's financial liabilities, other fixed operating commitments and capital commitments is set out in Notes 15 and 14, respectively.

The Corporation is faced with several risks that may have a material impact on future operating results and liquidity. While management believes it has developed planned courses of action and identified other opportunities to mitigate the operating and liquidity risks, there is no assurance that management will be able to, if needed, achieve any or all of the opportunities it has identified or obtain sufficient liquidity, including, if events or conditions develop that are not consistent with management's expectations and planned courses of actions,

In addition to the risks related to the economic conditions as described above, the following are the key risks that the Corporation is monitoring which may impact operating results and liquidity:

- Market risks
- Pension funding obligations
- Covenants in credit card agreements
- Cargo investigations

Market Risks

Market risk includes the risk that future cash flows will fluctuate because of changes in market prices, including foreign exchange rates, interest rates, and commodity prices. During 2008, the Corporation's operating results and cash flows were significantly affected by historically high and volatile fuel prices during the first half of the year and the weakening of the Canadian dollar during the second half of the year. While management is able to mitigate certain of these risks through certain hedging activities, the volatility of the markets has created challenges to mitigating the full extent of some of these risks. The price of fuel, foreign exchange rates and interest rates are beyond the control of management and it is reasonably possible market volatility will continue in the future which may adversely impact operating results and cash flows. Note 15 discloses sensitivity analysis with respect to our market risks related to financial instruments outstanding as at December 31, 2008.

Pension Funding Obligations

The Corporation maintains several defined benefit pension plans as described in Note 8. The Corporation's pension funding obligations are likely to rise significantly starting in the second half of 2009. Based on preliminary estimates, the solvency deficit as at January 1, 2009 in the registered pension plans, which is used to determine funding requirements, is estimated to be approximately $3,200, a significant increase versus the $1,175 determined as at January 1, 2008. Based on pension funding legislation and regulations as at December 31, 2008, this solvency deficit would be funded over five years causing an approximate $410 increase to cash funding obligations for 2009.

The Government of Canada has proposed certain amendments to the general pension funding requirements for federally registered pension plans to address concerns over the impact of the 2008 decline in value of pension assets. These proposals include increasing the limit for smoothing asset valuation fluctuations over five years and increasing the period for funding a solvency deficiency from five years to ten years, subject to certain conditions. In particular, both members and retirees would need to agree to the extended schedule, or the difference between the 5 and 10 year payment schedules would need to be secured by a letter of credit. One of these two conditions would need to be met by December 31, 2009. If agreement by plan members and retirees or a letter of credit were not secured by the end of 2009, the plan would be required to fund the deficiency over the following 5 years. If these provisions are finalized, and based on the above preliminary estimates, the Corporation estimates funding requirements for 2009 will increase by approximately $150 versus 2008, resulting in estimated aggregate pension funding payments of approximately $605 during 2009. The estimated funding payments of $605 include the estimated impact of funding changes to current service costs as well as other pension arrangements which amount to a reduction of approximately $10. Management is monitoring the government's actions and dialoguing with government officials on this matter. Until the government finalizes this proposal and the funding valuation is completed during the first half of 2009, uncertainty as to the amount and timing of additional pension funding continue to exist. There can be no assurance that the proposed funding relief will be implemented. Any increase in funding obligations for 2009 will be paid in the second half of the year as the funding in the first half of the year is based upon the January 1, 2008 actuarial valuation reports.

Covenants in Credit Card Agreements

The Corporation has various agreements with companies that process customer credit card transactions. Approximately 80% of the Corporation's sales are processed using credit cards, with remaining sales processed through cash based transactions. The Corporation receives payment for a credit card sale generally in advance of when the passenger transportation is provided.

Under the terms of one credit card processing agreement, the credit card processing company may withhold payment of funds to Air Canada upon the occurrence of certain events ("triggering events"), which include Cash, cash equivalents and Short-term investments ("unrestricted cash") being less than $900 as at the end of any month and operating losses in excess of certain amounts. The amount of funds withheld ("the deposit") is based upon a specified percentage of credit card sales processed through the credit card processing company for which transportation has not been provided to the passenger. The specified percentage increases based upon the level of unrestricted cash below $900 or the level of operating losses. If a triggering event occurred, based upon advance sales as at December 31, 2008, the deposit could be from a minimum of $110 up to a maximum of $425.

Under the terms of the credit card processing agreement, beginning at the end of the second quarter of 2009, the triggering events for deposits will change and be based upon a matrix of unrestricted cash and a debt service coverage ratio. The ratio is based upon an EBITDAR (earnings before interest, income taxes, depreciation, amortization, aircraft rentals, certain non operating income (expense) and special items) to fixed charges (principal, interest and aircraft rentals) ratio for the preceding four quarters. Under these triggering events, beginning at the end of the second quarter 2009, the unrestricted cash required in order to avoid a deposit could be as much as $1.3 billion. The basis for calculating the amount of the deposit, if required, remains consistent with the above description.

Cargo Investigations

The Corporation is exposed to potential liabilities related to the cargo matter, as described in Note 17. During 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. Amounts could become payable within the year and may be materially different than management's preliminary estimate.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A) PRINCIPLES OF CONSOLIDATION

These consolidated financial statements include the accounts of all entities controlled by Air Canada, with adjustments for non-controlling interests. The consolidated financial statements of the Corporation include the accounts of variable interest entities for which the Corporation is the primary beneficiary. All inter-company balances and transactions are eliminated.

B) USE OF ESTIMATES

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Significant estimates made in the preparation of the consolidated financial statements include those used in accounting for employee future benefits (Note 8), accounting for income taxes (Note 7), the determination of passenger revenues, the determination of amortization period for long-lived assets, the impairment considerations on long-lived assets and the carrying value of financial instruments recorded at fair value.

C) PASSENGER AND CARGO REVENUES

Airline passenger and cargo advance sales are deferred and included in Current liabilities. Advance sales also include the proceeds from the sale of flight tickets to Aeroplan, a company that provides loyalty program services to Air Canada and purchases seats from Air Canada under the Commercial Participation and Services Agreement ("CPSA") (Note 14). Passenger and cargo revenues are recognized when the transportation is provided, except for revenue on unlimited flight passes which is recognized on a straight-line basis over the period during which the travel pass is valid. The Corporation has formed alliances with other airlines encompassing loyalty program participation, code sharing and coordination of services including reservations, baggage handling and flight schedules. Revenues are allocated based upon formulas specified in the agreements and are recognized as transportation is provided.

The Corporation performs regular evaluations on the deferred revenue liability which may result in adjustments being recognized as revenue. Due to the complex pricing structures; the complex nature of interline and other commercial agreements used throughout the industry; historical experience over a period of many years; and other factors including refunds, exchanges and unused tickets, certain relatively small amounts are recognized as revenue based on estimates. Events and circumstances may result in actual results that are different from estimates; however these differences have historically not been material.

D) CAPACITY PURCHASE AGREEMENTS – JAZZ & TIER III CARRIERS

Air Canada has capacity purchase agreements with Jazz and certain other regional carriers, which are referred to as Tier III carriers, operating aircraft of 18 seats or less. Under these agreements, Air Canada is responsible for the marketing, ticketing and commercial arrangements relating to these flights and records the revenue it earns under Passenger revenue. Operating expenses under capacity purchase agreements include the capacity purchase fees, which include a variable component that is dependent on Jazz aircraft utilization, and pass-through costs, which are non-marked-up costs charged to the Corporation, which include fuel, airport and user fees and other; these expenses are recorded in the applicable category within Operating expenses.

The Corporation does not hold any partnership units of Jazz. Due to 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 the deconsolidation, the Corporation has one reportable segment.

As a result of the deconsolidation of Jazz, the Corporation recorded an adjustment of $82 as a credit to Contributed surplus. This credit consists of the Corporation's initial negative investment in Jazz of $78, which had not previously reversed as none of the income of Jazz is distributed to Air Canada, and a future income tax credit of $4.

The cash flow impact during 2007 of the Corporation's deconsolidation of Jazz of $138 reflects the Jazz cash being removed from the Consolidated Statement of Financial Position of the Corporation and classified as a cash outflow from investing activities.

The following table outlines CPA and pass through costs with Jazz for the year:

	2008		2007	
Expenses from CPA with Jazz	$	948	$	923
Pass through fuel expense from Jazz		427		320
Pass through airport expense from Jazz		201		201
Pass through other expense from Jazz		38		36
	$	**1,614**	**$**	**1,480**

CPA expenses with Jazz total $537 for the year ended December 31, 2007 post-deconsolidation on May 24, 2007.

Notwithstanding that the Corporation is no longer the primary beneficiary of Jazz effective May 24, 2007; Air Canada continues to hold a significant variable interest in Jazz through the contractual arrangements with Jazz as described in Note 14.

E) AEROPLAN LOYALTY PROGRAM

Air Canada is an Aeroplan partner providing certain of Air Canada's customers with Aeroplan Miles, which can be redeemed by customers for air travel or other rewards acquired by Aeroplan.

Under the CPSA between the Corporation and Aeroplan, Aeroplan purchases passenger tickets from Air Canada to meet its obligation for the redemption of Aeroplan Miles for air travel. The proceeds from the sale of passenger tickets to Aeroplan are included in Advance ticket sales. Revenue related to these passenger tickets is recorded in passenger revenues when transportation is provided.

For Aeroplan Miles earned by Air Canada customers, Air Canada purchases Miles from Aeroplan in accordance with the terms of the CPSA. The cost of purchasing Aeroplan Miles from Aeroplan is accounted for as a sales incentive and charged against passenger revenues when the points are issued, which is upon the qualifying air travel being provided to the customer.

In November 2008 the Corporation reached agreement with Aeroplan to have the loyalty management company accelerate payment terms on Air Canada redemption tickets issued through to May 29, 2009, in exchange for future credits to be settled in 2009, resulting in the substantial elimination of the trade receivable from Aeroplan relating to the sale of passenger tickets through to May 2009. As a result of this agreement, cash flows from operations have been favourably impacted by $63 as at December 31, 2008. This impact will reverse in 2009 upon expiry of this agreement.

F) OTHER REVENUES

Other revenue includes revenues from the sale of the ground portion of vacation packages, ground handling services and other airline related services. Vacation package revenue is recognized as services are provided over the period of the vacation. Other airline related service revenues are recognized as the products are sold to passengers or the services are provided.

Other revenue also includes revenue related to the lease or sublease of aircraft to third parties. Lease or sublease revenues are recognized on a straight line basis over the term of the lease or sublease. Rental revenue from operating leases amounted to $113 in 2008 (2007 - $52).

In certain subleases of aircraft to Jazz, the Corporation reports the sublease revenues net against aircraft rent expense as the terms of the sublease match the terms of the Corporation's lease. The Corporation acts as lessee and sublessor in these matters. Refer to Note 14 for the lease commitments under these arrangements.

The Corporation provides certain services to related parties, ACE and Aveos, and former related parties, Aeroplan and Jazz, consisting principally of administrative services in relation to information technology, human resources, finance and accounting, treasury and tax services, corporate real estate, and environmental affairs. Administrative service revenues are recognized as services are provided. Real estate rental revenues are recognized on a straight line basis over the term of the lease.

G) EMPLOYEE FUTURE BENEFITS

The cost of pensions, other post-retirement and post-employment benefits earned by employees is actuarially determined annually as at December 31. This is a change in measurement date of November 30 used in the prior year. The change in date did not have any significant impact on pension and other benefits expense or the net benefit obligations. The cost is determined using the projected benefit method prorated on service, market interest rates, and management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health care costs.

A market-related valuation method is used to value plan assets for the purpose of calculating the expected return on plan assets. Under the selected method, the differences between investment returns during a given year and the expected investment returns are amortized on a straight line basis over 4 years.

Past service costs arising from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment. This period does not exceed the average remaining service period of such employees up to the full eligibility date. The average remaining service life of active employees (or average remaining life expectancy of retired members for a plan with no active members) is between 7 and 16 years for pension plans and between 10 and 11 years for post retirement and post employment benefit plans.

Cumulative unrecognized net actuarial gains and losses in excess of 10% of the greater of the projected benefit obligation or market-related value of plan assets at the beginning of the year are amortized over the remaining service life of active employees.

As described in Note 8, some of the Corporation's employees perform work for ACE, and others are contractually assigned to Aveos Fleet Performance Inc. ("Aveos" and formerly called ACTS Aero Technical Support & Services Inc. ("ACTS Aero")) and Aeroplan. These employees are members of the Corporation's sponsored defined benefit pension plans and also participate in the Corporation's sponsored health, life and disability future benefit plans. These consolidated financial statements include all of the assets and liabilities of all sponsored plans of the Corporation. Pension and other employee benefits expenses are recorded net of costs recovered from these entities pertaining to employees assigned by the Corporation to these entities based on an agreed upon formula. The cost recovery reduces the Corporation's benefit cost.

H) EMPLOYEE PROFIT SHARING PLAN

The Corporation has an employee profit sharing plan. Expenses are calculated annually on full calendar year results and recorded throughout the year as a charge to salary and wage expense based on the estimated annual payment under the plan.

I) STOCK-BASED COMPENSATION PLANS

Certain employees of the Corporation, for the relevant periods, participate in ACE and Air Canada stock based compensation plans, as described in Note 10.

The fair value of stock options granted to Corporation employees is recognized as compensation expense and a credit to Contributed surplus on a straight line basis over the applicable vesting period. For a stock option award attributable to an employee who is eligible to retire at the grant date, the fair value of the stock option award is expensed on the grant date. For a stock option award attributable to an employee who will become eligible to retire during the vesting period, the fair value of the stock option award is recognized over the period from the grant date to the date the employee becomes eligible to retire. The amount of compensation cost recognized at any date at least equals the value of the vested portion of the options at that date. Refer to Note 10 for a discussion of the accelerated vesting of ACE options in 2007.

Air Canada also maintains an employee share purchase plan. Under this plan, contributions by the Corporation's employees are matched to a specific percentage by the Corporation. Employees must remain with the Corporation until March 31 of the subsequent year for vesting of the Company's contributions. These contributions are included in Wages, salaries, and benefits expense as earned.

J) MAINTENANCE AND REPAIRS

Maintenance and repair costs for both leased and owned aircraft, including line maintenance, component overhaul and repair, and maintenance checks, are charged to Operating expenses as incurred, with the exception of maintenance and repair costs related to return conditions on short-term aircraft leases, which are accrued over the term of the lease. Line maintenance consists of routine daily and weekly scheduled maintenance inspections and checks, overhaul and repair involves the inspection or replacements of major parts, and maintenance checks consist of more complex inspections and servicing of the aircraft.

K) OTHER OPERATING EXPENSES

Included in Other operating expenses are expenses related to building rent and maintenance, terminal handling, professional fees and services, crew meals and hotels, advertising and promotion, insurance costs, credit card fees, ground costs for Air Canada Vacations packages, and other expenses. Expenses are recognized as incurred.

L) FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING

Under the Corporation's risk management policy derivative financial instruments are used only for risk management purposes and not for generating trading profits.

Financial assets and financial liabilities, including derivatives, are 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. 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. For financial instruments classified as other than held-for-trading, transaction costs are added to the initial fair value of the related financial instrument.

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 (expense). 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.

The Corporation enters into interest rate, foreign currency, and fuel derivatives to manage the associated risks. 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 (expense) with the exception of foreign exchange risk management contracts, which are recorded in Foreign exchange gain (loss), and fuel derivatives designated as effective cash flow hedges, as further described below. These contracts are included in the Consolidated Statement of Financial Position at fair value in Prepaid expenses and other current assets, Deposits and other assets, Accounts payable and accrued liabilities, or Other long-term liabilities as appropriate. All cash flows associated with purchasing and selling derivatives are classified as operating cash flows in the Consolidated Statement of Cash Flow.

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 re-measure the fair value of the financial guarantee unless it qualifies as a derivative.

The Corporation has implemented the following classifications:

- Cash and cash equivalents and Short-term investments are classified as held-for-trading and any period change in fair value is recorded through net income.

- Aircraft related and other deposits are classified as held-to-maturity investments and are measured at amortized cost using the effective interest rate method. Interest income is recorded in net income, as applicable.

- Accounts receivable are classified as loans and receivables and are measured at amortized cost using the effective interest rate method. Interest income is recorded in net income, as applicable.

- 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. Interest income is recorded in net income, as applicable.

Fuel Derivatives Under Hedge Accounting

The Corporation has designated certain of 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 (expense). Upon maturity of the fuel derivatives, the effective gains and losses previously recognized in Accumulated OCI ("AOCI") are recorded in fuel expense.

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 amounts previously recognized in AOCI are reclassified to fuel expense during the periods when the derivative matures. Refer to Note 15 for the impact of fuel derivatives during the year.

M) FOREIGN CURRENCY TRANSLATION

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at rates of exchange in effect at the date of the Consolidated Statement of Financial Position. Non-monetary assets and liabilities, revenues and expenses arising from transactions denominated in foreign currencies, are translated at the historical exchange rate or the average exchange rate during the period, as applicable. Adjustments to the Canadian dollar equivalent of foreign denominated monetary assets and liabilities due to the impact of exchange rate changes are recognized in Foreign exchange gain (loss).

N) INCOME TAXES

The Corporation utilizes the asset and liability method of accounting for income taxes under which future income tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amount and the tax basis of assets and liabilities. Future income tax assets and liabilities are measured using substantively enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. Income taxes are recognized in the income statement except to the extent that it relates to items charged or credited to Shareholders' equity, in which case the taxes are netted with such items. The effect on future income tax assets and liabilities of a change in tax rates is recognized in earnings in the period when the change is substantively enacted. Future income tax assets are recognized to the extent that realization is considered more likely than not. The Corporation applied fresh start reporting on September 30, 2004 under which the assets and liabilities of the Corporation were comprehensively revalued, excluding goodwill ("fresh start"). The benefit of future income tax assets that existed at fresh start, and for which a valuation allowance is recorded, will be recognized first to reduce to nil any remaining intangible assets (on a pro-rata basis) that were recorded upon fresh start reporting with any remaining amount as a credit to Shareholders' equity. The benefit of future income tax assets that arise after fresh start will be recognized in the Consolidated Statement of Operations.

O) CASH AND CASH EQUIVALENTS

Cash includes $416 pertaining to investments with original maturities of three months or less at December 31, 2008 (2007 - $411). Investments include bankers' acceptances and bankers discount notes, which may be liquidated promptly and have original maturities of three months or less. The weighted average interest rate on investments as at December 31, 2008 is 2.06% (2007 - 4.68%).

P) SHORT-TERM INVESTMENTS

Short-term investments, comprised of bankers' acceptances and bankers' discount notes, have original maturities over three months, but not more than one year. The weighted average interest rate on Short-term investments as at December 31, 2008 is 2.90% (2007 - 4.61%).

Q) RESTRICTED CASH

The Corporation has recorded $45 (2007 - $124) in Restricted cash, under Current assets, representing funds held in trust by Air Canada Vacations in accordance with regulatory requirements governing advance ticket sales, recorded under Current liabilities, for certain travel related activities.

Restricted cash with maturities greater than one year from the balance sheet date is recorded in Deposits and other assets. This restricted cash relates to funds on deposit with various financial institutions as collateral for letters of credit and other items.

R) AIRCRAFT FUEL INVENTORY

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 and have been adopted by the Corporation as described below. Aircraft fuel inventory as at December 31, 2008 amounts to $97 (2007 - $98).

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. No write downs or reversals were applicable during the periods presented.
- 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.

S) PROPERTY AND EQUIPMENT

Property and equipment is initially recorded at cost. Property under capital leases and the related obligation for future lease payments are initially recorded at an amount equal to the lesser of fair value of the property or equipment and the present value of those lease payments.

Property and equipment are depreciated to estimated residual values based on the straight-line method over their estimated service lives. Property and equipment under capital leases and within variable interest entities are depreciated to estimated residual values over the life of the lease. Aircraft and flight equipment, including spare engines and related parts ("rotables") are depreciated over 20 to 25 years, with 10% to 20% estimated residual values. Aircraft reconfiguration costs are amortized over 3 to 5 years. Betterments to owned aircraft are capitalized and amortized over the remaining service life of the aircraft. Betterments to aircraft on operating leases are amortized over the term of the lease.

Buildings are depreciated over their useful lives not exceeding 40 to 50 years on a straight line basis. An exception to this is where the useful life of the building is greater than the term of the land lease. In these circumstances, the building is depreciated over the life of the lease. Leasehold improvements are amortized over the lesser of the lease term or 5 years. Ground and other equipment is depreciated over 3 to 25 years.

T) INTEREST CAPITALIZED

Interest on funds used to finance the acquisition of new flight equipment and other property and equipment is capitalized for periods preceding the dates that the assets are available for service. Capitalized interest related to the acquisition of new flight equipment and other property and equipment is included in purchase deposits within Property and equipment (Note 3). Capitalized interest also includes financing costs charged by the manufacturer on capital commitments as described in Note 14.

U) INTANGIBLE ASSETS

As a result of the application of fresh start reporting, intangible assets were recorded at their estimated fair values at September 30, 2004. For periods subsequent to September 30, 2004, intangible assets are initially recorded at cost. Indefinite life assets are not amortized while assets with finite lives are amortized on a straight line basis to nil over their estimated useful lives.

	Estimated Useful Life
International route rights and slots	Indefinite
Air Canada trade name	Indefinite
Other marketing based trade names	Indefinite
Star Alliance membership	25 years
Other contract and customer based intangible assets	10 to 15 years
Technology based intangible assets	1 to 5 years

V) IMPAIRMENT OF LONG-LIVED ASSETS

Long-lived assets are tested for impairment whenever circumstances indicate that the carrying value may not be recoverable. When events or circumstances indicate that the carrying amount of long-lived assets, other than indefinite life intangibles, are not recoverable, the long-lived assets are tested for impairment by comparing the estimate of future expected cash flows to the carrying amount of the assets or groups of assets. If the carrying value is not recoverable from future expected cash flows, any loss is measured as the amount by which the asset's carrying value exceeds fair value and recorded in the period. Recoverability is assessed relative to undiscounted cash flows from the direct use and disposition of the asset or group of assets.

Indefinite life intangible assets are subjected to impairment tests on an annual basis or when events or circumstances indicate a potential impairment. If the carrying value of such assets exceeds the fair values, the assets are written down to fair value.

W) AIRCRAFT LEASE PAYMENTS IN EXCESS OF OR LESS THAN RENT EXPENSE

Total aircraft operating lease rentals over the lease term are amortized to operating expense on a straight-line basis. Included in Deposits and other assets and Other long-term liabilities are the differences between the straight line aircraft rent expense and the payments as stipulated under the lease agreement.

X) ASSET RETIREMENT OBLIGATIONS

The Corporation records an asset and related liability for the costs associated with the retirement of long-lived tangible assets when a legal liability to retire such assets exists. The fair value of a liability for an asset retirement obligation is recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and then amortized over its estimated useful life. In subsequent periods, the asset retirement obligation is adjusted for the passage of time through charges to income and any changes in the amount of the underlying cash flows through increases or decreases to the asset retirement obligation and related asset. A gain or loss may be incurred upon settlement of the liability.

Y) RELATED PARTY TRANSACTIONS

Related party transactions not in the normal course of operations are measured at the exchange amount when the change in ownership interest in the item transferred is substantive and the exchange amount is supported by independent evidence; otherwise it is recorded at the carrying amount. Related party transactions in the normal course of operations are measured at the exchange amount.

Z) VARIABLE INTEREST ENTITIES

Aircraft Leasing Transactions

The Corporation has aircraft leasing transactions with a number of special purpose entities that are variable interest entities (a "VIE") under Accounting Guideline 15 of the CICA Handbook, Variable Interest Entities ("AcG-15"). As a result of the Corporation being the primary beneficiary of these VIEs, the Corporation consolidates leasing entities covering 44 aircraft.

Fuel Facilities Arrangements

The Corporation participates in fuel facilities arrangements operated through fuel facility corporations (the "Fuel Facility Corporations"), along with other airlines to contract for fuel services at various major Canadian airports. The Fuel Facility Corporations are organizations incorporated under federal or provincial business corporations acts in order to acquire, finance and lease assets used in connection with the fuelling of aircraft and ground support equipment. The Fuel Facilities Corporations operate on a cost recovery basis.

Under AcG-15, the Corporation is the primary beneficiary of three of the Fuel Facility Corporations in Canada. Five of the Fuel Facility Corporations in which Air Canada participates in Canada that have not been consolidated have assets of approximately $150 and debt of approximately $127, which is the Corporation's maximum exposure to loss without taking into consideration any cost sharing and asset retirement obligations that would occur amongst the other contracting airlines. The Corporation considers this loss potential as remote.

AA) FUTURE ACCOUNTING STANDARD CHANGES

The following is an overview of accounting standard changes that the Corporation will be required to adopt in future years:

Goodwill and Intangible Assets

In February 2008, the Canadian Institute of Charted Accountants ("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.

Business Combinations, Consolidated Financial Statements and Non-controlling Interests

The CICA issued three new accounting standards in January 2009: section 1582, *Business Combinations*, section 1601, *Consolidated Financial Statements*, and section 1602, *Non-controlling interests*. These new standards will be effective for fiscal years beginning on or after January 1, 2011. The Corporation is in the process of evaluating the requirements of the new standards.

Section 1582 replaces section 1581, and establishes standards for the accounting for a business combination. It provides the Canadian equivalent to International Financial Reporting Standard IFRS 3 – *Business Combinations*. The section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011.

Sections 1601 and 1602 together replace 1600 – *Consolidated Financial Statements.* Section 1601, establishes standards for the preparation of consolidated financial statements. Section 1601 applies to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. It is equivalent to the corresponding provisions of International Financial Reporting Standard IAS 27 - *Consolidated and Separate Financial Statements* and applies to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011.

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3. PROPERTY AND EQUIPMENT

	2008		2007	
Cost				
Flight equipment, including spare engines (a)	$	6,235	$	5,433
Assets under capital leases (b)		1,940		1,899
Buildings, including leasehold improvements		643		603
Ground and other equipment		160		136
		8,978		8,071
Accumulated depreciation and amortization				
Flight equipment, including spare engines (a)		1,101		685
Assets under capital leases (b)		562		438
Buildings, including leasehold improvements		148		118
Ground and other equipment		49		35
		1,860		1,276
		7,118		**6,795**
Purchase deposits, including capitalized interest (c)		351		1,124
Property and equipment at net book value (d)	**$**	**7,469**	**$**	**7,919**

(a) Included in flight equipment as at December 31, 2008 are rotable parts, including spare engines with a cost of $798 (2007 - $560) less accumulated depreciation of $279 (2007 - $121) for a net book value of $519 (2007 - $439). Also included in flight equipment are 30 aircraft and 1 engine (2007 – 33 aircraft) which are leased to Jazz (Note 14) and third parties with a cost of $942 (2007 - $753) less accumulated depreciation of $289 (2007 - $152) for a net book value of $653 (2007 - $601).

(b) Included in capital leases as at December 31, 2008 are 41 aircraft (2007 - 39) with a cost of $1,874 (2007 - $1,825) less accumulated depreciation of $554 (2007 - $409) for a net book value of $1,320 (2007 - $1,416), computer equipment with a cost of nil (2007 - $28) less accumulated depreciation of nil (2007 - $23) for a net book value of nil (2007 - $5) and facilities with a cost of $66 (2007 - $46) less accumulated depreciation $8 (2007 - $6) for a net book value of $58 (2007 - $40).

(c) Includes $259 (2007 - $867) for Boeing B777/787 aircraft, nil (2007 - $26) for Empresa Brasileira de Aeronautica S.A. ("Embraer") aircraft, $58 (2007 - $205) for the aircraft interior refurbishment program and $34 (2007 - $26) for equipment purchases and internal projects. Refer to Note 6(l) relating to the financing of Boeing pre-delivery payments.

(d) Net book value of Property and equipment includes $836 (2007 - $973) consolidated for aircraft leasing entities and $150 (2007 - $123) consolidated for fuel facility corporations; both of which are consolidated under AcG-15.

As at December 31, 2008, flight equipment included 21 aircraft (2007 - 12), that are retired from active service with a net carrying value of $33 (2007 - $5).

Interest and fees capitalized during 2008 amounted to $37 (2007 - $108) with $10 at an interest rate of 1 month US LIBOR plus 1.14%, $6 at an interest rate of 3 month US LIBOR plus 3.00%, $17 at an interest rate of 7.72%, and $4 of fees.

During 2008:

- The Corporation received delivery of eight Boeing 777 aircraft. Three aircraft were financed with guarantee support from the Export-Import Bank of the United States ("EXIM") (Note 6). Five of the aircraft were financed under sale and leaseback transactions with proceeds of $708. The resulting gain on sale of $81 was deferred and is being 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.

- 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 six Dash-8 aircraft for proceeds of $10 with a book value of $8, resulting in a gain on sale of $2.

- 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 2007:

- The Corporation sold an in-service aircraft for proceeds of $23 with a book value of $21, resulting in a gain on sale of $2 (loss of $2 net of tax).

- The Corporation sold a building to Aveos for proceeds of $28 which was equal to the carrying value of the asset (Note 18).

- 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).

- The Corporation sold one of its commercial real estate properties for net proceeds of $42 with a carrying value of $37, resulting in a gain on sale of $5 ($4 net of tax).

- The Corporation sold 18 parked aircraft for proceeds of $2 with a nil book value, resulting in a gain on sale of $2 ($1 net of tax).

4. INTANGIBLE ASSETS

	2008	2007
Indefinite life assets		
International route rights and slots	$ 327	$ 327
Air Canada trade name	298	298
Other marketing based trade names	31	31
	656	**656**
Finite life assets		
Star Alliance membership	131	131
Other contract and customer based	144	144
Technology based	279	186
	554	461
Accumulated depreciation and amortization		
Star Alliance membership	(32)	(27)
Other contract and customer based	(99)	(81)
Technology based	(82)	(57)
	(213)	(165)
Finite life assets, net	**341**	**296**
	$ 997	**$ 952**

The amortization of intangible assets in 2008 amounted to $48 (2007 - $41).

In 2007, as a result of recognizing the benefit of future income tax assets that existed at fresh start, and for which a valuation allowance was recorded, intangible assets were reduced on a pro-rata basis by $252.

5. DEPOSITS AND OTHER ASSETS

		2008	2007
Aircraft related deposits (a)		$ 203	$ 150
Restricted cash		65	84
Deposit related to the Pension and Benefits Agreement	Note 18	42	101
Asset backed commercial paper (b)		29	29
Aircraft lease payments in excess of rent expense	Note 2w	49	51
Other deposits		78	56
Other		29	17
		$ 495	**$ 488**

(a) Represents the amount of deposits with lessors for the lease of aircraft and flight simulators.

(b) The Corporation has $37 ($29 net of a fair value adjustment) in non-bank sponsored ABCP. The carrying value as at December 31, 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 2008.

6. LONG-TERM DEBT AND CAPITAL LEASES

	Base Currency	Final Maturity	Stated Interest Rate (%)	2008	2007
Embraer aircraft financing (a)	USD	2017 - 2021	3.37-8.49	$ 1,425	$ 1,138
Boeing aircraft financing (b)	USD	2019 - 2020	1.50-5.69	871	647
Boeing aircraft financing (c)	JPY	2020	1.04-1.20	270	-
Conditional sales agreements (d)	USD	2019	4.37-6.44	175	149
Spare engine financing (e)	USD	2013	5.13	95	-
Spare parts financing (f)	USD	2014	6.97	97	-
Lufthansa cooperation agreement (g)	USD	2009	6.50	16	25
GE loan (h)	USD	2015	4.60	24	38
Revolving credit facility (i)	CDN			50	-
Canadian Regional Jet (j)	CDN	2012	4.38	25	33
Short-term loan due 2009 (k)	USD	2009	6.45	190	-
Direct Corporation debt				**3,238**	**2,030**
Boeing pre-delivery payments (l)	USD	2009 - 2013	1.61	81	521
Aircraft and engine leasing entities - debt (m)				828	771
Fuel facility corporations - debt (n)				125	125
Debt consolidated under AcG-15				**1,034**	**1,417**
Capital lease obligations (o)				1,082	972
Total debt and capital leases				**5,354**	**4,419**
Current portion				(663)	(413)
Long-term debt and capital leases				**$ 4,691**	**$ 4,006**

The Stated Interest Rate in the table above is the rate as of December 31, 2008

(a) Embraer aircraft financing amounts to US$1,163 as at December 31, 2008 (2007 - US$1,151). Principal and interest is repaid quarterly until maturity. The loan is secured by the 60 delivered Embraer aircraft, with a carrying value of $1,665.

(b) Boeing aircraft financing amounts to US$711 as at December 31, 2008 (2007 - US$655), which is financed under loan guarantee support provided by EXIM. Principal and interest is repaid quarterly until maturity. The loan is secured by the 8 delivered aircraft with a carrying value of $1,103.

(c) Boeing aircraft financing amounts to JPY19,995 as at December 31, 2008, which is financed under loan guarantee support provided by the EXIM. Principal and interest is repaid quarterly until maturity. The loan is secured by the 2 delivered aircraft with a carrying value of $244.

(d) US$142 principal outstanding on acquisitions of two A340-500 aircraft financed through conditional sales agreements. Principal and interest is paid quarterly until maturity in 2019. The purchase price installments bear interest at a three month LIBOR rate plus 2.9% (4.37% - 6.44% as at December 31, 2008 and 7.74% - 7.97% as at December 31, 2007). The carrying value of the two A340-500 aircraft provided as security under the conditional sales agreements is $238 as at December 31, 2008.

(e) US$78 principal outstanding to mature in 2013, with quarterly repayments and a final payment at maturity of 50% of the original principal, at a floating interest rate equal to the three month LIBOR rate plus 3.40%. The loan is secured by 10 spare engines with a carrying value of $121.

The loan agreement contains a current market value test, beginning on the first anniversary of the facility, and annually thereafter until expiry. This test relates to 10 engines and under the test, the Corporation may be required to provide additional collateral or prepay certain facility amounts, based on engine current market values, as of the date of the test. Any amounts prepaid would be recorded as a reduction of the loan. The maximum amount payable on the first anniversary, assuming the engines are worth nil and no additional collateral has been provided, is $86 (US$71). This amount declines over time to fifty percent of the original principal upon the loan expiry. In January 2009 an additional $46 (US$37) principal and 22 engines were added under the original agreement with the same terms as described above.

(f) US$80 principal outstanding to mature in 2014, with quarterly repayments, at a floating interest rate equal to the three month LIBOR rate plus the lenders incremental cost of funds rate and a margin of 3.00%. The loan is secured by spare parts and other assets with a carrying value of $295. The loan agreement contains a collateral value test, performed on a monthly basis. This test relates to all inventory collateral and the Corporation may be required to provide additional inventory collateral, cash collateral, letters of credit, prepay some of the loan or any combination of the above based on appraised values, as of the date of the test. Any amounts prepaid would be recorded as a reduction of the loan. This amount declines over time to nil upon the loan expiry. In January 2009 an additional $92 (US$75) principal was added under the original agreement with the same terms as described above.

(g) US$13 principal outstanding to mature in 2009, with semi-annual repayments, at a fixed interest rate of 4.50% plus an annual 2.0% guarantee fee.

(h) US$20 principal outstanding to mature in 2015, with quarterly repayments, at a floating interest rate equal to the six month LIBOR rate plus 2.75% pre-payable on any interest payment date after December 23, 2007. The next interest payment date is March 20, 2009. The debt is secured by certain flight training equipment with a current carrying value of $39.

(i) The revolving credit facility is a $100 senior secured revolving credit facility (the "Credit Facility"). The Credit Facility has a one year term that can be extended at Air Canada's request for additional one-year periods on each anniversary of the closing, subject to prior approval of the lenders. The Credit Facility replaces Air Canada's previous secured syndicated three year revolving credit facility, which was a $400 facility as of December 31, 2007. The total amount available for borrowing under the Credit Facility is subject to a borrowing base restriction based on certain percentages of the values of eligible accounts receivable and eligible real property. As at December 31, 2008, the funds available under the Credit Facility were $50. The Credit Facility is secured by a first priority security interest and hypothec over the present and after-acquired personal property of Air Canada, subject to certain exclusions and permitted liens, and by a first priority charge and hypothec over certain owned and leased real property of Air Canada. Air Canada's obligations are guaranteed by 1209265 Alberta Ltd., a subsidiary of Air Canada, which provides a first priority security interest over its present and after-acquired personal property, subject to certain exclusions and permitted liens, as security for its guarantee obligations. The Credit Facility contains customary representations and warranties and is subject to customary terms and conditions (including negative covenants, financial covenants and events of default). Financial covenants require the Corporation to maintain, as of the last business day of each month, a minimum liquidity level of $900, which includes the unused and available commitment under the facility, and an interest coverage ratio test determined as at the end of each fiscal quarter. The interest rate margin for drawn amounts is, at the option of Air Canada, prime plus 13.00% or bankers' acceptances plus 14.00%.

(j) As at December 31, 2008, the principal outstanding is $25 on four CRJ aircraft (2007 - $33). Principal and interest are paid quarterly to maturity in 2012. The financing bears interest at a floating rate of the 3 month Canadian bankers' acceptance rate plus 1.7%. The loan is secured by the aircraft with a carrying value of $26.

(k) During 2008, the Corporation arranged for and received financing amounting to $190 (US$155). The first payment of US$80 matured and was repaid in January 2009. The remainder of the 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 6.45%) and is secured by a security interest and a movable hypothec in the principal amount of $400. The financing can be repaid at any time prior to maturity, in whole or in part, without penalty.

(l) On October 30, 2007, the Corporation entered into an agreement with a syndicate of banks for the financing of pre-delivery payments ("PDP") for 10 of the 16 Boeing B777 aircraft contemplated in the Boeing Purchase Agreement. The PDP financing is a series of loans that are aircraft specific with a maximum aggregate commitment of up to $568 (US$575). The PDP loans have a term of five years, but may be prepaid upon the delivery of the aircraft without penalty. During 2008, the Corporation drew $39 (US$39) (2007 - $585 (US$592)). The Corporation prepaid $516 ($US501) towards 8 aircraft during 2008 (2007 - $64 (US$65) toward one aircraft). In addition, the Corporation has served notice to the PDP syndicate that it will be repaying the final PDP loan on delivery of the tenth aircraft expected to be delivered in February 2009. At year-end 2008, the balance outstanding on the PDP loans was $81 (US$66) (2007 - $521 (US$528)). The year to date capitalized interest relating to this financing is $10 (2007 - $5) at an interest rate of 30 day LIBOR plus 1.14% (1.61% as at December 31, 2008).

(m) The Corporation has entered into aircraft and engine lease transactions with several special purpose entities that qualify as VIEs. The debt has a weighted average effective interest rate of approximately 8% (2007 - 8%). These aircraft have a carrying value of $836 and are charged as collateral against the debt by the owners thereof. The creditors under these leasing arrangements have recourse to the Corporation, as lessee, in the event of default or early termination of the lease. Aircraft related debt amounting to US$676 ($828) (2007 - US$780 ($771)) is summarized as follows:

	Final Maturity	2008	2007
Canadian Regional Jet	2010-2011	$ 257	$ 218
Boeing 767-300	2011-2016	185	163
Engines	2008	-	54
Airbus 319	2011-2014	242	215
Airbus 321	2017	144	121
Total		**$ 828**	**$ 771**

(n) Under AcG-15, the Corporation is the primary beneficiary of certain Fuel Facility Corporations in Canada. The debt is comprised of bankers' acceptances with bankers' acceptance plus 2%, bank loans at prime plus 0.25%, and bonds payable with an interest rate of 5.09%. $107 of debt matures in 2032 with equal semi-annual payments of principal and interest. The remaining debt has varying maturities. The debt is secured by a general security agreement covering all assets of the Fuel Facility Corporations. The carrying value of the assets of the fuel facilities is $150 as at December 31, 2008.

(o) Capital leases, related to computer equipment, facilities and 41 aircraft, total $1,082 ($84 and US$815) [2007 - total $972 ($71 and US$912)]. The debt has a weighted average effective interest rate of approximately 8% and final maturities range from 2009 to 2027. During 2008, the Corporation recorded interest expense on capital lease obligations of $78 (2007 - $96).

Certain aircraft lease agreements contain a fair value test, beginning on July 1, 2009, and annually thereafter until lease expiry. This test relates to 26 aircraft under lease of which 23 are accounted for as capital leases. Under the test, the Corporation may be required to prepay certain lease amounts, based on aircraft fair values, as of the date of the test. Any amounts prepaid would be recorded as a reduction of the lease obligation. The Corporation contracts with certain third parties to provide residual value support for certain aircraft. If the Corporation is required under the loan to value test to prepay lease obligations, these amounts are recoverable from the third party residual value support provider upon lease expiry to the extent that the adjusted obligation taking into account prepayments is less than the residual value support. The maximum amount payable on July 1, 2009, assuming the related aircraft are worth nil, is $896 (US$731). The maximum payable amount declines over time to nil upon lease expiry. As the Corporation does not expect to have to prepay any significant amounts based upon expectations of aircraft fair values into the future, the amortized cost of these capital lease obligations reflects the scheduled payments over the term to final maturity.

Interest paid on Long-term debt and capital leases in 2008 by the Corporation was $293 (2007 - $263).

Refer to Note 14 for the Corporation's 5 year principal and interest repayment requirements as at December 31, 2008.

7. FUTURE INCOME TAXES

The following income tax related amounts appear in the Corporation's Consolidated Statement of Financial Position:

	2008		2007	
Liability				
Long-term tax payable (a)	$	(10)	$	(10)
Future income tax liability (c)		(88)		(88)
	$	**(98)**	**$**	**(98)**

a) Taxes Payable

During 2007, Air Canada recorded a current income tax expense of $10 resulting from the Federal and Ontario harmonization of corporate taxes. Air Canada will have a cash tax payable of $10 that will be payable over a five year period beginning in 2010. This amount is included in Other long-term liabilities.

b) Valuation Allowance

The Corporation has determined that it is more likely than not that future income tax assets of $1,157 are not recoverable and have been offset by a valuation allowance. However, the future tax deductions underlying the future tax assets remain available for use in the future to reduce taxable income. The benefit of future income tax assets that existed at fresh start, and for which a valuation allowance is recorded, is recognized first to reduce to nil any remaining intangible assets (on a pro-rata basis) that were recorded upon fresh start reporting with any remaining amount as a credit to Shareholders' equity. The benefit of future income tax assets that arise after fresh start are recognized in the Consolidated Statement of Operations.

c) Future Income Tax Liability

It has been assumed that certain intangibles and other assets with nominal tax cost and a carrying value of approximately $656, have indefinite lives and accordingly, the associated future income tax liability is not expected to reverse until the assets are disposed of or become amortizable, resulting in the reporting of a future income tax liability of $88

The future income tax assets and liabilities are as follows:

	2008		2007	
Future tax assets				
Loss carry forwards	$	588	$	52
Post-employment obligations		466		556
Accounting provisions not currently deductible for tax		261		129
Tax basis of capital over book basis		-		187
Deferred gains		40		8
Other		95		67
Total future tax assets		1,450		999
Future tax liabilities				
Book basis of capital over tax basis		217		-
Intangible assets		126		135
Other		38		109
Total future tax liabilities		381		244
Net future tax assets		1,069		755
Less valuation allowance (b)		1,157		843
Net recorded future income tax liability	**$**	**(88)**	**$**	**(88)**

The reconciliation of income tax attributable to continuing operations, computed at the statutory tax rates, to income tax expense is as follows:

	2008		2007	
Provision (recovery) based on combined federal and provincial rates	$	(319)	$	206
Non-taxable portion of capital (gains) losses		68		(32)
Non-deductible expenses		53		17
Effect of tax rate changes on future income taxes		51		64
Other		23		11
		(124)		266
Valuation Allowance (refer to (b) above)		148		(76)
Provision for income taxes	**$**	**24**	**$**	**190**

Significant components of the Provision for income taxes attributable to continuing operations are as follows:

	2008		2007	
Current tax expense	$	1	$	16
Future income tax expense (recovery) relating to temporary differences		(176)		186
Future income tax expense from tax rate changes		51		64
Valuation allowance		148		(76)
Provision for income taxes	**$**	**24**	**$**	**190**

In addition to the above items impacting the Provision for income taxes, during 2007, a future income tax expense of $5 was recorded in Contributed surplus related to the proceeds from repair schemes and non-compete agreement with ACTS (Note 18). Refer to Note 15 for future income taxes recorded in other comprehensive income related to fuel derivatives designated under fuel hedge accounting.

Income taxes paid in 2008 by the Corporation were less than $1 (2007 - $6).

The balances of tax attributes as at December 31, 2008, namely the balances of non-capital loss carry forwards, vary amongst different taxing jurisdictions. The following are the Federal tax loss expiry dates:

	Tax Losses	
2014	$	18
2026		3
2027		1,380
2028		956
	$	**2,357**

There are no net capital losses (2007 - $61).

8. PENSION AND OTHER BENEFIT LIABILITIES

The Corporation maintains several defined benefit and defined contribution plans providing pension, other post-retirement and post-employment benefits to its employees, including those employees of the Corporation who are contractually assigned to Aveos and Aeroplan.

The Corporation is the administrator and sponsoring employer of ten Domestic Registered Plans ("Domestic Registered Plans") under the Pension Benefits Standard Act, 1985 (Canada). The US plan, UK plan and Japan plan are international plans covering employees in those countries. In addition, the Corporation maintains a number of supplementary pension plans, which are not registered. The defined benefit pension plans provide benefits upon retirement, termination or death based on the member's years of service and final average earnings for a specified period.

The other employee benefits consist of health, life and disability. These benefits consist of both post-employment and post-retirement benefits. The post-employment benefits relate to disability benefits available to eligible active employees, while the post-retirement benefits are comprised of health care and life insurance benefits available to eligible retired employees.

Certain Corporation employees perform work for ACE and others are contractually assigned to Aveos or Aeroplan. These employees are members of Corporation-sponsored defined benefit pension plans and also participate in Corporation-sponsored health, life and disability future benefit plans. These consolidated financial statements include all of the assets and liabilities of all Corporation-sponsored plans. The employee benefit expense in these consolidated financial statements includes the expenses for all employees participating in the plans less a cost recovery which is charged to ACE, Aveos, and Aeroplan for those employees assigned. The cost recovery includes current service costs for pensions along with their portion of post-employment and post-retirement benefits, based on the actuarial calculation for their specific employee group. This cost recovery amounted to $40 for the year ended December 31, 2008 (2007 - $40).

As described in Note 18, Air Canada and Aveos are parties to a Pension and Benefits Agreement covering the future transfer of certain pension and benefit assets and obligations to Aveos.

As described in Note 2, the accounting for pensions requires management to make significant estimates including estimates as to the discount rate applicable to the benefit obligation and the expected rate of return on plan assets.

Discount Rate

The discount rate used to determine the pension obligation was determined by reference to market interest rates on corporate bonds rated "AA" or better with cash flows that approximately match the timing and amount of expected benefit payments. An increase of 0.25% results in a decrease of $305 to the pension obligation and $10 to the pension expense. A decrease of 0.25% results in an increase of $313 to the pension obligation and $9 to the pension expense.

Expected Return on Assets Assumption

The expected long-term rate of return on assets assumption is selected based on the facts and circumstances that exist as of the measurement date and the specific portfolio mix of plan assets. Air Canada's management, in conjunction with its actuaries, reviews anticipated future long-term performance of individual asset categories and considers the asset allocation strategy adopted by Air Canada, including the longer duration in its bond portfolio in comparison to other pension plans. These factors are used to determine the average rate of expected return on the funds invested to provide for the pension plan benefits. The determination of the long term rate considers recent fund performance, including the significant drop in the value of plan assets during 2008, and historical returns, to the extent that the past is indicative of the expected long-term, prospective rate. There can be no assurance that the plan will earn the assumed rate of return.

Benefit Obligation and Plan Assets

The following table presents financial information related to the changes in the pension and other post-employment benefits plans:

	Pension Benefits		Other Employee Future Benefits	
	2008	2007	2008	2007
Change in benefit obligation				
Benefit obligation at beginning of year	$ 12,150	$ 13,235	$ 899	$ 966
Current service cost	203	254	62	69
Interest cost	706	649	52	49
Employees' contributions	83	88	-	-
Benefits paid	(677)	(648)	(57)	(51)
Plan amendments	2	-	-	-
Other termination benefits	-	2	-	-
Actuarial gain	(1,738)	(1,278)	(189)	(119)
Deconsolidation of Jazz	-	(100)	-	-
Foreign exchange gain (loss)	-	(52)	23	(15)
	10,729	12,150	790	899
Change in plan assets				
Fair value of plan assets at beginning of year	11,747	11,858	-	8
Actual return (loss) on plan assets	(1,879)	197	-	-
Employer contributions	456	382	57	43
Employees' contributions	83	88	-	-
Benefits paid	(677)	(648)	(57)	(51)
Deconsolidation of Jazz	-	(81)	-	-
Foreign exchange gain (loss)	(13)	(49)	-	-
	9,717	11,747	-	-
Deficit at end of year	**1,012**	**403**	**790**	**899**
Employer contributions after measurement date	-	(7)	-	(5)
Unrecognized past service costs	(2)	-	-	-
Unrecognized net actuarial gain (loss)	(479)	497	321	149
Valuation allowance against accrued benefit	9	1	-	-
Net benefit obligation	**$ 540**	**$ 894**	**$ 1,111**	**$ 1,043**
Weighted average assumptions used to determine the accrued benefit liability				
Discount rate	7.35%	5.75%	6.25 - 7.35%	5.75 - 6.00%
Rate of compensation increase (a)	2.50%	2.50%		

(a) As a result of pay awards, a rate of compensation increase of 1.75% was used for years 2007 and 2008 in determining the net benefit obligation for the pension plan and 2.50% for the remaining years.

Under the terms of the domestic registered and supplementary plans, there is no indexation provided after January 1, 2007.

The pension benefit deficit of only those plans that are not fully funded at the end of the year is as follows:

	2008	2007
Domestic registered plans	$ 383	$ 35
US, UK, and Japan	83	17
Supplementary plans	606	665
	$ **1,072**	$ **717**

The net deficit, on an accounting basis, at December 31, 2008 for pension benefits was $1,012 (2007 - $403). The increase in the accounting deficit is mainly the result of the significant losses on the market value of plan assets offset by the gains resulting from the increase in the discount rate used to value pension obligations along with the funding of past service employer contributions of $189.

The net benefit obligation is recorded in the statement of financial position is as follows:

	2008	2007
Pension benefits	$ 540	$ 894
Other employee future benefits	1,111	1,043
Net benefit obligation	**1,651**	**1,937**
Current portion	(244)	(113)
Pension and other benefit liabilities	**$ 1,407**	**$ 1,824**

The current portion of pension benefits represents past service contributions for the Domestic Registered Plans, scheduled to be paid during 2009 while the current portion of other employee future benefits is an estimate of the claims to be incurred during 2009. The current portion is included in Accounts payable and accrued liabilities.

Total cash payments for 2008, consisting of cash contributed by the Corporation to its defined benefit plans, cash payments to beneficiaries for post-employment and post-retirement plans, and cash contributed to its defined contribution plans were $514 (2007 - $428).

Pension and Other Employee Future Benefit Expense

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

	Pension Benefits		Other Employee Future Benefits	
	2008	**2007**	**2008**	**2007**
Components of Net Periodic Pension Cost				
Current service cost	$ 203	$ 254	$ 62	$ 69
Interest cost	706	649	52	49
Actual return on plan assets	1,879	(148)	-	-
Actuarial gain	(1,738)	(1,278)	(189)	(119)
Plan amendments	2	-	-	-
Other benefits	-	2	-	-
Costs arising in the year	**1,052**	**(521)**	**(75)**	**(1)**
Differences between costs arising in the year and costs recognized in the year in respect of:				
Return on plan assets	(2,711)	(622)	-	-
Actuarial loss	1,742	1,285	172	103
Plan amendments	(2)	-	-	-
Increase in valuation allowance provided against accrued benefit asset	8	1	-	-
Net periodic benefit cost of plans	**89**	**143**	**97**	**102**
Amount charged to ACE, Aveos, and Aeroplan	(24)	(23)	(16)	(17)
Net defined benefit pension and other employee benefits expense (1)	**$ 65**	**$ 120**	**$ 81**	**$ 85**
Weighted average assumptions used to determine the accrued benefit cost				
Discount rate	5.75%	5.00%	5.75 - 6.00%	5.00 - 5.50%
Expected long-term rate of return on plan assets	7.15%	7.15%	n/a	n/a
Rate of compensation increase (2)	2.50%	2.50%		

(1) Includes nil of Pension Benefits related to Jazz (2007 - $4), which was consolidated until May 24, 2007 under AcG-15.

(2) A rate of compensation increase of 1.75% in 2007 and in 2008 was used in determining the net benefit pension expense and 2.50% for the remaining years.

Other Benefits — Sensitivity Analysis

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. An 8.25% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2008 (2007 - 9.25%). The rate is assumed to decrease gradually to 5% by 2015. A one percentage point increase in assumed health care trend rates would have increased the service and interest costs by $1 and the obligation by $16. A one percentage point decrease in assumed health care trend rates would have decreased the service and interest costs by $1 and the obligation by $21.

Pension Plan Cash Funding Obligations

Pension plan cash funding paid in 2008 amounted to $456 for domestic registered plans and other pension arrangements. For domestic registered plans, the funding requirements are based on minimum past service contributions disclosed in the annual actuarial valuation plus a projection of the current service contributions. The final funding obligation for 2009 will be determined based on the January 1, 2009 valuation, which will be completed in the first half of 2009.

As at January 1, 2008, the solvency deficit in the registered domestic plans was $1,175. As at January 1, 2009, based on preliminary estimates, the solvency deficit in the registered pension plans is estimated to be approximately $3,200. Based on pension funding legislation and regulations as at December 31, 2008, this preliminary estimate of the solvency deficit would be funded over five years requiring an approximate $410 increase to cash funding obligations for 2009.

The Corporation is actively monitoring and pursuing a number of initiatives, certain of which are beyond the control of the Corporation, which may reduce the cash funding obligations in and after 2009 as described further below. These include:

- Temporary solvency funding relief proposed by the Government of Canada;
- The asset smoothing method, if any, that could be applied to the value of assets; and
- A review of the legislative and regulatory framework of pension plans by the Government of Canada, which is currently underway.

In November 2008, the Government of Canada proposed temporary solvency funding relief for defined benefit pension plans under federal regulation. The proposed funding relief would allow plans to extend their solvency funding payment schedule to 10 years from 5 in respect of solvency deficiencies that emerged in 2008, subject to certain conditions. In particular, both members and retirees would need to agree to the extended schedule, or the difference between the 5- and 10-year payment schedules would need to be secured by a letter of credit. One of these two conditions would need to be met by December 31, 2009. If agreement by plan members and retirees or a letter of credit were not secured by the end of 2009, the plan would be required to fund the deficiency over the following 5 years. This measure, if implemented by the Government of Canada, would reduce 2009 pension funding by $165 versus the preliminary estimate of funding requirements on the January 1, 2009 valuation report, when completed. Funding reductions in subsequent years would be dependent upon satisfying on of the two conditions as noted above. There can be no assurance that the proposed relief will be implemented.

The Pension Benefits Standards Act and Regulations allow the use of an asset smoothing method over five years, limited to 110% of the market value of plan assets, to determine minimum funding requirements on a solvency basis. Any such smoothing method would also have to comply with actuarial practice and be accepted by regulators. In January 2009, the Government of Canada announced that it will work with the body that regulates federally regulated pension plans to consider additional funding flexibility options regarding asset smoothing. The Corporation will monitor these developments to determine the impact, if any, on the Corporation's pension funding obligations. Based on preliminary estimates, if a smoothed asset value limited to 110% of market value were to be used to determine Air Canada's minimum funding requirement, cash funding obligations for year 2009 would be reduced by a further $85.

Given the economic uncertainty and the uncertain outcome of the pension funding regulations, the Corporation's actual funding obligations for 2009 cannot be determined with any reasonable degree of certainty however they will rise significantly over 2008 levels. If the provisions outlined above are finalized, and assuming preliminary estimates, the Corporation estimates funding requirements for 2009 would increase by approximately $150 versus 2008, which would result in estimated aggregate pension funding payments of approximately $605 during 2009. The estimated funding payments of $605 include the estimated impact of funding changes to current service costs as well as other pension arrangements which amount to a reduction of approximately $10. Management is monitoring the government's actions and dialoguing with government officials on this matter. Until the government finalizes this proposal and the funding valuation is completed during the first half of 2009, uncertainty as to the amount and timing of additional pension funding continue to exist. Any increase in funding obligations for 2009 would be paid in the second half of the year as the funding in the first half of the year is based upon the January 1, 2008 actuarial valuation reports.

Air Canada Pension Plan Solvency Deficiency Funding Regulations

On August 9, 2004, the Government of Canada adopted the Air Canada Pension Plan Solvency Deficiency Funding Regulations (the "Pension Regulations"). The Pension Regulations allow Air Canada to fund the solvency deficiencies in its Domestic Registered Plans as of January 1, 2004 over ten years, rather than the five years required under the ordinary rules, and to pay down such deficiencies by way of an agreed schedule of variable annual contributions rather than by way of equal annual contributions as required under the ordinary rules. The Pension Regulations came into force upon Air Canada's emergence from CCAA protection on September 30, 2004, on which date Air Canada issued subordinated secured promissory notes in an aggregate amount of approximately $347 in favour of the pension plan trustee. Such notes reduce as the principal amount of the solvency deficiencies is paid down, and will only be called on the occurrence of certain specified events of default. The amount of secured promissory notes outstanding as at December 31, 2008 is $20 (2007 - $89). The effect of the issuance of the subordinated secured promissory notes is included within the value of the obligation for pension benefits as reflected in the Corporation's Consolidated Statement of Financial Position. The funding of the notes is included in all future expected cash flows required to fund the benefit obligation.

The composition of the Domestic Registered Plan assets and the target allocation consist of the following:

	2008	2007	Target Allocation
Equity securities	52.9%	58.9%	59.0%
Bonds and mortgages	43.5%	36.1%	41.0%
Cash and temporary investments	3.6%	5.0%	0.0%
	100.0%	**100.0%**	**100.0%**

Domestic Registered Plans

For the Domestic Registered Plans, the investments conform to the Statement of Investment Policy and Objectives of the Air Canada Pension Master Trust Fund. The investment return objective of the fund is to achieve a total annualized rate of return that exceeds inflation by at least 3.75% over the long term.

In addition to the broad asset allocation, as summarized in the asset allocation section above, the following policies apply to individual asset classes:

- Equity investments can include convertible securities, and are required to be diversified among industries and economic sectors. Foreign equities can comprise 37% to 43% of the total market value of the trust. Limitations are placed on the overall allocation to any individual security at both cost and market value. Derivatives are permitted to the extent they are not used for speculative purposes or to create leverage.

- Bond and Mortgage investments are oriented toward risk averse, long term, investment grade securities rated "A" or higher. With the exception of Government of Canada securities or a province thereof, in which the plan may invest the entire fixed income allocation, these investments are required to be diversified among individual securities and sectors. The target return is comprised of 40% of the total return of the Scotia Capital Universe Bond Index and 60% of the total return of the Scotia Capital Long Term Bond Index.

Similar investment policies are established for the other pension plans sponsored by the Corporation.

Defined Contribution Plans

The Corporation's management, administrative and certain unionized employees may participate in defined contribution plans. Contributions range from 3% to 6% for those employees in Canada and 3% to 7% for those participants in the United Kingdom. The Corporation contributes an equal amount. The Corporation's expense for defined contribution plans amounted to $1 for the year ended December 31, 2008 (2007 - $4).

9. OTHER LONG-TERM LIABILITIES

		2008		2007	
Aeroplan Miles obligations (a)		$	-	$	29
Unfavourable contract liability on aircraft leases (b)			37		54
Aircraft rent in excess of lease payments	Note 2w		56		54
Long-term employee liabilities (c)			35		47
Workplace safety and insurance board liabilities			37		45
Deferred gains on aircraft sale leasebacks			76		-
Other (d)			129		107
		$	**370**	**$**	**336**

(a) Air Canada has a liability related to Aeroplan Miles which were issued by Air Canada prior to January 1, 2002. As of December 31, 2008 a liability for approximately $35, remains in Air Canada, all of which is included in Advanced ticket sales (2007 - $84).

(b) The unfavourable contract liability on aircraft leases represents the net present value of lease payments in excess of estimated market rents related to lease arrangements that existed on fresh start reporting.

(c) The following table outlines the changes to labour related provisions which are included in long-term employee liabilities:

		2008		2007	
Beginning of year		$	66	$	106
Interest accretion			4		5
Charges recorded in wages, salaries, and benefits			21		14
Amounts disbursed			(37)		(55)
Deconsolidation of Jazz	Note 2d		-		(4)
End of year			54		66
Current portion in Accounts payable and accrued liabilities			(19)		(19)
		$	**35**	**$**	**47**

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

In response to record high fuel prices, on June 17, 2008, Air Canada announced a reduction in capacity which had an impact on fleet and staffing levels effective with the implementation of its fall and winter schedule. During 2008, Air Canada recorded an expense of $8 in Wages, salaries and benefits expense related to the reduction of employees under this plan. These costs will be disbursed within a year.

d) "Other" includes asset retirement obligations of the Corporation. Under the terms of their respective land leases, each Fuel Facility Corporation has an obligation to restore the land to vacant condition at the end of the lease and to rectify any environmental damage for which it is responsible. If it were found that the Fuel Facility Corporations had to contribute to any remediation costs, each contracting airline would share pro rata, based on system usage, in the costs. For all Fuel Facility Corporations in Canada in which the Corporation participates, the Corporation has recorded an obligation of $8 ($50 undiscounted) (2007 - $7 ($44 undiscounted)) representing the present value of the estimated decommissioning and remediation obligations at the end of the lease using an 8% (2007 - 8%) discount rate, with lease term expiry dates ranging from 2032 to 2039. This estimate is based on numerous assumptions including the overall cost of decommissioning and remediation and the selection of alternative decommissioning and remediation approaches.

10. STOCK-BASED COMPENSATION

Air Canada Long-Term Incentive Plan

Certain of the Corporation's employees participate in the Air Canada Long-term Incentive Plan (the "Long-term Incentive Plan") administered by the Board of Directors of Air Canada. The Long-term Incentive Plan provides for the grant of options and performance share units to senior management and officers of Air Canada.

The options to purchase shares granted under the Long-term Incentive Plan have a maximum term of 10 years and an exercise price based on the fair market value of the shares at the time of the grant of the options. Fifty percent of all options vest over four years. The remaining options will vest based upon performance conditions. The performance vesting conditions are based on operating margin (operating income over operating revenues) and net income targets established by the Air Canada Board over the same time period. The terms of the Long-term Incentive Plan specify that upon the retirement of the employee, options granted may be exercised as the rights to exercise accrue within three years from the retirement date.

The number of Air Canada stock options granted to employees, the related compensation expense recorded and the assumptions used to determine stock-based compensation expense, using the Black-Scholes option valuation model were as follows:

	2008	2007
Compensation expense (recovery) ($ millions)	$ (3)	$ 4
Number of stock options granted to Air Canada employees	11,000	482,870
Weighted average fair value per option granted ($)	$ 1.99	$ 4.32
Aggregated fair value of options granted ($ millions)	$ -	$ 2
Weighted average assumptions:		
Risk-free interest rate	3.29%	3.94% - 4.43%
Expected volatility	34%	34% - 35%
Dividend yield	0%	0%
Expected option life (years)	4.50	4.50

During 2008, previously recorded stock-based compensation expense, related to stock options, of $3 was reversed as management had determined that the performance vesting criteria will not be met.

A summary of the activity related to Corporation employees participating in the Air Canada Long-term Incentive Plan is as follows:

	2008		2007	
	Options	Weighted Average Exercise Price/Share	Options	Weighted Average Exercise Price/Share
Beginning of year	1,720,092	$ 19.24	1,699,678	$ 21.00
Granted	11,000	8.51	482,870	14.74
Forfeited	(29,645)	21.00	(462,456)	21.00
Outstanding options, end of year	1,701,447	$ 19.14	1,720,092	$ 19.24
Options exercisable end of year	362,253	$ 19.96	154,653	$ 21.00

		2008 Outstanding Options			2008 Exercisable Options	
Range of Exercise Prices	Expiry Dates	Number of Options Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price/Share	Number of Exercisable Options	Weighted Average Exercise Price/Share
$21.00	2013	1,207,577	5	$ 21.00	301,894	$ 21.00
$11.08 - $18.60	2014	482,870	6	14.74	60,359	14.74
$8.51	2015	11,000	7	8.51	-	-
		1,701,447		$ 19.14	362,253	$ 19.96

		2007 Outstanding Options			2007 Exercisable Options	
Range of Exercise Prices	Expiry Dates	Number of Options Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price/Share	Number of Exercisable Options	Weighted Average Exercise Price/Share
$21.00	2013	1,237,222	6	$ 21.00	154,653	$ 21.00
$11.08 - $18.60	2014	482,870	7	14.74	-	-
		1,720,092		**$ 19.24**	**154,653**	**$ 21.00**

Performance Share Units

The Long-term Incentive Plan also includes Performance Share Units ("PSUs"). The value of the PSUs is based on the fair market value of the shares at the time of the grant and is accounted for as an equity settled instrument. The vesting term of PSUs is three years, generally commencing on January 1 of the year following granting, and incorporate performance vesting features based upon achieving the average Earnings Per Share target established over the vesting period. Subject to vesting and other conditions, each PSU shall entitle the employee to receive a payment in the form of one common share, cash in the amount equal to market value of one common share, or a combination thereof, at the discretion of the Board of Directors. The terms of the plan specify that upon the retirement of an employee, the number of PSUs that vest are prorated based on the total number of completed months of active service during the PSU vesting term.

The number of PSUs granted to employees and the related compensation expense were as follows:

	2008	2007
Compensation expense (recovery) ($ millions)	$ (2)	$ 2
Number of PSUs granted	1,125,092	232,760
Weighted average fair value per PSU granted ($)	$ 5.22	$ 16.46
Aggregate fair value of PSUs granted ($ millions)	$ 6	$ 4

During the year 5,275 PSUs were forfeited (2007 – 27,314).

During 2008, previously recorded stock based compensation expense, related to PSUs, of $2 was reversed as management has determined that the performance vesting criteria will not be met.

Employee Share Purchase Plans

Employee share purchase plans have been established for shares of Air Canada under which eligible employees are allowed to invest up to 6% of their base salary for the purchase of shares on the secondary market. Air Canada will match 33.3% of the investments made by the employee. During 2008, the Corporation recorded compensation expense of $1 (2007 - $1).

ACE Stock Option Plan

Certain of the Corporation's employees participated in the ACE stock option plan.

In compliance with the terms of the ACE stock option plan, in November 2007, the Board of ACE resolved to immediately vest all remaining unvested ACE stock options. This resulted in the immediate expense recognition of $6 for all deferred stock based compensation on outstanding ACE options granted to Air Canada employees. An additional $3 in compensation expense was recorded during 2007 for a total compensation expense of $9. As a result of this immediate vesting of all ACE options granted to Air Canada employees, no further stock based compensation expense has been recorded related to the ACE stock option plan during 2008.

The following tables outline the details of the outstanding ACE stock options held by Air Canada employees:

		2008 Outstanding and Exercisable Options			
Range of Exercise Prices	Expiry Dates	Number of Options Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price/Share	
$11.05	2011	38,319	3	$	11.05
$19.23	2013	22,911	5		19.23
		61,230		$	14.11

		2007 Outstanding and Exercisable Options			
Range of Exercise Prices	Expiry Dates	Number of Options Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price/Share	
$11.05	2011	129,077	4	$	11.05
$19.10 - $20.04	2013	194,677	6		19.12
		323,754		$	15.90

11. SHAREHOLDERS' EQUITY

Share capital (net of issue costs) consists of the following:

	2008	2007
Common shares	$ 274	$ 274
	$ 274	**$ 274**

Common Shares

As at December 31, 2008, the common shares issuable by Air Canada consist of an unlimited number of Class A Variable Voting Shares ("Variable Voting Shares") and an unlimited number of Class B Voting Shares ("Voting Shares"). The two classes of common shares have equivalent rights as common shareholders except for voting rights. Holders of Variable Voting Shares are entitled to one vote per share unless (i) the number of Variable Voting Shares outstanding, as a percentage of the total number of voting shares of Air Canada exceeds 25% or (ii) the total number of votes cast by or on behalf of holders of Variable Voting Shares at any meeting exceeds 25% of the total number of votes that may be cast at such meeting. If either of the above noted thresholds would otherwise be surpassed at any time, the vote attached to each Variable Voting Share will decrease proportionately such that (i) the Variable Voting Shares as a class do not carry more than 25% of the aggregate votes attached to all issued and outstanding voting shares of Air Canada and (ii) the total number of votes cast by or on behalf of holders of Variable Voting Shares at any meeting do not exceed 25% of the votes that may be cast at such meeting.

Variable Voting Shares may only be held, beneficially owned or controlled, directly or indirectly, by persons who are not Canadians. An issued and outstanding Variable Voting Share shall be converted into one Voting Share automatically and without any further act of Air Canada or the holder, if such Variable Voting Share becomes held, beneficially owned and controlled, directly or indirectly, otherwise than by way of security only, by a Canadian, as defined in the Canada Transportation Act.

Voting Shares may only be held, beneficially owned and controlled, directly or indirectly, by Canadians. An issued and outstanding Voting Share shall be converted into one Variable Voting Share automatically and without any further act of Air Canada or the holder, if such Voting Share becomes held, beneficially owned or controlled, directly or indirectly, otherwise than by way of security only, by a person who is not a Canadian.

The issued and outstanding common shares of Air Canada, along with the potential common shares, were as follows as at December 31:

Outstanding shares	2008	2007
Issued and outstanding		
Class A variable voting shares	15,475,659	16,654,049
Class B voting shares	84,524,341	83,345,951
Total issued and outstanding	**100,000,000**	**100,000,000**
Potential common shares		
Stock options	1,701,447	1,720,092
Performance share units	1,671,068	551,251
Total potential common shares	**3,372,515**	**2,271,343**

Accumulated Other Comprehensive Income (Loss)

The following table outlines the components of Accumulated other comprehensive income (loss) as at December 31:

	2008	2007
Accumulated other comprehensive income (loss)		
Unrealized change in fair value of derivatives (net of tax of 2008 - $6 and 2007 - $28)	$ (606)	$ 56
Total Accumulated other comprehensive income (loss)	**$ (606)**	**$ 56**

12. EARNINGS PER SHARE

The following table outlines the calculation of basic and diluted earnings per share:

(in millions, except per share amounts)	2008	2007
Numerator:		
Numerator for basic earnings per share:		
Income (loss) for the year	$ (1,025)	$ 429
Adjusted numerator for diluted earnings per share	**$ (1,025)**	**$ 429**
Denominator:		
Denominator for basic earnings per share:		
Weighted-average shares	100	100
Effect of potential dilutive securities:		
Performance share units	-	1
Adjusted denominator for diluted earnings per share	**100**	**101**
Basic earnings (loss) per share	**$ (10.25)**	**$ 4.29**
Diluted earnings (loss) per share	**$ (10.25)**	**$ 4.27**

The calculation of earnings per share is based on whole dollars and not on rounded millions.
As a result, the above amounts may not be recalculated to the per share amount disclosed above.

The dilutive effect of outstanding stock options on earnings per share is based on the application of the treasury stock method. Under this method, the proceeds from the exercise of such securities are assumed to be used to purchase Class B Voting Shares.

Excluded from the 2008 calculation of diluted earnings per share were 1,701,447 (2007 - 1,606,820) outstanding options where the options' exercise prices were greater than the average market price of the common shares for the year. The 1,671,068 performance share units outstanding at December 31, 2008 were also excluded as management determined that the performance vesting criteria will not be met.

13. SEGMENT INFORMATION

Effective May 24, 2007, as described in Note 2d, Air Canada has one reportable segment. Prior to the deconsolidation of Jazz, Air Canada had two business segments; Air Canada Services and Jazz. Segment information has been prepared on a basis consistent with how financial information is produced internally for the purposes of making operating decisions. 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:

	2008	2007*			
	Air Canada	Air Canada Segment	Jazz	Elimination	Consolidated Total
Operating revenues					
Passenger	$ 9,713	$ 9,329	$ -	$ -	$ 9,329
Cargo	515	550	-	-	550
Other	854	717	3	-	720
External revenue	11,082	10,596	3	-	10,599
Inter-segment	-	50	610	(660)	-
Total revenues	**11,082**	**10,646**	**613**	**(660)**	**10,599**
Operating expenses					
Aircraft fuel	3,419	2,552	125	(124)	2,553
Wages, salaries and benefits	1,877	1,920	139	-	2,059
Airport and navigation fees	1,001	1,022	80	(81)	1,021
Capacity purchase with Jazz	948	923	-	(386)	537
Depreciation and amortization	694	548	9	-	557
Aircraft maintenance	659	757	50	(8)	799
Food, beverages and supplies	314	313	6	-	319
Communications and information technology	286	275	2	-	277
Aircraft rent	279	282	57	(16)	323
Commissions	194	201	-	-	201
Other	1,450	1,420	83	(45)	1,458
Total operating expenses	**11,121**	**10,213**	**551**	**(660)**	**10,104**
Operating income (loss) before under noted item	**(39)**	**433**	**62**	**-**	**495**
Provision for cargo investigations	(125)	-	-	-	-
Operating income (loss)	**(164)**	**433**	**62**	**-**	**495**
Interest income	57	92	2	-	94
Interest expense	(319)	(348)	(3)	-	(351)
Interest capitalized	37	108	-	-	108
Gain (loss) on capital assets	(34)	19	-	-	19
Gain on financial instruments recorded at fair value	92	26	-	-	26
Other non-operating income (expense)	(3)	(19)	1	-	(18)
Non-controlling interest	(12)	(9)	-	(62)	(71)
Foreign exchange gain (loss)	(655)	317	-	-	317
Provision for income taxes	(24)	(190)	-	-	(190)
Segment income (loss)	**$ (1,025)**	**$ 429**	**$ 62**	**$ (62)**	**$ 429**

** 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 2008 of $646 (2007 - $514). In 2007, this was broken down by segment as follows: Air Canada $505 and Jazz $9.

Passenger revenues	2008	2007
Canada	$ 4,108	$ 3,970
US Transborder	1,876	1,884
Atlantic	1,883	1,806
Pacific	995	967
Other	851	702
	$ 9,713	**$ 9,329**

Cargo revenues	2008	2007
Canada	$ 97	$ 108
US Transborder	18	25
Atlantic	212	219
Pacific	142	159
Other	46	39
	$ 515	**$ 550**

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.

14. COMMITMENTS

Boeing

As at December 31, 2008, the Corporation has outstanding purchase commitments with The Boeing Company ("Boeing") for the acquisition of one Boeing 777 and 37 Boeing 787 aircraft. The Corporation also has purchase rights for 18 Boeing 777 and purchase options for 23 Boeing 787 aircraft. The remaining Boeing 777 aircraft delivery is expected in the first quarter of 2009 and the Corporation has received notice from Boeing that deliveries of the Boeing 787 aircraft will commence in the second half of 2012.

For the remaining firm aircraft orders, the Corporation has financing commitments from Boeing and the engine manufacturer covering the one remaining Boeing 777 and 21 of the 37 Boeing 787. The financing under the commitment covers up to 90% of the capital expenditure and is based on a floating or fixed rate equivalent with an equivalent rate of 7.94% as at December 31, 2008. The term to maturity is 15 years with principal payments made on a mortgage style basis resulting in equal installment payments of principal and interest over the term to maturity. In addition to this available financing, the one remaining Boeing 777 delivery has commitments for loan guarantee support from EXIM. The loan guarantee, subject to conditions, covers a 12 year loan term for 85 percent of the capital expenditure at an interest rate based on floating rates. It is expected that this loan guarantee support will be used for the final Boeing 777 aircraft. Should the Corporation not utilize the Boeing financing commitments on the remaining 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.

In July 2009, the Corporation expects to take delivery of one Boeing 777-300ER on a 10-year operating lease with International Lease Finance Corporation ("ILFC").

Embraer

As of December 31, 2008, the Corporation had 7 Embraer 190 series exercisable options remaining.

Aircraft Interior Refurbishment Program

In addition to acquiring new aircraft, the Corporation commenced a major refurbishment of the interior of its existing aircraft in April 2006. The Corporation has completed the refurbishment of all its Airbus A319, A320 and A321 aircraft, one Airbus A330 and 27 of its 28 Boeing 767-300 aircraft to date, for a total of 116 aircraft. An additional $30 is expected for 2009 refurbishments at which time the refurbishment program will be completed. The Embraer and Boeing 777 aircraft are being delivered with the new seats and entertainment systems already installed. The capital expenditures associated with this program, which are committed, are amortized over a five-year period.

Capital Commitments

The estimated aggregate cost of the future firm deliveries and other capital purchase commitments as at December 31, 2008 approximates $5,414 (of which $3,518 is subject to committed financing, subject to the fulfillment of certain terms and conditions). US dollar amounts are converted using the December 31, 2008 noon day rate of CDN$1.2246. The estimated aggregate cost of aircraft is based on delivery prices that include estimated escalation and, where applicable, deferred price delivery payment interest calculated based on the 90-day US LIBOR rate at December 31, 2008.

2009	2010	2011	2012	2013	Thereafter	Total
$ 141	$ 79	$ 119	$ 438	$ 1,081	$ 3,556	$ 5,414

Operating Lease Commitments

As at December 31, 2008 the future minimum lease payments under existing operating leases of aircraft and other property amount to $2,652 (2007 - $2,108) using year end exchange rates.

	2009	2010	2011	2012	2013	Thereafter	Total
Aircraft	$ 367	$ 360	$ 318	$ 298	$ 271	$ 740	$ 2,354
Other property	49	38	36	33	22	120	298
Total	$ 416	$ 398	$ 354	$ 331	$ 293	$ 860	$ 2,652

The above minimum lease payments include residual value guarantees, except for those for which the Corporation has obtained residual value support.

The Corporation subleases certain aircraft to Jazz on a flow through basis, which are reported net on the statement of operations. These subleases relate to 33 Bombardier CRJ-200 aircraft and 15 Bombardier CRJ-705 aircraft. The operating lease commitments under these aircraft, which are recovered from Jazz, are not included in the aircraft operating lease commitments table above but are summarized as follows:

2009	2010	2011	2012	2013	Thereafter	Total
$ 89	$ 68	$ 51	$ 51	$ 51	$ 327	$ 637

The subleases with Jazz have the same terms and maturity as the Corporation's corresponding lease commitments to the lessors.

The future minimum non-cancellable commitments for the next 12 months under the capacity purchase agreements with Jazz is approximately $764 (2007 - $650) and with unaffiliated regional carriers is $30 (2007 - $20). As described in Note 2d, the initial term of the Jazz CPA expires December 31, 2015 with two automatic renewal periods of five years each, subject to either party's right not to renew by notice at least one year prior to the expiration of the then applicable term. The rates under the Jazz CPA are subject to change based upon, amongst other things, changes in Jazz's costs and the results of a benchmarking exercise with other regional carriers to be completed in 2010. It is not possible to determine the minimum commitment beyond 2009; however the commitment is not expected to change significantly from the 2009 amount.

Maturity Analysis

Principal and interest repayment requirements as at December 31, 2008 on Long-term debt and capital lease obligations, and aircraft, engine and fuel facility debt consolidated as variable interest entities under AcG-15 are as follows:

Principal	2009	2010	2011	2012	2013	Thereafter	Total
Long-term debt obligations	$ 487	$ 239	$ 257	$ 275	$ 325	$ 1,699	$ 3,282
Debt consolidated under AcG-15	70	136	378	90	37	323	1,034
Capital lease obligations	106	110	113	173	124	456	1,082
	$ 663	**$ 485**	**$ 748**	**$ 538**	**$ 486**	**$ 2,478**	**$ 5,398**

Interest	2009	2010	2011	2012	2013	Thereafter	Total
Long-term debt obligations	$ 168	$ 147	$ 135	$ 120	$ 106	$ 323	$ 999
Debt consolidated under AcG-15	56	47	28	20	16	58	225
Capital lease obligations	88	79	68	59	44	123	461
	$ 312	**$ 273**	**$ 231**	**$ 199**	**$ 166**	**$ 504**	**$ 1,685**

Principal repayments in the table above exclude deferred financing charges of $44 which are offset against Long-term debt and capital leases in the Consolidated Statement of Financial Position.

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 December 31, 2008.

	2009	2010	2011	2012	2013	Thereafter	Total
Long-term debt obligations	$ 655	$ 386	$ 392	$ 395	$ 431	$ 2,022	$ 4,281
Debt consolidated under AcG-15	126	183	406	110	53	381	1,259
Capital lease obligations	194	189	181	232	168	579	1,543
Accounts payable and							-
accrued liabilities	1,440	-	-	-	-	-	1,440
Fuel derivatives	420	-	-	-	-	-	420
	$ 2,835	**$ 758**	**$ 979**	**$ 737**	**$ 652**	**$ 2,982**	**$ 8,943**

Minimum Committed Purchase of Aeroplan Miles

The Commercial Agreement between the Corporation and Aeroplan outlines a requirement for the Corporation to purchase a minimum number of Aeroplan Miles from Aeroplan. The estimated minimum requirement for 2009 is $208. The annual commitment is based on 85% of the average total Miles actually issued in respect of Air Canada flights or Air Canada airline affiliate products and services in the three preceding calendar years. It is not possible to determine the minimum commitment beyond 2009; however the commitment is not expected to change significantly from the 2009 amount. During 2008, the Corporation purchased $248 from Aeroplan.

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Summary of Financial Instruments

	Carrying Amounts					
	December 31, 2008					December 31, 2007
	Financial instruments classification					
	Held for trading	Held to maturity	Loans and receivables	Liabilities at amortized cost	Total	
Financial Assets						
Cash and cash equivalents	$ 499	$ -	$ -	$ -	$ 499	$ 527
Short-term investments	506	-	-	-	506	712
Restricted cash	45	-	-	-	45	124
Accounts receivable	-	-	702	-	702	750
Collateral deposits for fuel derivatives	328	-	-	-	328	-
Deposits and other assets						
Restricted cash	65	-	-	-	65	84
Asset backed commercial paper	29	-	-	-	29	29
Aircraft related and other deposits	-	323	-	-	323	309
Derivative instruments						
Fuel derivatives	-	-	-	-	-	10
Foreign exchange derivatives	64	-	-	-	64	-
Interest rate swaps	21	-	-	-	21	7
	$ 1,557	$ 323	$ 702	$ -	$ 2,582	$ 2,552
Financial Liabilities						
Accounts payable	$ -	$ -	$ -	$ 1,440	$ 1,440	$ 1,102
Current portion of long-term debt and capital leases	-	-	-	663	663	413
Long-term debt and capital leases	-	-	-	4,691	4,691	4,006
Derivative instruments						
Fuel derivatives [1]	15	-	-	-	15	-
Foreign exchange derivatives	-	-	-	-	-	124
Interest rate swaps	-	-	-	-	-	2
	$ 15	$ -	$ -	$ 6,794	$ 6,809	$ 5,647

(1) The fuel derivatives above relate to fuel derivatives not designated under fuel hedge accounting. Fuel derivatives under hedge accounting have a fair value of $405 in favour of the counterparties (2007 - $67 in favour of the Corporation) and are described further below.

There have been no changes in classification of financial instruments since December 31, 2007, other than the designation or de-designation of fuel derivatives.

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 $18 (2007 - $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, $11 (2007 - $4) has been assigned as collateral to secure the Corporation's obligations to the lessors and financiers 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 Gain on Financial Instruments Recorded at Fair Value

	2008		2007	
Ineffective portion of fuel hedges	$	83	$	(12)
Fuel derivatives not under hedge accounting		(9)		26
Cross currency interest rate swaps		4		-
Other		14		12
Gain on financial instruments recorded at fair value [1]	**$**	**92**	**$**	**26**

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

Risk Management

Under its risk management policy, the Corporation manages its interest rate risk, foreign exchange risk, and market risk through the use of various interest rate, foreign exchange, and fuel derivative financial instruments. The Corporation uses derivative financial instruments only for risk management purposes, not for generating trading profit.

As noted below, the Corporation engages in derivative hedging to mitigate various risks. The derivative fair values represent the amount of the consideration that could be exchanged in an arm's length transaction between willing parties who are under no compulsion to act. Fair value of these derivatives is determined using active markets, where available. When no such market is available, valuation techniques are applied such as discounted cash flow analysis. Where practical, the valuation technique incorporates all factors that would be considered in setting a price.

<u>Interest Rate Risk</u>

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 December 31, 2008 is 58% fixed and 42% floating, including the effects of interest rate swap positions.

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

- During 2008, the Corporation entered into and subsequently terminated 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 converted US denominated debt principal and interest payments into Canadian denominated debt at a foreign exchange rate of par (US$1/CAD$1) and converted from a fixed interest rate of 5.208% and 5.640% to a floating interest rate. These derivative instruments were not designated as hedges for accounting purposes and were fair valued on a quarterly basis. During 2008, a gain of $4 was recorded in Gain on financial instruments recorded at fair value related to these derivatives. These swaps were terminated on October 1, 2008 with a fair value of $4 in favour of the Corporation.

- As at December 31, 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 $118 (US$96) (2007 - $103 (US$104)). These swaps convert the lease payments on the two aircraft leases from fixed to floating rates. The fair value of these contracts as at December 31, 2008 was $21 in favour of the Corporation (2007 - $7 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 2008, a gain of $14 was recorded in Gain on financial instruments recorded at fair value related to these derivatives (2007 - $3).

- The Corporation enters into forward interest rate agreements to manage the risks associated with interest rate movement on US dollar and Canadian dollar floating rate debt and investments. During 2006 the Corporation entered into 19 interest rate swaps with a notional value of US$414 to receive floating rates and pay a weighted average fixed rate of 5.81% for the debt to be arranged in relation to the financing of Embraer 190 aircraft between June 2006 and February 2008. The swaps had 15 year terms from the expected delivery date of the aircraft and their maturities ranged from June 2021 to December 2022. The Corporation has settled the interest rate swaps upon delivery of the related aircraft. The Corporation did not apply hedge accounting to these derivative instruments. During 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 (2007 - $2 in favour of the counterparty). No gain or loss was recorded during the period (2007 – net loss of $10 on 11 contracts).

Interest income includes $47 (2007 - $84) related to Cash and cash equivalents, Short-term investments, and Collateral deposits for fuel derivatives, which are classified as held for trading. Interest expense reflected on the Consolidated Statement of Operations relates to financial liabilities recorded at amortized cost.

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 Corporation's risk management objective is to reduce cash flow risk related to foreign denominated cash flows.

The Corporation's cash inflows are primarily in Canadian dollars, while a large portion of its outflows are in US dollars. This unbalanced mix results in a US dollar shortfall from operations annually. In order to mitigate this imbalance, the Corporation has adopted the practice of converting excess revenues from offshore currencies into US dollars. In 2008, this conversion generated coverage of approximately 30% of the imbalance. The remaining 70% was covered through the use of a variety of foreign exchange derivatives, including spot transactions, which had maturity dates corresponding to the forecasted shortfall dates. The level of foreign exchange derivatives expiring at any one point in time is dependent upon a number of factors, which include the amount of foreign revenue conversion available, US dollar net cash flows, as well as the amount attributed to aircraft and debt payments.

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, leased or sub-leased to third parties, 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.

As noted below, given the substantial depreciation of the Canadian dollar during the fourth quarter of 2008, the Corporation chose to terminate certain of its foreign currency contracts in order to realize on the positive mark-to-market cash value of these derivatives. Consistent with the Corporation's risk management objectives, new derivative positions are being entered into at current foreign exchange rates.

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

- As at December 31, 2008, the Corporation had entered into foreign currency forward contracts and option agreements converting US dollars and Euros into Canadian dollars on $632 (US$516) and $5 (EUR 3) which mature in 2009 and 2010 (2007 - $2,132 (US$2,158) and $26 (EUR 18) of future purchases in 2008 and 2009). The fair value of these foreign currency contracts as at December 31, 2008 was $64 in favour of the Corporation (2007 - $124 in favour of the counterparties). These derivative instruments have not been designated as hedges for accounting purposes and are fair valued on a quarterly basis. During 2008, a gain of $327 was recorded in Foreign exchange gain (loss) related to these derivatives (2007 - $(221) loss).

- The cross-currency swap as described above under interest rate risk management acted 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).

- The Corporation had entered into currency swap agreements for 16 CRJ aircraft operating leases until lease terminations between 2007 and 2011. The final 11 currency swap agreements matured in January 2008 with a nominal fair value (2007 - $10 in favour of the Corporation for five agreements). No gain or loss was recorded during the year (2007 - nil). These currency swaps with third parties had a nominal fair value in favour of the Corporation as at December 31, 2007 and had a notional amount of $78 (US$79). These were not designated as hedges for hedge accounting purposes.

<u>Liquidity risk</u>

Liquidity risk is the risk that the Corporation will encounter difficulty in meeting obligations associated with its financial liabilities and other contractual obligations.

Refer to the maturity analysis in Note 14.

Credit Card Agreement

The Corporation has various agreements with companies that process customer credit card transactions. Approximately 80% of the Corporation's sales are processed using credit cards, with remaining sales processed through cash based transactions. The Corporation receives payment for a credit card sale generally in advance of when the passenger transportation is provided.

Under the terms of one credit card processing agreement, the credit card processing company may withhold payment of funds to Air Canada upon the occurrence of certain events ("triggering events"), which include Cash, cash equivalents and Short-term investments ("unrestricted cash") being less than $900 as at the end of any month and operating losses in excess of certain amounts. The amount of funds withheld ("the deposit") is based upon a specified percentage of credit card sales processed through the credit card processing company for which transportation has not been provided to the passenger. The specified percentage increases based upon the level of unrestricted cash below $900 or the level of operating losses. If a triggering event occurred, based upon advance sales as at December 31, 2008, the deposit could be from a minimum of $110 up to a maximum of $425.

Under the terms of the credit card processing agreement, beginning at the end of the second quarter of 2009, the triggering events for deposits will change and be based upon a matrix of unrestricted cash and a debt service coverage ratio. The ratio is based upon an EBITDAR (earnings before interest, income taxes, depreciation, amortization, aircraft rentals, certain non operating income (expense) and special items) to fixed charges (principal, interest and aircraft rentals) ratio for the preceding four quarters. Under these triggering events, beginning at the end of the second quarter 2009, the unrestricted cash required in order to avoid a deposit could be as much as $1.3 billion. The basis for calculating the amount of the deposit, if required, remains consistent, as described above.

Refer to Note 1c for a further discussion on liquidity risk.

<u>Market risk</u>

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.

The Corporation uses derivative instruments to reduce market exposures from changes in foreign currency rates, interest rates, and fuel prices. 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 is designed to be offset by changes in cash flows related to the risk being hedged.

Refer to the Asset Backed Commercial Paper section below for information regarding these instruments held by the Corporation and the associated market risks.

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 as at December 31, 2008. 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. Given the recent volatility in the financial and commodity markets, the actual percentage changes may differ significantly from the percentage changes outlined below. Each risk is contemplated independent of other risks.

	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	$ 5	$ -	$ -	$ -	$ -	$ -	$ -
Short-term investments	$ 5	$ -	$ -	$ -	$ -	$ -	$ -
Aircraft related deposits	$ -	$ (11)	$ 11	$ -	$ -	$ -	$ -
Long-term debt and capital leases	$ 17	$ 262	$ (262)	$ -	$ -	$ -	$ -
Foreign exchange derivatives	$ -	$ (26)	$ 24	$ -	$ -	$ -	$ -
Fuel derivatives	$ -	$ -	$ -	$ (37)	$ (16)	$ 37	$ 16

(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.

Credit Risk

Credit risk is the risk of loss due to a counterparty's inability to meet its obligations. As at December 31, 2008, the Corporation's credit risk exposure consists mainly of the carrying amounts of Cash and cash equivalents, Short-term investments and Accounts receivable as well as Collateral deposits for fuel derivatives extended to counterparties. Cash and cash equivalents and Short-term investments are in place with major financial institutions, the Canadian government, and major corporations. Accounts receivable are generally the result of sales of tickets to individuals, often through the use of major credit cards, through geographically dispersed travel agents, corporate outlets, or other airlines, often through the use of major credit cards. Credit rating guidelines are used in determining counterparties for fuel hedging. In order to manage its exposure to credit risk and assess credit quality, the Corporation reviews counterparty credit ratings on a regular basis and sets credit limits when deemed necessary.

The Corporation has $328 in collateral deposits extended to fuel hedge counterparties. Any credit risk related to these deposits is offset against the related liability to the counterparty under the fuel derivative.

During 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).

Refer to the Asset Backed Commercial Paper section below for further credit risk information.

Fuel Price Risk

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, 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. Throughout 2008 a systematic hedging strategy was applied by adding hedging positions on a regular basis. The Corporation's policy permits hedging of up to 75% of the projected jet fuel purchases for the next 12 months, 50% for the next 13 to 24 months and 25% for the next 25 to 36 months. These are maximum (but not mandated) limits. There is no minimum monthly hedging requirement. There are regular reviews to adjust the strategy in light of market conditions. The Corporation does not purchase or hold any derivative financial instruments for trading purposes.

The types of derivative instruments used by the Corporation within its hedging program, such as swaps and the put options within collar structures, expose the Corporation to the potential to have to make collateral deposits. When fuel prices decrease causing the Corporation's derivative position to be in a liability position below the set credit thresholds with counterparties, the Corporation is responsible for extending collateral to the counterparties. As at December 31, 2008 the Corporation had extended $328 of collateral to counterparties (2007 – nil). $322 of this amount relates to cash outflows reflected in Fuel hedge collateral deposits, net and $6 relates to foreign exchange revaluation reflected in Foreign exchange (gain) loss within Operating activities on the Consolidated Statement of Cash Flow.

As of December 31, 2008, approximately 35% of the Corporation's anticipated purchases of jet fuel for 2009 are hedged at an average WTI-equivalent capped price of USD$100 per barrel, of which 79% is subject to an average WTI-equivalent floor price of US$86 per barrel. The Corporation's contracts to hedge anticipated jet fuel purchases over the 2009 period is comprised of jet fuel, heating oil and crude-oil based contracts. The Corporation also hedged approximately 14% of its 2010 anticipated jet fuel purchases in crude-oil based contracts at an average capped price of USD$110/bbl and subject to an average WTI floor price of USD$103/bbl.

The following table outlines the notional volumes per barrel along with the weighted average floor and capped price for each year currently hedged by type of derivative instruments. These average contract prices represent the equivalent price in West Texas Intermediate ("WTI") using the forward prices for WTI, heating oil, and jet oil as at December 31, 2008.

Derivative Instruments	Term	Volume (BBLs)	WTI-equivalent Average Floor Price (USD$/bbl)	WTI-equivalent Average Capped Price (USD$/bbl)
Call options (a)	2009	1,620,000	$ n/a	$ 127
Swaps (a)	2009	1,455,000	$ 100	$ 100
	2010	1,250,000	$ 100	$ 100
Collars (a)	2009	4,760,000	$ 82	$ 92
	2010	1,960,000	$ 106	$ 116
Put options (b)	2009	1,200,000	$ 40	$ n/a

(a) The Corporation is expected to generate fuel hedging gains if oil prices increase above the average capped price and is exposed to fuel hedging losses if prices decrease below the average floor price.

(b) Given the recent significant decrease in oil price, the Corporation purchased crude-oil put options. The Corporation is expected to generate fuel hedging gains if oil prices decrease below the average floor price. Their objective is to protect against potential additional collateral requirements caused from further price decreases. The fair value of these derivative instruments increases as crude oil price decreases, therefore offsetting in part the exposure on the total portfolio and limiting the collateral requirements. The premium paid related to these contracts was $4 (USD$3).

The Corporation designates certain of its fuel derivatives as cash flow 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) when it occurs.

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 (expense). 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 (expense).

During 2008 hedge accounting was discontinued for certain fuel hedge contracts where the hedging relationship ceased to satisfy the conditions for hedge accounting. The value of the AOCI balance recognized in connection with these derivatives will be taken into fuel expense upon the maturity of the contracts. The Corporation still continues to hold these derivatives as it believes they continue to be good economic hedges in managing its exposure to jet fuel prices. Also during 2008, and as further described below, certain derivatives were terminated by the Corporation prior to their scheduled maturities.

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

- During 2008, fuel derivative contracts matured with fair values in favour of the Corporation for $118 (2007 - $44).
- During 2008, fuel derivative contracts were terminated with fair values in favour of the counterparties for $137 (2007 - nil). The value of the AOCI balance recognized in connection with these derivatives will be taken into fuel expense in the period where the derivative was scheduled to mature.
- The fair value of outstanding fuel derivatives under hedge accounting at December 31, 2008 was $405 in favour of the counterparties (2007 – $67 in favour of the Corporation). This balance is reflected within Current liabilities on the Consolidated Statement of Financial Position due to the counterparty's ability to terminate the derivatives at fair value at any time prior to maturity.
- The change in fair value of fuel derivatives under hedge accounting during 2008 was $(522) (2007 - $134):
    - The unrealized effective change in the fair value of derivatives recorded in OCI was a loss of $613 (2007 - gain of $84). The realized effective change in the fair value of derivatives recorded in OCI during 2008 was a gain of $8 (2007 – gain of $62). OCI amounts for 2008 and 2007 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) was a gain of $83 (2007 - loss of $12). 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.
- During 2008, reclassification of realized gains on fuel derivatives resulted in a benefit to fuel expense of $79 (2007 - $36). This benefit was recognized through the removal of the amount from AOCI, which is reported as a reclassification of net realized gains of $57 net of tax (2007 - $25 net of tax).
- During 2008, the net impact to AOCI was a decrease of $684 before tax of $22 (2007 - $110 before tax of $28). As at December 31, 2008, the balance in AOCI was $(606). The estimated net amount of existing losses reported in AOCI that is expected to be reclassified to net income (loss) during the following 12 months is $418 before tax.

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

- During 2008, fuel derivative contracts matured in favour of the Corporation for $11 (2007 - $17).
- During 2008, fuel derivative contracts were terminated with fair values in favour of the counterparties for $23 (2007 - nil).

- The fair value of outstanding fuel derivatives not under hedge accounting at December 31, 2008 was $15 in favour of the counterparties. (2007 - $10 in favour of the Corporation).

- The change in fair value of the derivative contracts for the year was a loss of $9 (2007 - gain of $26) and was recorded in Non-operating income (expense).

As noted above, the total fair value of terminated fuel derivative contracts amounted to $160 during 2008 (2007 - nil). The cash outflow is included in Fuel and other derivatives in the Consolidated Statement of Cash Flow.

Subsequent to December 31, 2008, the Corporation modified its fuel hedge portfolio with the termination of swap and sold put option contracts for cash settlements of $156 under hedge accounting and $16 not under hedge accounting, both in favour of the counterparty. For the derivative contracts under fuel hedge accounting, the value of the AOCI balance recognized in connection with these derivatives will be taken into fuel expense in the period where the derivative was scheduled to mature.

Financial Instrument Fair Values in the Consolidated Statement of Financial Position

The carrying amounts reported in the Consolidated Statement of Financial Position for short term financial assets and liabilities, which includes Accounts receivable and Accounts payable, approximate fair values due to the immediate or short-term maturities of these financial instruments. Cash equivalents, Short-term investments, and Collateral deposits for fuel derivatives are classified as held for trading and therefore are recorded at fair value.

The carrying amounts of interest rate swaps, foreign exchange, and fuel derivatives are equal to fair value, which is based on the amount at which they could be settled based on estimated current market rates.

Management estimated the fair value of its long-term debt based on valuation techniques taking into account market rates of interest, the current tightness in credit markets and current estimated credit margins applicable to the Corporation based on recent transactions. The recent decreases in market rates of interest offset any increase in credit margins observed in recent transactions such that the fair value of the Corporation's long-term debt approximates its carrying value of $5,354.

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 December 31, 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 2008.

16. CAPITAL DISCLOSURES

The Corporation views capital as the sum of Long-term debt and capital leases, Non-controlling interest, Capitalized operating leases, and Shareholders' equity. The Corporation currently has pre-delivery 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 and capital lease obligations, Non-controlling interest, Capitalized operating leases, and Shareholders' equity less Cash and 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 contractual obligations as they become due and to ensure adequate cash levels to withstand deteriorating economic conditions;
- 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 December 31, 2008 and December 31, 2007 is calculated as follows:

	2008	2007
Long-term debt and capital leases	$ 4,691	$ 4,006
Current portion of long-term debt and capital leases	663	413
	5,354	4,419
Non-controlling interest	190	184
Capitalized operating leases	2,093	2,115
Less pre-delivery financing included in long-term debt	(81)	(521)
Adjusted debt and non-controlling interest	7,556	6,197
Shareholders' equity	762	2,443
Total Capital	**$ 8,318**	**$ 8,640**
Adjusted debt and non-controlling interest	**$ 7,556**	**$ 6,197**
Less Cash and cash equivalents and Short-term investments	(1,005)	(1,239)
Adjusted net debt and non-controlling interest	**$ 6,551**	**$ 4,958**
Adjusted net debt to adjusted net debt plus shareholders' equity ratio	**89.6%**	**67.0%**

The adjusted net debt and non-controlling interest amount has increased by $1,593 in 2008 largely attributable to the impact of the substantial depreciation of the Canadian dollar and the resulting impact on US dollar debt. The decrease in the cash balance during the year was also a significant contributor, driven by many factors including high fuel prices during most of 2008, the requirement to fund $322 in fuel collateral deposits (Note 15), higher past service pension funding payments and deteriorating economic conditions impacting travel demand.

To offset these factors, the Corporation has been actively pursuing cost cutting measures and alternate financing arrangements.

17. CONTINGENCIES, GUARANTEES AND INDEMNITIES

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. 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, or have led, to proceedings against the Corporation and a number of airlines and other cargo operators in certain jurisdictions including in the European Union where all formal procedural steps preceding a decision have been completed. 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 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 and investigations 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 and investigations. Additional material provisions may be required.

Porter Airlines Inc.

In February 2006, Jazz commenced proceedings before the Ontario Superior Court of Justice against Porter Airlines Inc. ("Porter") and other defendants (collectively the "Porter Defendants") after Jazz became aware that it would be excluded from operating flights from Toronto City Centre (Island) Airport (the "TCCA"). On October 26, 2007, the Porter Defendants counter-claimed against Jazz and Air Canada alleging various violations of competition law, including that Jazz and Air Canada's commercial relationship contravenes Canadian competition laws, and claiming $850 in damages. Concurrently with the Ontario Superior Court of Justice proceedings, Jazz commenced judicial review proceedings against the Toronto Port Authority ("TPA") before the Federal Court of Canada relating to Jazz' access to the TCCA. The Porter Defendants were granted intervener and party status in these proceedings. In January of 2008, Porter filed a defence and counterclaim against Jazz and Air Canada making allegations and seeking conclusions similar to those in the Ontario Superior Court counterclaim. Management views Porter's counterclaims in both jurisdictions as being without merit.

Pay Equity

The Canadian Union of Public Employees ("CUPE"), which represents the Corporation's flight attendants, has a complaint before the Canadian Human Rights Commission where it alleges gender-based wage discrimination. CUPE claims the predominantly female flight attendant group should be paid the same as the predominantly male pilot and mechanics groups because their work is of equal value. The complaint dates from 1991 but has not been investigated on the merits because of a legal dispute over whether the three groups work in the same "establishment" within the meaning of the Canadian Human Rights Act. On January 26, 2006, the Supreme Court of Canada ruled that they do work in the same "establishment" and sent the case back to the Canadian Human Rights Commission, which may now proceed to assess the merits of CUPE's complaint. On March 16, 2007, the Canadian Human Rights Commission referred the complaint against the Corporation for investigation. The Corporation considers that any investigation will show that it is complying with the equal pay provisions of the Canadian Human Rights Act; however, management has determined it is not possible at this time to predict with any degree of certainty the final outcome of the Commission's investigation.

Other Contingencies

Various other lawsuits and claims, including claims filed by various labour groups of Air Canada are pending by and against the Corporation and provisions have been recorded where appropriate. It is the opinion of management that final determination of these claims will not have a significant material adverse effect on the financial position or the results of the Corporation.

With respect to 45 aircraft leases, the difference between the amended rents as a result of the implementation of the Plan of Reorganization, Compromise and Arrangement (the "Plan") under the Companies' Creditors Arrangement Act ("CCAA") on September 30, 2004 and amounts due under the original lease contracts will be forgiven at the expiry date of the leases if no material defaults have occurred. If a material default occurs, which does not include any cross defaults to other agreements, this difference plus interest will become due and payable and all future rent will be based on the original contracted rates. Rent expense is being recorded on the renegotiated lease agreements and any liability would be recorded only at the time management believes the amount is likely to occur.

Guarantees

Guarantees in Fuel Facilities Arrangements

The Corporation participates in fuel facility arrangements operated through Fuel Facility Corporations, along with other airlines that contract for fuel services at various major airports in Canada. The Fuel Facility Corporations operate on a cost recovery basis. The purpose of the Fuel Facility Corporations is to own and finance the system that distributes the fuel to the contracting airlines, including leasing the Land Rights under the land lease. The aggregate debt of the five Fuel Facility Corporations in Canada that have not been consolidated by the Corporation under AcG-15 is approximately $127 as at December 31, 2008 (2007 - $119), which is the Corporation's maximum exposure to loss without taking into consideration any cost sharing that would occur amongst the other contracting airlines. The Corporation views this loss potential as remote. Each contracting airline participating in a Fuel Facility Corporation shares pro rata, based on system usage, in the guarantee of this debt.

Indemnification Agreements

The Corporation enters into real estate leases or operating agreements, which grant a license to the Corporation to use certain premises, in substantially all cities that it serves. It is common in such commercial lease transactions for the Corporation as the lessee to agree to indemnify the lessor and other related third parties for tort liabilities that arise out of or relate to the Corporation's use or occupancy of the leased or licensed premises. Exceptionally, this indemnity extends to related liabilities arising from the negligence of the indemnified parties, but usually excludes any liabilities caused by their gross negligence or willful misconduct. Additionally, the Corporation typically indemnifies such parties for any environmental liability that arises out of or relates to its use or occupancy of the leased or licensed premises.

In aircraft financing or leasing agreements, the Corporation typically indemnifies the financing parties, trustees acting on their behalf and other related parties and/or lessors against liabilities that arise from the manufacture, design, ownership, financing, use, operation and maintenance of the aircraft and for tort liability, whether or not these liabilities arise out of or relate to the negligence of these indemnified parties, except for their gross negligence or willful misconduct. In addition, in aircraft financing or leasing transactions, including those structured as leveraged leases, the Corporation typically provides indemnities in respect of various tax consequences including in relation to the leased or financed aircraft, the use, possession, operation maintenance, leasing, subleasing, repair, insurance, delivery, import, export of such aircraft, the lease or finance arrangements entered in connection therewith, changes of law and certain income, commodity and withholding tax consequences.

When the Corporation, as a customer, enters into technical service agreements with service providers, primarily service providers who operate an airline as their main business, the Corporation has from time to time agreed to indemnify the service provider against liabilities that arise from third party claims, whether or not these liabilities arise out of or relate to the negligence of the service provider, but excluding liabilities that arise from the service provider's gross negligence or willful misconduct.

Under its general by-laws and pursuant to contractual agreements between the Corporation and each of its officers and directors, the Corporation has indemnification obligations to its directors and officers. Pursuant to such obligations, the Corporation indemnifies these individuals, to the extent permitted by law, against any and all claims or losses (including amounts paid in settlement of claims) incurred as a result of their service to the Corporation.

The maximum amount payable under the foregoing indemnities cannot be reasonably estimated. The Corporation expects that it would be covered by insurance for most tort liabilities and certain related contractual indemnities described above.

18. RELATED PARTY TRANSACTIONS

At December 31, 2008, ACE has a 75% ownership interest in Air Canada. Air Canada has various related party transactions with ACE and Aveos (formerly called ACTS Aero Technical Support & Services Inc. ("ACTS Aero")), which conducts the business previously operated by ACTS LP ("ACTS") prior to the sale of ACTS announced by ACE and completed on October 16, 2007.

During 2008, ACTS LP settled certain contracts with Air Canada for $11, in relation to the October 2007 sale of assets of ACTS LP. These contracts were accounted for as equity transactions, resulting in an increase to Contributed surplus of $11.

Related party trade balances, as outlined below, mainly arise from the provision of services, including the allocation of employee related costs, as further described in Note 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:

	2008	2007
Accounts receivable		
ACE	$ 2	$ 9
Aveos	120	75
	$ 122	**$ 84**
Prepaid Maintenance		
Aveos	$ 5	$ 24
	$ 5	**$ 24**
Accounts payable and accrued liabilities		
Aveos	$ 99	$ 88
	$ 99	**$ 88**

Revenues and expenses with related parties are summarized as follows:

	2008	2007
Revenues		
Property rental revenues from ACE and Aveos	$ 29	$ 39
Revenues from information technology services to Aveos	15	14
Revenues from corporate services and other to ACE and Aveos	15	16
Cargo revenues from Aveos	-	1
Other revenues	-	1
	$ 59	**$ 71**
Expenses		
Maintenance expense for services from Aveos	$ 478	$ 632
Recovery of wages, salary and benefit expense for employees assigned to ACE and Aveos	(277)	(362)
Other expenses	1	-
	$ 202	**$ 270**

Summary of significant related party agreements

The Relationship between the Corporation and Aveos

On October 16, 2007, ACE announced the completion of the sale of ACTS LP, its wholly owned maintenance, repair and overhaul subsidiary, pursuant to which ACTS LP sold substantially all its assets, liabilities and business to Aveos (formerly ACTS Aero), a new entity established to purchase the assets of ACTS LP, with ACE retaining a 23% interest in Aveos as at the date of this transaction.

On closing of the ACTS sale, the following transactions were recorded by Air Canada:

- Proceeds of $28 for the sale of a building to Aveos.
- Proceeds of $17 for the settlement of a related party receivable with ACTS.
- Proceeds of $20 pursuant to the Non-Compete and Repair Schemes Transfer Agreement ("Repair Schemes and Non-Compete Agreement") described below
- The funding of a letter of credit in the amount of $101 related to the Pension and Benefits Agreement described below.

Aveos is a related party to Air Canada due to ACE's investment in both entities.

The ACTS Maintenance Agreements, the ACTS Master Services Agreement, and the General Services Agreements, all between Air Canada and ACTS, and the Repair Schemes and Non-Compete Agreement described below were assigned from ACTS to Aveos upon closing of the ACTS sale.

Pension and Benefits Agreement

The Corporation, ACTS and Aveos entered into a Pension and Benefits Agreement effective as of October 16, 2007, as amended ("Pension and Benefits Agreement"), relating to pension and benefits arrangements pertaining to (i) the non-unionized employees of Air Canada who were previously assigned to the ACTS operation and who became employees of Aveos on October 16, 2007 and (ii) those unionized employees of Air Canada who were assigned to ACTS Aero operation pursuant to general services agreements between Air Canada and ACTS for the assignment of unionized employees from Air Canada to ACTS (these agreements were assigned to ACTS Aero (i.e. Aveos) upon closing of the ACTS Sale). Aveos is required to establish new defined benefit and defined contribution pension plans as well as other employee and retiree benefit arrangements (including health, life and disability) (the "ACTS Benefit Arrangements").

Upon receipt of regulatory approval where required and based upon valuations of the relevant pension and benefit arrangements of Air Canada (the "Air Canada Benefit Arrangements") as at October 16, 2007, the assets and obligations under the Air Canada Benefit Arrangements pertaining to the transferring non-unionized employees will be transferred to Aveos or the ACTS Benefit Arrangements, as applicable. Amounts with a present value equal to the solvency deficiency in the defined benefit pension plans as at October 16, 2007 related to transferring non-unionized employees will be paid by Air Canada through quarterly payments to Aveos until 2014. Amounts with a present value equal to the accounting liability as at October 16, 2007 in respect of retiree and disability benefits related to transferring non-unionized employees are to be paid by Air Canada through quarterly payments to Aveos until 2012. The present value of these quarterly payments is also referred to as the compensation amount. Until such future time as the assets and obligations under the Air Canada Benefit Arrangements pertaining to non-unionized employees may be transferred to Aveos, the current service pension cost and the current service and interest costs for other employee benefits are expensed by Air Canada with a full offset recorded as an amount charged to affiliates (Aveos).

In addition, the Pension and Benefits Agreement contemplates similar asset and liability transfer and compensation arrangements in respect of unionized employees, which arrangements would take effect at such future time as those unionized employees may commence employment with Aveos pursuant to the Transition MOA, as described further below. However, the solvency deficiencies in respect of transferring unionized employees for which the future quarterly compensation payments would be made are determined as at October 16, 2007, subject to certain adjustments, and the discount rate used to compute the accounting liability for the unionized employees' retiree and disability benefits is fixed as at October 16, 2007. The compensation payments in respect of these solvency deficiencies and accounting liabilities will be made quarterly during the five years beginning after the unionized employees are transferred to Aveos, but only if such a transfer occurs. Until such future time as the assets and obligations under the Air Canada Benefit Arrangement pertaining to unionized employees may be transferred to Aveos, the current service pension cost and the current service and interest costs for other employee benefits in respect of Air Canada employees providing services to Aveos are charged to Aveos.

The Pension and Benefits Agreement also required that Air Canada provide letters of credit to Aveos on October 16, 2007, to secure the above-described payment obligations in respect of the solvency deficiencies of the defined benefit pension plans and accounting liabilities for other retiree and disability benefit arrangements. The letters of credit initially totaled $101, subject to adjustment once the exact amounts of the relevant solvency deficiencies and accounting liabilities as at October 16, 2007 were determined by actuarial valuations. The face amount of the letter of credit in respect of the unionized solvency deficiency is also adjusted annually to recognize past service costs paid by Air Canada to the plan in respect of unionized employees assigned to Aveos. The face amount of the letters of credit decreases as the related quarterly funding payments described above are made. During 2008, as described below under "Agreement with Aveos on Revised Payment Terms", the Corporation and Aveos also agreed to temporarily cancel certain letters of credit in the amount of $40. Aveos may call the letters of credit in whole or in part, in the event of a default as defined in the Pension and Benefits Agreement. Collateral equal to the amount of the letters of credit was paid in cash with the asset recorded in Deposits and other assets. Refer to Note 5 for the current amount of the letters of credit related to the Pension and Benefits Agreement.

During 2008, Air Canada, Aveos, and the union representing the employees assigned to Aveos continued discussions regarding the options under which certain unionized employees would commence employment directly with Aveos and the creation of a separate bargaining unit for those employees at Aveos. On January 8, 2009, these same parties entered into a Memorandum of Agreement (the "Transition MOA") in order to resolve certain remaining issues and in order to (i) facilitate the orderly transition of certain Air Canada employees to Aveos and (ii) to establish terms and conditions of employment that will apply to those Air Canada employees who elect to become employees of Aveos. In relation to the Transition MOA, the Corporation and Aveos also entered into certain ancillary agreements (the "Ancillary Transition Agreements") to address commercial issues relating to the transition of employees contemplated by the Transition MOA. Before taking effect, the parties must complete a mediation and, if necessary, arbitration of certain issues they have not yet resolved but have agreed to submit to these processes, and the application to separate the bargaining unit must be ordered by the Canada Industrial Relations Board.

Non-Compete and Repair Schemes Transfer Agreement

Aveos and Air Canada are parties to a Non-Compete and Repair Schemes Transfer Agreement, effective as of October 16, 2007. Generally described, repair schemes are processes and methods which may be used in the maintenance and repair of aircraft and related equipment. The Non-Compete and Repair Schemes Transfer Agreement confirmed an arrangement and provides for the sale from Air Canada to ACTS Aero (as successor to ACTS LP) of an undivided joint ownership interest in repair schemes owned by Air Canada or approved under Air Canada's airworthiness engineering organization as well as the sale from Aveos to Air Canada of an undivided joint ownership interest in the repair schemes owned or developed by Aveos and applicable to airframe heavy maintenance services provided by ACTS to Air Canada under the parties' airframe heavy maintenance services agreement. However, in September 2004 as part of the implementation of the Corporation's plan of arrangement under the Companies' Creditors Arrangement Act, the Corporation had already granted ACTS full and exclusive right to these schemes on a royalty free basis.

The Non-Compete and Repair Schemes Transfer Agreement also restricts Air Canada's ability to own any equity interest in an entity (other than entities in which Air Canada previously held interests), or to carry on a business activity, related to the following commercial maintenance, repair and overhaul services in the airline industry, namely, airframe heavy maintenance and paint services, engine and auxiliary power unit ("APU") overhaul maintenance services, and component maintenance services. The applicable non-compete periods are as follows:

- With respect to airframe heavy maintenance services and paint services, the non-compete period ends one year after the current heavy maintenance services agreement is terminated or expires (the current term of the heavy maintenance services agreement expires October 1, 2011);
- With respect to engine and APU overhaul maintenance services, the non-compete period ends on October 1, 2015; and
- With respect to component maintenance services, the non-compete period ends on October 1, 2016;

The Non-Compete and Repair Schemes Transfer Agreement does not restrict Air Canada from holding interests in any entities in which it held interests at the time of concluding the agreement nor does it limit Air Canada's line maintenance activities which it continues to operate.

In consideration for the transfer of the repair schemes, Air Canada received $20. These proceeds were recorded in financing activities on the Consolidated Statement of Cash Flows and a credit of $20 was recorded in Contributed surplus ($15 after future income tax) as the transaction was recorded at the Corporation's carrying amount of nil.

The Non-Compete and Repair Schemes Transfer Agreement was assigned to Aveos upon closing of the ACTS Sale.

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 above, were canceled. The cancellation of the letters of credit provided 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. 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.

Maintenance Agreements

Aveos and Air Canada are parties to a general terms and related services agreements effective October 1, 2006, pursuant to which Aveos provides technical services to the Corporation including engine and auxiliary power unit maintenance services, aircraft heavy maintenance services (excluding line and cabin maintenance services which are provided by the Corporation), component maintenance services, paint services, training services and ancillary services. Aveos serves as the Corporation's exclusive repair agency in respect of aircraft heavy maintenance, engine maintenance, auxiliary power unit maintenance services as well as for maintenance services relating to certain components. Aveos serves as the Corporation's non-exclusive repair agency in respect of other services provided. The services agreement relating to aircraft heavy maintenance services, which expires in October 2011, will be extended to June 2013 conditional upon the issuance of an order of the Canada Industrial Relations Board establishing that Aveos is a distinct employer, bound by separate collective agreements and providing for the transition of employees from Air Canada to Aveos which are fully within the scope of the Transition MOA and the Ancillary Transition Agreements mentioned above. The services agreement relating to engine maintenance expires in October 2013, except in respect of certain engine types, for which the parties have agreed to extend the term to December 31, 2018. The services agreement relating to paint services expires in October 2009 and each of the other maintenance agreements referred to above expire in October 2013.

Master Services Agreement (MSA)

Aveos and Air Canada are parties to an amended and restated master services agreement (the "Aveos MSA"), effective January 1, 2007, pursuant to which the Corporation provides Aveos with services including infrastructure support and services which are mostly administrative in nature, including information technology, human resources, finance and accounting, and claims services in return for fees paid by Aveos to the Corporation. Aveos may elect to terminate any services under the Aveos MSA or the entire Aveos MSA upon six months' prior written notice, with the exception of services relating to information technology which Aveos cannot terminate prior to the expiry of the Aveos MSA. Air Canada may elect to terminate any services under the Aveos MSA or the entire Aveos MSA upon 18 months' prior written notice. These amounts are recorded in the above table summarizing related party revenues and expenses under Revenues from corporate services and other.

General Services Agreements

Aveos and Air Canada are parties to an amended and restated general services agreement (the "Aveos GSA"), effective as of June 22, 2007, pursuant to which the Corporation provides Aveos with the services of a group of unionized employees for which the Corporation is reimbursed by Aveos for all costs, including salary and benefits, on a fully allocated basis. The Aveos GSA may be terminated by either party at any time upon 30 days' prior written notice.

Real Estate Agreements

As part of the closing of the monetization of ACTS LP, Air Canada sold a building to Aveos for proceeds of $28 effective as of October 16, 2007. In connection with the sale, Air Canada and Aveos entered into a land sublease for certain land contiguous with the building and a service contract whereby the Corporation provides Aveos certain services related to the operation of the building.

Aveos and Air Canada are parties to a master lease agreement, effective as of October 1, 2006, pursuant to which Aveos leases space from the Corporation at the Vancouver, Winnipeg, Toronto and Montreal airports.

The Relationship between the Corporation and ACE

Master Services Agreement

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.

Air Canada has received notice from ACE that the substantive majority of these service agreements will be terminated in 2009.

Share Purchase Rights Sold by Air Canada to ACE

During 2007, Air Canada entered into an aircraft transaction with an unrelated third party whereby partial consideration was paid to the Corporation in the form of the right to acquire shares of the unrelated third party. The Corporation recorded the value of the share purchase rights at fair value of $1. The transaction related to the sale by the Corporation of two Airbus A319 aircraft and the sublease by the Corporation of an additional two Airbus A319 aircraft, all of which was completed in 2007 with the exception of one of the owned Airbus A319 aircraft, which was completed in 2008. The Corporation sold the right to acquire the shares received from the unrelated third party to ACE, for proceeds of $1.

Warrants purchased from ACE

On November 26, 2007, Air Canada purchased certain share warrants held by ACE for consideration of $4, which was paid in 2007 and recorded as a decrease to Contributed surplus. These warrants are for the purchase of shares of an unrelated third party from which the Corporation purchases services. The equity of the unrelated third party is not quoted in an active market and therefore fair value is not reliably measurable. As such, the financial instrument is recorded at cost, being the carrying amount in ACE of nil.

Purchase of Air Canada Vacations

During 2007, Air Canada purchased from ACE its 49% interest in Air Canada Vacations causing Air Canada Vacations to be wholly owned by the Corporation. Consideration for the interest was $10. The consideration is accounted for on the Consolidated Statement of Financial Position in Contributed surplus. Air Canada Vacations remains consolidated within the results of the Corporation.