AIR CANADA

2010
Consolidated Financial Statements

February 10, 2011

PRICEWATERHOUSECOOPERS

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February 9, 2011

Independent Auditor's Report

To the Shareholders
of Air Canada

We have audited the accompanying consolidated financial statements of Air Canada and its subsidiaries, which comprise the consolidated balance sheets as at December 31, 2010 and 2009 and the consolidated statements of operations, changes in shareholders' equity, comprehensive income and cash flow for the years then ended, and the related notes including a summary of significant accounting policies.

Management's responsibility for the consolidated financial statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' responsibility
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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Air Canada and its subsidiaries as at December 31, 2010 and 2009 and the results of their operations and their cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants[1]

[1] Chartered accountant auditor permit No. 18144

Consolidated Statement of Operations

For the year ended December 31 (Canadian dollars in millions except per share figures)		2010	2009
Operating revenues			
Passenger		$ 9,427	$ 8,499
Cargo		466	358
Other		893	882
		10,786	9,739
Operating expenses			
Aircraft fuel		2,652	2,448
Wages, salaries and benefits		1,885	1,751
Airport and navigation fees		961	971
Capacity purchase with Jazz	Note 2D	934	973
Depreciation and amortization	Notes 3 & 4	679	660
Aircraft maintenance		677	759
Food, beverages and supplies		280	291
Communications and information technology		316	293
Aircraft rent		346	335
Commissions		259	186
Other		1,436	1,388
		10,425	10,055
Operating income (loss) before under noted item		**361**	**(316)**
Provision adjustment for cargo investigations, net	Note 17	46	-
Operating income (loss)		407	(316)
Non-operating income (expense)			
Interest income		19	14
Interest expense		(378)	(373)
Interest capitalized		1	4
Loss on assets	Notes 3 & 4	(7)	(95)
Gain (loss) on financial instruments recorded at fair value	Note 15	(3)	95
Other		(20)	-
		(388)	(355)
Income (loss) before the following items		**19**	**(671)**
Non-controlling interest		(9)	(15)
Foreign exchange gain		145	657
Recovery of (provision for) income taxes	Note 7		
Current		4	7
Future		(52)	(2)
Net income (loss) for the year		**$ 107**	**$ (24)**
Net income (loss) per share			
Basic	Note 12	$ 0.38	$ (0.18)
Diluted	Note 12	$ 0.37	$ (0.18)

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)		2010	2009
ASSETS			
Current			
Cash and cash equivalents	Note 2O	$ 1,090	$ 1,115
Short-term investments	Note 2P	1,102	292
		2,192	1,407
Restricted cash	Note 2Q	80	78
Accounts receivable		641	701
Aircraft fuel inventory		67	63
Spare parts and supplies inventory	Note 2R	88	64
Prepaid expenses and other current assets		377	338
		3,445	2,651
Property and equipment	Note 3	5,747	6,369
Intangible assets	Note 4	840	916
Deposits and other assets	Note 5	512	470
		$ 10,544	**$ 10,406**
LIABILITIES			
Current			
Accounts payable and accrued liabilities		$ 1,182	$ 1,246
Advance ticket sales		1,375	1,288
Current portion of long-term debt and capital leases	Note 6	505	468
		3,062	3,002
Long-term debt and capital leases	Note 6	3,952	4,054
Future income taxes	Note 7	80	85
Pension and other benefit liabilities	Note 8	1,059	1,163
Other long-term liabilities	Note 9	482	455
		8,635	8,759
Non-controlling interest		169	201
SHAREHOLDERS' EQUITY			
Share capital	Note 11	534	532
Contributed surplus		1,826	1,825
Deficit		(620)	(727)
Accumulated other comprehensive loss	Notes 2L & 15	-	(184)
		1,740	1,446
		$ 10,544	**$ 10,406**

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
Chairman

Signed
Michael M. Green
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)		2010	2009
Share capital			
Common shares, beginning of year		$ 532	$ 274
Shares issued	Notes 8 & 11	2	258
Total share capital		534	532
Contributed surplus			
Balance, beginning of year		1,825	1,797
Fair value of stock options issued to Corporation employees recognized as compensation expense	Note 10	1	2
Warrants issued under the credit facility	Note 6	-	7
Warrants issued under the public offering	Note 11	-	19
Total contributed surplus		1,826	1,825
Deficit			
Balance, beginning of year		(727)	(703)
Net income (loss) for the year		107	(24)
Deficit		(620)	(727)
Accumulated other comprehensive income (loss)			
Balance, beginning of year		(184)	(606)
Other comprehensive income		184	422
Total accumulated other comprehensive loss		-	(184)
Total deficit and accumulated other comprehensive loss		(620)	(911)
Total shareholders' equity		**$ 1,740**	**$ 1,446**

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

Consolidated Statement of Comprehensive Income

For the year ended December 31 (Canadian dollars in millions)		2010	2009
Comprehensive income (loss)			
Net income (loss) for the year		$ 107	$ (24)
Other comprehensive income (loss), net of taxes:			
Net losses on fuel derivatives under hedge accounting, net of taxes	Note 15	-	(1)
Reclassification of net realized losses on fuel derivatives to income, net of taxes	Note 15	184	423
		184	422
Total comprehensive income		**$ 291**	**$ 398**

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)		2010	2009
Cash flows from (used for)			
Operating			
Net income (loss) for the year		$ 107	$ (24)
Adjustments to reconcile to net cash from operations			
Depreciation and amortization		679	660
Loss on assets	Notes 3 & 4	7	95
Foreign exchange gain		(172)	(633)
Future income taxes		52	2
Excess of employee future benefit funding over expense		(126)	(368)
Non-controlling interest		9	15
Fuel and other derivatives	Note 15	102	41
Fuel hedge collateral deposits, net	Note 15	43	268
Provision adjustment for cargo investigations, net	Note 17	(46)	-
Changes in non-cash working capital balances		154	(234)
Other		55	11
		864	**(167)**
Financing			
Proceeds from borrowings	Note 6	1,175	926
Shares issued	Note 11	2	230
Warrants issued under the public offering and credit facility	Notes 6 & 11	-	26
Reduction of long-term debt and capital lease obligations		(1,135)	(1,237)
Other		(35)	-
		7	**(55)**
Investing			
Short-term investments		(810)	214
Additions to capital assets		(118)	(232)
Proceeds from contractual commitments	Note 9	-	230
Proceeds from sale of assets	Note 3	29	103
Proceeds from sale-leaseback transactions	Note 3	20	552
Reduction to Aveos letter of credit	Note 18	23	-
Other		(40)	(29)
		(896)	**838**
Increase (decrease) in cash and cash equivalents		**(25)**	**616**
Cash and cash equivalents, beginning of year		1,115	499
Cash and cash equivalents, end of year		**$ 1,090**	**$ 1,115**

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

For the years ended December 31, 2010 and 2009
(Canadian dollars in millions – except per share amounts)

1. BASIS OF PRESENTATION AND NATURE OF OPERATIONS

A) BASIS OF PRESENTATION

The accompanying consolidated financial statements are of Air Canada (the "Corporation"). 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 in Canada ("GAAP").

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 wholly-owned subsidiaries of Air Canada, including Air Canada Cargo Limited Partnership ("Air Canada Cargo") up to and including November 30, 2009, ACGHS Limited Partnership ("Air Canada Ground Handling Services" or "ACGHS") up to and including November 30, 2009 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).

Effective December 1, 2009, the operations of Air Canada Cargo and Air Canada Ground Handling Services, previously operated by wholly-owned subsidiaries of Air Canada, were wound up into Air Canada. These wind-ups had no impact on the consolidated financial statements.

Air Canada is Canada's largest domestic, US transborder 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 Aviation LP ("Jazz") (the successor to Jazz Air LP) through a capacity purchase agreement between Air Canada and Jazz (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 passenger charter services under the brand name "AC Jetz".

Air Canada offers air cargo services on domestic and US transborder routes using cargo capacity on aircraft operated by Air Canada and Jazz. Prior to December 1, 2009, these services were provided by Air Canada Cargo. 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 provided passenger handling services to Air Canada, Jazz and other airlines with a primary focus on Canadian stations. Services covered included passenger check-in, gate management, baggage and cargo handling and processing, cabin cleaning, de-icing as well as aircraft ramp services. Effective December 1, 2009 with the wind-up of ACGHS, Air Canada offers these services directly.

Air Canada Vacations is one of Canada's leading tour operators. Based in Montreal and Toronto, Air Canada Vacations operates its business in the outbound leisure travel market (Caribbean, Mexico, U.S., Europe, Central and South America, South Pacific and Asia) by developing, marketing and distributing vacation travel packages. Air Canada Vacations also offers cruise packages in North America, Europe and the Caribbean.

Air Canada is managed as one operating segment based on how financial information is produced internally for the purposes of making operating decisions.

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, accounting for income taxes, the determination of passenger revenues, the determination of amortization period for long-lived assets, the impairment considerations on long-lived assets, the carrying value of financial instruments recorded at fair value and provisions for investigations and proceedings related to alleged anti-competitive cargo pricing activities.

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 Canada Inc. (“Aeroplan”), a corporation that provides loyalty program services to Air Canada and purchases seats from Air Canada pursuant to the Commercial Participation and Services Agreement between Aeroplan and Air Canada (the "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. Passenger revenue also includes revenues from passenger-related services such as ticket changes, seat selection, and excess baggage which are recognized as the services are 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.

D) CAPACITY PURCHASE AGREEMENTS – JAZZ & TIER III CARRIERS

Air Canada has capacity purchase agreements with Jazz and certain other regional carriers, some of which are referred to as Tier III carriers, operating aircraft of 18 seats or less. Under these agreements, Air Canada markets, tickets and enters into other 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, under the Jazz CPA, are based on variable and fixed rates (“CPA Rates”) plus mark-up and pass-through costs. The CPA Rates are periodically set by the parties for rate periods of three years. The parties set the rates through negotiations based on Jazz’s forecasted costs for the applicable rate period and an operating plan for the applicable rate period provided by Air Canada. Pass-through costs are non-marked-up costs charged to the Corporation and include fuel, airport and user fees and other costs. These expenses are recorded in the applicable category within Operating expenses.

The following table outlines expenses and pass-through costs under the Jazz CPA for 2009 and 2010:

	2010	2009
Expenses from Jazz CPA	$ 934	$ 973
Pass-through fuel expense from Jazz CPA	292	253
Pass-through airport expense from Jazz CPA	193	196
Pass-through other expense from Jazz CPA	39	35
	$ 1,458	**$ 1,457**

Due to terms of the Jazz CPA, Jazz is deemed to be a variable interest entity. Notwithstanding that Air Canada is not the primary beneficiary of Jazz, Air Canada holds a significant variable interest in Jazz through the contractual arrangements with Jazz as described in Note 14.

The Corporation entered into an agreement amending the terms of the Jazz CPA effective August 1, 2009. This amending agreement includes among other items (i) a reduction to fees paid under the Jazz CPA based on a reduction in the mark-up paid to Jazz from 16.72% to 12.5%; (ii) a reduction in Air Canada's commitment to Jazz's covered fleet from 133 to 125 aircraft; (iii) a contract term extension of five years (from December 31, 2015 to December 31, 2020), during which a second benchmarking review will be performed; and (iv) agreement on Jazz's turboprop fleet renewal strategy relating to the introduction of 15 Dash-8-400 aircraft which will replace 13 CRJ-100 aircraft.

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, 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 Aeroplan 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 occurs upon the qualifying air travel being provided to the customer.

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 and subleases amounted to $101 in 2010 (2009 - $126).

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 former related parties 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. 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 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 four years.

Past service costs arising from plan amendments are amortized on a straight-line basis over the expected average remaining service period of employees active at the date of amendment. This period does not exceed the expected average remaining service period of such employees up to the full eligibility date. The expected average remaining service period of active employees (or expected average remaining life expectancy of retired members for a plan with no active members) is between 7 and 15 years for pension plans and between 5 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 expected remaining service life of active employees.

As described in Note 8, certain Corporation employees perform work for a former related party, namely Aveos Fleet Performance Inc. ("Aveos"), and are members of Corporation-sponsored defined benefit pension plans and also participate in Corporation-sponsored health, life and disability benefit plans. Other Corporation employees performed work for Aeroplan until June 1, 2009, the date of transition to employment at Aeroplan and then ceased to accrue benefits under the Corporation-sponsored defined benefit pension plans and under the Corporation-sponsored health, life and disability 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 contractually 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 participate in Air Canada's Long-Term Incentive Plan, which provides for the grant of stock options and performance share units ("PSUs"), as further described in Note 10.

The fair value of stock options with a graded vesting schedule is determined based on different expected lives for the options that vest each year, as it would be if the award were viewed as several separate awards, each with a different vesting date, and it is accounted for on that basis. 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 options at that date.

For grants of PSUs that are accounted for as equity settled instruments, the Corporation recognizes Compensation expense offset by Contributed surplus equal to the market value of an Air Canada common share at the date of grant on a straight line basis over the applicable vesting period. Compensation expense is adjusted for subsequent changes in management's estimate of the number of PSUs that are expected to vest. For grants of PSUs that are accounted for as cash settled instruments, the Corporation recognizes Compensation expense offset by Other long-term liabilities equal to the market value of an Air Canada common share at the date of grant on a straight line basis over the applicable vesting period. Compensation expense is adjusted for subsequent changes in the market value of Air Canada common shares and management's estimate of the number of PSUs that are expected to vest. Refer to Note 15 for a description of derivative instruments used by the Corporation to hedge the cash flow exposure to PSUs.

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 Corporation'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

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 rate method. Investments in equity instruments classified as available-for-sale that do not have a quoted market price in an active market are measured at cost.

The Corporation enters into interest rate, foreign currency, and fuel derivatives and share forward contracts 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 value 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 based on the terms of the contractual agreements. 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 rate 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 interest income.
- Restricted cash is classified as held-for-trading and any period change in fair value is recorded through interest 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 the Consolidated Statement of Operations, 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 the Consolidated Statement of Operations, 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 expense is recorded in the Consolidated Statement of Operations, as applicable.

Fuel Derivatives

Prior to the Corporation discontinuing hedge accounting for all fuel derivatives effective the third quarter of 2009 as described below, it had 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 Other comprehensive income ("OCI") while the ineffective portion is recognized in Non-operating income (expense). The effective gains and losses previously recognized in Accumulated OCI ("AOCI") are recorded in fuel expense when the forecasted hedge transaction occurs.

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 previously forecasted hedge transaction occurs. Refer to Note 15 for the impact of fuel derivatives during the year.

After considering the costs and benefits specific to the application of cash flow hedge accounting, the Corporation elected to discontinue hedge accounting for all fuel derivatives effective the third quarter of 2009. The derivative instruments continue to be recorded at fair value in each period with both realized and unrealized changes in fair value recognized immediately in earnings in non-operating income (expense). Amounts deferred to AOCI for derivatives previously designated under hedge accounting were taken into fuel expense in the period in which the previously forecasted hedge transaction occurred. As at December 31, 2010, there is no remaining balance in AOCI related to fuel hedging contracts.

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 and cash equivalents include $497 pertaining to investments with original maturities of three months or less at December 31, 2010 (2009 - $323). 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, 2010 is 1.37% (2009 - 0.29%).

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, 2010 is 1.13% (2009 - 0.53%).

Q) RESTRICTED CASH

The Corporation has recorded $80 (2009 - $78) 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 AND SPARE PARTS AND SUPPLIES INVENTORY

Inventories of aircraft fuel and spare parts and supplies are measured at the lower of cost and net realizable value, with cost being determined using a weighted average formula.

The Corporation did not recognize any write-downs on inventories or reversals of any previous write-downs during the periods presented. Included in aircraft maintenance is $36 related to spare parts and supplies consumed during the year (2009 - $74).

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 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) based on the effective interest rate. 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	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 undiscounted cash flows to the carrying amount of the assets or groups of assets. If the carrying value is not recoverable from future expected undiscounted 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, Consolidation of Variable Interest Entities (“AcG-15”). As a result of the Corporation being the primary beneficiary of these VIEs, the Corporation consolidates leasing entities covering 37 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 $190 and debt of approximately $171, 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.

3. PROPERTY AND EQUIPMENT

	2010	2009
Cost		
Flight equipment, including spare engines (a)	$ 5,797	$ 5,866
Assets under capital leases (b)	1,959	1,959
Buildings, including leasehold improvements	702	688
Ground and other equipment	170	157
	8,628	8,670
Accumulated depreciation and amortization		
Flight equipment, including spare engines (a)	1,758	1,407
Assets under capital leases (b)	853	683
Buildings, including leasehold improvements	228	187
Ground and other equipment	76	62
	2,915	2,339
	5,713	**6,331**
Purchase deposits, including capitalized interest (c)	34	38
Property and equipment at net book value (d)	**$ 5,747**	**$ 6,369**

(a) Included in flight equipment as at December 31, 2010 are rotable parts, including spare engines with a cost of $786 (2009 - $821) less accumulated depreciation of $355 (2009 - $327) for a net book value of $431(2009 - $494). Also included in flight equipment are 24 aircraft and 1 spare engine (2009 –24 aircraft and 1 spare engine) which are leased to Jazz (Note 14) and third parties with a cost of $591 (2009 - $591) less accumulated depreciation of $282 (2009 - $237) for a net book value of $309 (2009 - $354).

(b) Included in capital leases as at December 31, 2010 are 40 aircraft (2009 - 40) with a cost of $1,893 (2009 - $1,893) less accumulated depreciation of $840 (2009 - $672) for a net book value of $1,053 (2009 - $1,221) and facilities with a cost of $66 (2009 - $66) less accumulated depreciation $13 (2009 - $11) for a net book value of $53 (2009 - $55).

(c) Includes $17 (2009 - $17) for Boeing B777/787 aircraft and $17 (2009 - $21) for equipment purchases and internal projects.

(d) Net book value of Property and equipment includes $698 (2009 - $798) consolidated for aircraft leasing entities and $155 (2009 - $165) consolidated for fuel facility corporations, both of which are consolidated under AcG-15.

As at December 31, 2010, flight equipment included 17 aircraft (2009 - 17) that are retired from active service with a net carrying value of $4 (2009 - $22). In 2010, the Corporation recorded an impairment charge of $7 on its fleet of retired B767-200 aircraft.

Interest capitalized during 2010 amounted to $1 at an interest rate of 6.68% (2009 - $4 at an interest rate of 7.38%).

Depreciation of property and equipment in 2010 amounted to $627 (2009 - $602).

During 2010:

- The Corporation received additional net proceeds of $20 upon completion of the remaining part of the sale-leaseback transaction of three Boeing 777 aircraft which was substantially completed in the fourth quarter of 2009. The Corporation recorded a loss on assets of $1 in 2010 for this remaining part of the transaction.

- The Corporation sold a spare engine for proceeds of $25 with a book value of $24, resulting in a gain on sale of $1.

During 2009:

- The Corporation took delivery of one Boeing 777 aircraft. The aircraft was financed with guarantee support from the Export-Import Bank of the United States ("EXIM").

- The Corporation entered into a sale lease-back transaction for a Boeing 777 aircraft, which was originally delivered in 2007 and debt financed. The proceeds from the transaction of $172 were used to repay the outstanding loan of $114. The Corporation recorded a charge of $17 in interest expense for this transaction including a prepayment fee of $14. The gain on sale of the aircraft of $26 has been deferred and will be recognized in Depreciation and amortization over the term of the lease. The lease is accounted for as a capital lease with a 12 year term, with monthly lease payments.

- The Corporation sold two A340 aircraft for proceeds of $91 with a book value of $93, resulting in a loss on sale of $2. The Corporation made a repayment of $82 for the associated debt.

- The Corporation entered into a sale lease-back transaction for three Boeing 777 aircraft, which were originally delivered in 2007 and debt financed. The proceeds from the transaction of $380 were used to repay the outstanding principal of $273. The Corporation recorded a charge of $8 in interest expense for this transaction and a loss on sale of the aircraft of $24. The leases are accounted for as operating leases with a 12 year term, with monthly lease payments.

4. INTANGIBLE ASSETS

	2010	2009
Indefinite life assets		
International route rights and slots	$ 310	$ 329
Air Canada trade name	276	298
Other marketing based trade names	29	31
	615	**658**
Finite life assets		
Star Alliance membership	125	131
Other contract and customer based	141	144
Technology based	277	254
	543	529
Accumulated depreciation and amortization		
Star Alliance membership	(42)	(37)
Other contract and customer based	(116)	(110)
Technology based	(160)	(124)
	(318)	(271)
Finite life assets, net	**225**	**258**
	$ 840	**$ 916**

The amortization of intangible assets in 2010 amounted to $47 (2009 - $58).

As a result of recognizing the benefit during the year ended December 31, 2010 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 $56 (2009 – nil).

During 2009, the Corporation recorded an impairment charge of $68 related to previously capitalized costs incurred pertaining to the development of a new reservation system, referred to as POLARIS, which was recorded in Technology based intangible assets.

5. DEPOSITS AND OTHER ASSETS

		2010	2009
Aircraft related deposits (a)		$ 131	$ 189
Restricted cash		130	121
Investment in Aveos	Note 18	51	-
Accrued pension benefit asset	Note 8	28	-
Aircraft lease payments in excess of rent expense	Note 2W	52	51
Deposit related to the Pension and Benefits Agreement	Note 18	20	43
Asset backed commercial paper	Note 15	29	29
Other deposits		34	24
Other		37	13
		$ **512**	**$ 470**

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

6. LONG-TERM DEBT AND CAPITAL LEASES

		Base Currency	Final Maturity	Actual Interest Rate (%)	2010	2009
Embraer aircraft financing (a)		USD	2017-2021	2.18-8.49	$ 1,041	$ 1,164
Boeing aircraft financing (b)		USD	2019-2021	0.29-5.69	386	450
Boeing aircraft financing (c)		JPY	2020	0.33	207	210
Senior secured first lien notes (d)		USD	2015	9.25	597	-
Senior secured first lien notes (d)		CDN	2015	10.13	300	-
Senior secured second lien notes (d)		USD	2016	12.00	199	-
Term credit facility (e)		CDN	2014		-	593
Aircraft leasing entities - debt (f)	Note 2Z				533	662
Term loan due 2013 (g)		USD	2013	6.25	75	78
Conditional sales agreements (h)		USD	2019	3.20-3.29	123	140
Fuel facility corporations - debt (i)	Note 2Z				134	136
Spare parts financing (j)		USD	2014	5.74	100	138
Spare engine financing (k)		USD	2013	3.70	62	74
Canadian Regional Jet financing (l)		CDN	2012	2.98	10	17
GE flight simulator financing (m)		USD	2015	3.50	13	17
Long-term debt					**3,780**	**3,679**
Capital lease obligations (n)					755	904
Total debt and capital leases					**4,535**	**4,583**
Unamortized discount					(16)	-
Unamortized debt issuance costs					(62)	(61)
Current portion					(505)	(468)
Long-term debt and capital leases					**$ 3,952**	**$ 4,054**

The Interest Rate in the table above is the actual rate as of December 31, 2010

Amounts reported below are before any transaction costs or fees recorded net against the carrying value of the debt.

Refer to note (f) for a description of a loan facility entered into on August 20, 2010 to refinance certain borrowings due in 2011 and 2012.

(a) Embraer aircraft financing amounts to US$1,046 as at December 31, 2010 (US$1,112 as at December 31, 2009). Principal and interest is repaid quarterly until maturity and the financing has both fixed and variable interest rates. The fixed rate financing of US$796 bears interest at rates ranging from 6.39% to 8.49% (6.39% to 8.49% as at December 31, 2009) and the variable rate financing of US$250 bears interest at a three month US LIBOR plus 1.9% (2.18% to 2.20% as at December 31, 2010 and 2.15% to 2.18% as at December 31, 2009). The financing can be repaid at any time, in whole or in part, with the payment of applicable fees. The financing is secured by the 60 delivered Embraer aircraft, with a carrying value of $1,527.

(b) Boeing aircraft financing amounts to US$388 as at December 31, 2010 (US$430 as at December 31, 2009), which is financed under loan guarantee support provided by the Export-Import Bank of the United States ("EXIM"). Principal and interest is repaid quarterly until maturity and the financing has both fixed and variable interest rates. The fixed rate financing of US$139 bears interest at rates ranging from 5.41% to 5.69% (5.41% to 5.69% as at December 31, 2009) and the variable rate financing of US$249 bears interest at a three month US LIBOR (0.29% to 0.31% as at December 31, 2010 and 0.25% to 0.28% as at December 31, 2009). The financing can be repaid at any time, in whole, with the payment of applicable fees. The financing is secured primarily by 5 delivered aircraft with a carrying value of $607.

(c) Boeing aircraft financing amounts to JPY16,872 as at December 31, 2010 (JPY18,671 as at December 31, 2009), which is financed under loan guarantee support provided by EXIM. Principal and interest is repaid quarterly until maturity and the financing bears interest at a three month JPY LIBOR (0.33% as at December 31, 2010 and 0.46% to 0.47% as at December 31, 2009). The financing can be repaid at any time, in whole, with the payment of applicable fees. The financing is secured primarily by 2 delivered aircraft with a carrying value of $225.

(d) In August 2010, the Corporation completed a private offering of two series of senior secured notes, consisting of US$600 senior secured first lien notes due 2015 (the "U.S. Dollar First Lien Notes") and $300 senior secured first lien notes due 2015 (the "Canadian Dollar First Lien Notes" and, collectively with the U.S. Dollar First Lien Notes, the “First Lien Notes”). In August 2010, the Corporation also completed a private offering of US$200 senior secured second lien notes due 2016 (the "Second Lien Notes" and, together with the First Lien Notes, the "Notes"). The Corporation received net proceeds of $1,075, after deduction of fees, expenses and discounts. The Corporation used approximately $729 of the net proceeds of the offerings to repay all of the outstanding debt under the Credit Facility described in note (e) below, including $29 for early payment fees.

The U.S. Dollar First Lien Notes bear interest at a rate of 9.250% per annum, the Canadian Dollar First Lien Notes bear interest at a rate of 10.125% per annum, and the Second Lien Notes bear interest at a rate of 12.000% per annum, in each case payable February 1 and August 1 of each year, beginning on February 1, 2011. The Corporation is required to pay additional special interest of 2% per annum on the Notes if (i) the priority lien debt value ratio (appraised value of collateral / priority lien debt) is less than 1.7:1.0, or (ii) the total appraised value ratio (total appraised value of collateral / secured debt) is less than 1.25:1.0.

The Corporation may redeem some or all of the First Lien Notes at any time on or after August 1, 2012 at certain established redemption prices, plus accrued and unpaid interest. At any time prior to August 1, 2012, Air Canada may redeem some or all of the First Lien Notes at a price equal to 100% of their principal amount plus a “make-whole” premium, and accrued and unpaid interest. At any time prior to August 1, 2012, Air Canada may redeem up to 35% of the aggregate principal amount of each issue of First Lien Notes with the proceeds of certain equity offerings, at established redemption prices, plus accrued and unpaid interest. In addition, at any time and from time to time prior to August 1, 2014, the Corporation may redeem, during any twelve-month period, up to 10% of the original aggregate principal amount of each issue of First Lien Notes at a redemption price of 103% of the principal amount, plus accrued and unpaid interest.

The Corporation may redeem some or all of the Second Lien Notes at any time on or after February 1, 2013 at certain established redemption prices, plus accrued and unpaid interest. At any time prior to February 1, 2013, Air Canada may redeem some or all of the Second Lien Notes at a price equal to 100% of their principal amount plus a “make-whole” premium, and accrued and unpaid interest. At any time prior to February 1, 2013, Air Canada may redeem up to 35% of the aggregate principal amount of the Second Lien Notes with the proceeds of certain equity offerings and by paying a redemption price equal to 112% of the principal amount of the Second Lien Notes being redeemed, plus accrued and unpaid interest thereon.

The prepayment options within the First Lien Notes and Second Lien Notes are considered embedded derivatives. The value of these embedded derivatives at December 31, 2010 is negligible. Upon specified change of control events or upon certain sales of assets, the Corporation must offer to repurchase the Notes.

The Notes are senior secured obligations of the Corporation, (i) secured on a first-lien basis (in the case of the First Lien Notes) or on a junior lien basis (in the case of the Second Lien Notes), subject to certain permitted liens, by accounts receivable, certain real estate interests, certain spare engines, ground equipment, certain airport slots and gate leaseholds, and the Corporation’s licenses to operate its Pacific routes and the airport slots and gate leaseholds utilized in connection with these Pacific routes and (ii) guaranteed on a senior secured basis by a subsidiary of the Corporation, subject to certain thresholds and exclusions.

(e) In July 2009, the Corporation received financing proceeds of $600, less financing fees of $20, under a secured term credit facility (the “Credit Facility”) pursuant to which the Corporation also issued warrants for the purchase of Air Canada’s Class A Variable Voting Shares or Class B Voting Shares as further described below. During the first quarter of 2010, the Corporation entered into arrangements with a new lender, comprised of a group of entities that are related to each other, to obtain a $100 increase to the facility. The addition to the facility increased, on a pro rata basis, the scheduled repayments, including the final payment. The Corporation received financing proceeds of $100, less financing fees of $2 in February 2010. No additional warrants were issued as a result of the increase to the credit facility. The Credit Facility was repayable in 16 consecutive quarterly instalments commencing in August 2010 of $30 with the final instalment of $120 due in July 2014.

As described above under (d), total outstanding debt under this facility of $700 was repaid upon the issuance of the Notes in August 2010. Based on the change in cash flows under the Credit Facility due to its repayment, the Corporation recorded a charge of $54 in interest expense in 2010, including early payment fees of $29 and $25 for the adjustment related to the unamortized portion of transaction costs and debt discounts.

Interest under the Credit Facility was charged at a rate based upon the greater of the bankers' acceptance rate or 3.00% plus 9.75% (12.75% as at December 31, 2009).

Under the Credit Facility, Air Canada issued to the lenders, concurrently with the first drawdown of $600, warrants for the purchase of Air Canada's Class A Variable Voting Shares or Class B Voting Shares representing an aggregate of 5% or 5 million of the total issued and outstanding shares as at the closing date of the Credit Facility, allocated among the lenders based on their pro rata lending commitments under the Credit Facility. These initial 5% warrants have an exercise price of $1.51 per share, are exercisable at any time and expire four years after the date of issuance. In the event that Air Canada did not grant additional security over certain assets within 90 days of closing, Air Canada was required to issue to the lenders additional warrants representing up to an additional 5% or 5 million of the total issued and outstanding shares (determined at the time of issuance of such additional warrants) with an average exercise price established based on a volume weighted average price over the 5 days before issuance, exercisable at any time and expiring four years after the date of issuance. These additional warrants were issued on October 19, 2009 and have an exercise price of $1.44 per share. The ascribed value of both the initial and additional warrants, totalling 10 million warrants, were included in Contributed surplus on the Consolidated Statement of Financial Position as at December 31, 2009 in the amount of $7.

(f) The Corporation has aircraft lease transactions with several special purpose entities that qualify as VIEs. The debt has a weighted average effective interest rate of approximately 8% (2009 - 8%). These aircraft have a carrying value of $698 (2009 - $798) 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$535 ($533) (US$633 ($662) as at December 31, 2009) is summarized as follows (in Canadian dollars):

	Final Maturity	2010	2009
Canadian Regional Jet	2011	$ 138	$ 211
Boeing 767-300	2011-2016	123	141
Airbus 319	2011-2014	170	192
Airbus 321	2017	102	118
Total		**$ 533**	**$ 662**

In August 2010, the Corporation concluded a credit agreement with GE Japan Corporation, PK Airfinance Japan ("GE Japan") for a senior secured term loan facility in the amount of up to approximately US$171 (the "Facility") to refinance amounts related to sixteen aircraft currently operated by Air Canada and leased from special purpose leasing entities which are consolidated by Air Canada. The credit agreement bears interest at a rate of one month US LIBOR plus 5.50%. On a consolidated basis, the draws on the Facility will be accounted for as a settlement of the special purpose leasing entities' debt related to these aircraft. Draw-downs under the facility are subject to certain customary terms and conditions.

The Facility will be available in 2011 to refinance up to US$129 of the amount related to eight Airbus A319 aircraft and four Boeing B767-300ER aircraft, with terms of seven and four years respectively. The Facility will also be available in 2012 to refinance up to US$42 of the amount related to four Airbus A319 aircraft, with a term of five years. As a result of this Facility, the amounts due under the existing debt maturities within the next 12 months that will be refinanced by the commitment on a long-term basis have been classified as long-term at December 31, 2010.

(g) The term loan financing amounts to US$75 principal outstanding at December 21, 2010 (US$75 as at December 31, 2009). The financing bears interest at one month LIBOR plus 5.98% (6.25% as at December 31, 2010 and 6.21% as at December 31, 2009) 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 the payment of applicable fees.

(h) Conditional sales agreements amount to US$124 principal outstanding at December 31, 2010 (US$133 as at December 31, 2009) on acquisitions of two A340-500 aircraft financed through conditional sales agreements. Principal and interest are paid quarterly until maturity in 2019. The purchase price instalments bear interest at a three month LIBOR rate plus 2.9% (3.20% - 3.29% as at December 31, 2010 and 3.15% - 3.31% as at December 31, 2009). The financing can be repaid at any time, in whole, with the payment of applicable fees. The carrying value of the two A340-500 aircraft provided as security under the conditional sales agreements is $185 as at December 31, 2010.

(i) The Corporation is the primary beneficiary of certain Fuel Facility Corporations in Canada. The debts bear interest at rates ranging from 2.93% to 5.09%. Of the total debts of $134, $101 relates to a bond payable at a fixed rate of interest of 5.09% which matures in 2032 with equal semi-annual payments of principal and interest. The remaining debts have varying maturities. The debts are 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 $155 as at December 31, 2010.

(j) Spare parts financing amounts to US$101 as at December 31, 2010 (US$132 as at December 31, 2009). Principal and interest are repaid quarterly until maturity in 2014, at a floating interest rate equal to the three month LIBOR rate plus the lender's incremental cost of funds rate and a margin of 3.00% (5.74% at December 31, 2010 and 5.73% at December 31, 2009). The financing can be repaid subsequent to the 36th monthly anniversary of the initial funding date, in whole or in part, with the payment of applicable fees. The loan is secured by spare parts and other assets with a carrying value of $214. The related financing agreements contain certain collateral value tests, performed on a monthly basis. These tests relate 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. There has not been a prepayment or additional collateral required as part of the collateral value test. This amount declines over time to nil upon the loan expiry.

(k) Spare engine financing amounts to US$63 as at December 31, 2010 (US$70 as at December 31, 2009). Principal and interest are paid quarterly until maturity in 2013, with 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% (3.70% at December 31, 2010 and 3.65% at December 31, 2009). The financing can be repaid at any time, in whole, with the payment of applicable fees. The loan is secured by 10 spare engines with a carrying value of $110.

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 in December 2011 on the next anniversary, assuming the engines are worth nil and no additional collateral has been provided, is $54 (US$54). There has not been a prepayment or additional collateral required as part of the current market value test. This amount declines over time to fifty percent of the original principal upon the loan expiry.

(l) Canadian Regional Jet financing amounts to $10 as at December 31, 2010 ($17 as at December 31, 2009). 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 1.70% (2.98% at December 31, 2010 and 2.13% at December 31, 2009). The financing can be repaid at any time, in whole or in part, with the payment of applicable fees. The loan is secured by four aircraft with a carrying value of $21.

(m) GE flight simulator financing amounts to US$13 as at December 31, 2010 (US$16 as at December 31, 2009). Principal and interest are repaid quarterly until maturity in 2015 at a floating interest rate equal to the six month LIBOR rate plus 2.75% (3.50% as at December 31, 2010 and 3.19% at December 31, 2009). The financing is pre-payable on any interest payment date after September 21, 2009, without the payment of applicable fees. The debt is secured primarily by certain flight training equipment with a current carrying value of $26.

(n) Capital leases, related to facilities and 40 aircraft, total $755 ($82 and US$670 ($904 ($83 and US$784) as at December 31, 2009). The debt has a weighted average effective interest rate of approximately 8% and final maturities range from 2013 to 2033. During 2010, the Corporation recorded interest expense on capital lease obligations of $75 (2009 - $102).

Certain aircraft lease agreements contain a fair value test, beginning on July 1, 2009, and annually thereafter until lease expiry. This test relates to 24 aircraft under lease of which 21 are accounted for as capital leases and the remainder relates to leasing entities that are consolidated under AcG-15. Under the test, the Corporation may be required to prepay certain lease amounts or to provide additional collateral, based on aircraft fair values, as of the date of the test. 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, 2011, assuming the related aircraft are worth nil, is $457 (US$459). The maximum payable amount declines over time to nil upon lease expiry. In September 2010 additional collateral of $48 in the form of cash deposits were made under the fair value test for certain aircraft leases pertaining to A340 and A330 aircraft. This cash outflow is reported in Investing on the consolidated statement of cash flow.

Interest paid on Long-term debt and capital leases in 2010 by the Corporation was $276 (2009 - $326).

Refer to Note 14 for the Corporation's principal and interest repayment requirements as at December 31, 2010.

7. FUTURE INCOME TAXES

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

	2010		2009	
Liability				
Tax payable (a)	$	(5)	$	(10)
Future income tax liability (b)		(80)		(85)
	$	**(85)**	**$**	**(95)**

(a) **Taxes Payable**

Air Canada has a cash tax payable of $5 of which $2 is included in Accounts payable and accrued liabilities and the remainder is recorded in Other long-term liabilities.

(b) **Future Income Tax Liability**

It has been assumed that certain intangibles and other assets with no tax cost and a carrying value of approximately $615, 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 $80.

The future income tax assets and liabilities are as follows:

	2010		2009	
Future tax assets				
Loss carryforwards	$	496	$	689
Post-employment obligations		287		322
Accounting provisions not currently deductible for tax		101		144
Tax basis of property and equipment over book basis		41		-
Deferred gains		35		24
Other		111		91
Total future tax assets		**1,071**		**1,270**
Future tax liabilities				
Book basis of property and equipment over tax basis		-		153
Intangible assets		110		120
Other		53		39
Total future tax liabilities		**163**		**312**
Net future tax assets		**908**		**958**
Less valuation allowance (c)		988		1,043
Net recorded future income tax liability	**$**	**(80)**	**$**	**(85)**

(c) **Valuation Allowance**

The Corporation has determined that it is more likely than not that future income tax assets of $988 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 provision for (recovery of) income taxes differs from the amount that would have resulted from applying the statutory income tax rate to income before income tax expense as follows:

	2010	2009
Provision (recovery) based on combined federal and provincial rates	$ 47	$ (9)
Non-taxable portion of capital gains	(23)	(105)
Non-deductible expenses (non-taxable income)	(11)	7
Effect of tax rate changes on future income taxes	7	76
Other	(18)	(15)
	2	(46)
Valuation allowance (refer to (c) above)	46	41
Provision for (recovery of) income taxes	**$ 48**	**$ (5)**

Significant components of the Provision for (recovery of) income taxes are as follows:

	2010	2009
Current tax recovery	$ (4)	$ (7)
Future income tax recovery relating to temporary differences	(1)	(115)
Future income tax expense from tax rate changes	7	76
Future income tax expense related to the valuation allowance	46	41
Provision for (recovery of) income taxes	**$ 48**	**$ (5)**

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 2010 by the Corporation were $4 (2009 – recovery of $5).

The balances of tax attributes as at December 31, 2010, namely the balances of non-capital loss carryforwards, vary amongst different taxing jurisdictions. The following are the Federal non-capital tax loss expiry dates:

	Tax Losses
2026	$ 2
2027	524
2028	904
2029	431
2030	11
	$ 1,872

There are no net capital losses as at December 31, 2010 (2009 - nil).

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 as well as employees of the Corporation who were contractually assigned to Aeroplan until June 1, 2009.

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 Aveos and are members of Corporation-sponsored defined benefit pension plans and also participate in Corporation-sponsored health, life and disability benefit plans. Other Corporation employees performed work for Aeroplan until June 1, 2009, the date of transition to employment at Aeroplan and then ceased to accrue benefits under the Corporation-sponsored defined benefit pension plans and under the Corporation-sponsored health, life and disability 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 Aveos and Aeroplan for those employees contractually assigned. The cost recovery includes current service costs for pensions for Aveos, past service cost to Aeroplan for pensions and a portion of post-employment and post-retirement benefits to Aveos, based on actuarial calculation for their specific employee group. This cost recovery amounted to $27 for the year ended December 31, 2010 (2009 - $32).

In May 2009, Air Canada and Aeroplan reached an agreement with the Canadian Auto Workers (CAW) Local 2002 providing for a process for the approximately 750 Air Canada employees then assigned to and working in the Aeroplan contact centres to choose to transition to employment at Aeroplan, effective June 1, 2009, or to remain employees of Air Canada. Employees at Air Canada work locations who became surplus to Air Canada's needs due to employees who were senior to them and then working at Aeroplan contact centres choosing to remain employees of Air Canada were given the option to transition to employment at Aeroplan. Effective October 4, 2009, all affected employees had completed the transition to Aeroplan. For those employees who transferred to Aeroplan, their service, which largely determines benefit levels under the Air Canada pension and other employee benefit plans, ceased to accrue as of the date of employment with Aeroplan. Air Canada and Aeroplan continue to discuss the terms surrounding the transfer of pension benefits and certain implications relating to same remain to be resolved. Air Canada continues to retain plan assets and report liabilities for services accrued for the transferred Aeroplan employees as at December 31, 2010, pending final determination of this matter. Post transition, Aeroplan is contributing current service costs in their pension plan for service accruing with Aeroplan.

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. In 2010, the Office of the Superintendent of Financial Institutions ("OSFI") provided its approval for the transfer of pension assets and liabilities from the Air Canada pension plans to the Aveos pension plan for certain non-unionized employees of Air Canada who became employees of Aveos effective October 16, 2007. The amount of the asset transfer was established as a pro-rata share, based on solvency liabilities, of assets in the Air Canada pension plans as at October 16, 2007. The resulting amount was adjusted by investment returns and benefit payments until the actual date funds were transferred. The transaction, completed in the second quarter of 2010, included an asset transfer of $43, as well as a reduction of $43 to the benefit obligation, in addition to transferring cash payments previously made under the Pension and Benefits Agreement of $2. An amount of $1 has also been accrued relating to the Pension and Benefits Agreement. The settlement was recognized in the unamortized actuarial gains (losses) upon the annual remeasurement at December 31, 2010 and will be amortized over the expected average remaining service life as appropriate.

As described in Note 2B, 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.

Pension Plan Cash Funding Obligations

As at January 1, 2010, based on the actuarial valuations which were used to determine certain pension funding requirements in 2010, the aggregate solvency deficit in the registered pension plans was $2,728. The next required valuations are as of January 1, 2011, and will be completed in the first half of 2011, but as described below, they will not increase the 2011 pension past service cost funding obligations.

In July 2009, the Government of Canada adopted the Air Canada 2009 Pension Regulations. The Air Canada 2009 Pension Regulations relieve Air Canada from making any past service contributions (i.e. special payments to amortize the plan deficits) to its ten domestic defined benefit registered pension plans in respect of the period beginning April 1, 2009 and ending December 31, 2010. Thereafter, in respect of the period from January 1, 2011 to December 31, 2013, the aggregate annual past service contribution shall equal the lesser of (i) $150, $175, and $225 in respect of 2011, 2012, and 2013, respectively, on an accrued basis, and (ii) the maximum past service contribution permitted under the Canadian Income Tax Act.

The Air Canada 2009 Pension Regulations were adopted during the third quarter of 2009 in coordination with pension funding agreements reached with all of the Corporation's Canadian-based unions ("the Pension MOUs"). Pursuant to the Pension MOUs, on October 26, 2009, Air Canada issued to a trust, 17,647,059 Class B Voting Shares. This number of shares represented 15% of the shares of Air Canada issued and outstanding as at the date of the Pension MOUs and the date of issuance (in both cases after taking into account such issuance). All net proceeds of sale of such shares by the trust are to be contributed to the pension plans. On October 26, 2009, upon the issuance of the shares to the trust, the Corporation recorded a decrease to its Pension and other benefit liabilities in the amount of $28 and an increase to Share capital in the amount of $28. For so long as the trust continues to hold at least 2% of the issued and outstanding shares of Air Canada, the trustee will have the right to designate one nominee (who shall not be a member or officer of any of Air Canada's Canadian-based unions) to Air Canada's board of directors, subject to completion of Air Canada's usual governance process for selection and confirmation of director nominees. Current service contributions will continue to be made in the normal course while the Air Canada 2009 Pension Regulations are in effect.

After consideration of the effect of the Air Canada 2009 Pension Regulations as outlined above, employer pension funding contributions during 2010 amounted to $243.

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 in the discount rate of 0.25% results in a decrease of $411 to the pension obligation and $9 to the pension expense. A decrease in the discount rate of 0.25% results in an increase of $411 to the pension obligation and $8 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, and historical returns, to the extent that the past is indicative of the expected long-term, prospective rate. There can be no assurance that any of the plans will earn the expected rate of return.

US Health Care Reform

The Corporation is a sponsor of certain US post-retirement health-care plans that were impacted by US health care reform legislation enacted in March 2010. Under this legislation, changes include the removal of lifetime benefit maximums. This legislation has the impact of increasing the Corporation's post-retirement benefit obligation by $55. The full amount is recognized as an actuarial loss and will be recognized in pension expense over the expected average remaining service life commencing in 2011.

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	
	2010	2009	2010	2009
Change in benefit obligation				
Benefit obligation at beginning of year	$ 11,937	$ 10,729	$ 851	$ 790
Current service cost	160	123	53	50
Interest cost	748	760	53	54
Employees' contributions	76	78	-	-
Benefits paid	(770)	(724)	(59)	(58)
Actuarial loss	1,501	1,015	110	33
Foreign exchange gain	(33)	(44)	(8)	(18)
	13,619	11,937	1,000	851
Change in plan assets				
Fair value of plan assets at beginning of year	10,751	9,717	-	-
Actual return on plan assets	1,270	1,296	-	-
Employer contributions	243	389	59	58
Employees' contributions	76	78	-	-
Pension MOUs share contribution	-	28	-	-
Benefits paid	(770)	(724)	(59)	(58)
Foreign exchange loss	(28)	(33)	-	-
	11,542	10,751	-	-
Deficit at end of year	**2,077**	**1,186**	**1,000**	**851**
Unrecognized past service costs	(2)	(2)	-	-
Unrecognized net actuarial gain (loss)	(2,104)	(1,079)	129	258
Valuation allowance against accrued benefit	1	15	**-**	**-**
Net benefit obligation (asset)	**$ (28)**	**$ 120**	**$ 1,129**	**$ 1,109**
Weighted average assumptions used to determine the accrued benefit liability				
Discount rate	5.50%	6.40%	4.25 - 5.50%	4.75 - 6.40%
Rate of compensation increase [(1)]	2.50%	2.50%		

[(1)] A rate of compensation increase of 0% plus merit was used for 2010 in determining the net benefit obligation for the pension plan and 2.50% plus merit 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:

	2010	2009
Domestic registered plans	$ 1,238	$ 496
US, UK, and Japan	98	78
Supplementary plans	755	653
	$ 2,091	**$ 1,227**

The net deficit, on an accounting basis, at December 31, 2010 for pension benefits was $2,077 (2009 - $1,186). The increase in the accounting deficit is mainly the result of the increase to the accrued benefit obligation resulting from the decrease in the discount rate and to some extent offset by the higher than expected returns on plan assets.

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

	2010	2009
Accrued pension benefit asset in Deposits and other assets	$ 28	$ -
Accrued benefit liabilities in Pension benefits obligation	$ -	$ 120
Other employee future benefits	1,129	1,109
Net benefit obligation	**1,129**	**1,229**
Current portion	(70)	(66)
Pension and other benefit liabilities	**$ 1,059**	**$ 1,163**

The current portion of the net benefit obligation represents an estimate of other employee future benefits claims to be paid during 2011. The current portion is included in Accounts payable and accrued liabilities.

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	
	2010	2009	2010	2009
Components of Net Periodic Pension Cost				
Current service cost	$ 160	$ 123	$ 53	$ 50
Interest cost	748	760	53	54
Actual return on plan assets	(1,270)	(1,296)	-	-
Actuarial loss on benefit obligation	1,501	1,015	110	33
Costs arising in the year	**1,139**	**602**	**216**	**137**
Differences between costs arising in the year and costs recognized in the year in respect of:				
Return on plan assets	469	460	-	-
Actuarial gain	(1,499)	(1,068)	(132)	(62)
Increase(decrease) in valuation allowance provided against accrued benefit asset	(14)	6	-	-
Net periodic benefit cost of plans	**95**	**-**	**84**	**75**
Amount charged to Aveos and Aeroplan	(16)	(20)	(11)	(12)
Net defined benefit pension and other employee benefits expense	**$ 79**	**$ (20)**	**$ 73**	**$ 63**
Weighted average assumptions used to determine the accrued benefit cost				
Discount rate	6.40%	7.35%	5.75 - 6.40%	6.25 - 7.35%
Expected long-term rate of return on plan assets	7.00%	7.15%	n/a	n/a
Rate of compensation increase (1)	2.50%	2.50%		

(1) A rate of compensation increase of 0% plus merit in 2010 was used in determining the net benefit pension expense and 2.5% plus merit 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 2010 (2009 - 8.25%). 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 $2 and the obligation by $47. A one percentage point decrease in assumed health care trend rates would have decreased the service and interest costs by $2 and the obligation by $46.

Composition of Pension Plan Assets

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

	2010	2009	Target Allocation [1]
Non-matched assets (mainly equities)	54.0%	55.9%	54.4%
Matched assets (mainly Canadian bonds)	46.0%	43.4%	45.6%
Cash and temporary investments	0.0%	0.7%	0.0%
	100.0%	**100.0%**	**100.0%**

[1] Weighted average of the Master Trust Fund target allocation (99% of Domestic Registered Plan assets) and the Bond Fund target allocation. The Bond Fund serves the purpose of altering the asset mix of some of the participating plans. These plans exhibit characteristics that differ from the majority of the participating plans, which are solely invested in the Master Trust.

Domestic Registered Plans

For the Domestic Registered Plans, the investments conform to the Statement of Investment Policy and Objectives of the Air Canada Pension Funds, as amended during 2010. The investment return objective is to achieve a total annualized rate of return that exceeds by a minimum of 1.0% before investment fees on average over the long term (i.e. 10 years) the total annualized return that could have been earned by passively managing the Liability Benchmark. The Liability Benchmark, which is referenced to widely used Canadian fixed income performance benchmarks (DEX), is composed of a mix of the DEX Universe Provincial Bond Index, DEX Long Term Provincial Bond Index and DEX Real Return Bond Index that closely matches the characteristics of the pension liabilities.

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

- Non-matched assets are mainly equities, and are required to be diversified among industries and economic sectors. Foreign equities can comprise 31% to 37% of the total market value of the Master Trust Fund. Limitations are placed on the overall allocation to any individual security at both cost and market value. Investments in non-publicly traded securities and in non-traditional asset classes are allowed up to 10% of the total market value of the Master Trust Fund.

- Matched assets are mainly Canadian bonds, oriented toward long term investment grade securities rated "BBB" 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.

Derivatives are permitted provided that they are used for hedging a particular risk (including interest rate risk related to pension liabilities) or to create exposures to given markets and currencies and that counterparties have a minimum credit rating of A. As of December 31, 2010, a 15% derivatives exposure to matched assets is in place to hedge interest rate risk related to pension liabilities.

Defined Contribution Plans

The Corporation's management, administrative and certain unionized employees may participate in defined contribution plans. Contributions range from 3% to 6% of annual pay for those employees in Canada and 3% to 7% of annual pay for those participants in the United Kingdom. The Corporation contributes an equal amount. The Corporation's expense for defined contribution plans amounted to $2 for the year ended December 31, 2010 (2009 - $1).

9. OTHER LONG-TERM LIABILITIES

		2010	2009
Unfavourable contract liability on aircraft leases (a)		$ 25	$ 31
Proceeds from contractual commitments (b)		107	107
Aircraft rent in excess of lease payments	Note 2W	32	41
Long-term employee liabilities (c)		25	33
Workplace safety and insurance board liabilities		42	40
Deferred gains on aircraft sale leasebacks		62	69
Collateral held in leasing arrangements and other deposits		46	33
Other (d)		143	101
		$ **482**	**$ 455**

(a) 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.

(b) Proceeds from contractual commitments represent non-refundable proceeds received, net of related costs and deposits, in consideration of various contractual commitments and will be recognized as reductions in the cost of those contractual commitments when incurred.

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

	2010	2009
Beginning of year	$ 61	$ 54
Interest accretion	2	3
Charges (credits) recorded in wages, salaries, and benefits	(2)	30
Amounts disbursed	(21)	(26)
End of year	40	61
Current portion in Accounts payable and accrued liabilities	(15)	(28)
	$ **25**	**$ 33**

The Corporation offers certain severance programs to certain employees from time to time. The cost of these programs is recorded within Operating expenses. As a result of a review of the outstanding provisions, it was determined that a portion of the provision amounting to $3 was no longer required and was adjusted in 2010.

(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 asset retirement obligations including all Fuel Facility Corporations in Canada in which the Corporation participates, the Corporation has recorded an obligation of $10 ($40 undiscounted) (2009 - $9 ($40 undiscounted)) representing the present value of the estimated decommissioning and remediation obligations at the end of the lease using an 8% (2009 - 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"). The Long-term Incentive Plan provides for the grant of options and performance share units to senior management and officers of Air Canada. 19,470,294 shares are authorized for issuance under the Long-term Incentive Plan in respect of either of stock options or performance share units.

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 are as follows:

	2010	2009
Compensation expense ($ millions)	$ 1	$ 2
Number of stock options granted to Air Canada employees	50,000	2,330,000
Weighted average fair value per option granted ($)	$ 1.06	$ 1.06
Aggregated fair value of options granted ($ millions)	$ -	$ 2
Weighted average assumptions:		
Risk-free interest rate	2.55%-3.23%	1.73%-3.14%
Expected volatility	80.0%-83.6%	83.0%-84.7%
Dividend yield	0%	0%
Expected option life (years)	4.50	4.50

A summary of the Long-term Incentive Plan option activity is as follows:

	2010		2009	
	Options	Weighted Average Exercise Price/Share	Options	Weighted Average Exercise Price/Share
Beginning of year	3,963,474	$ 8.66	1,701,447	$ 19.14
Granted	50,000	1.85	2,330,000	1.32
Exercised	(5,625)	1.59	-	-
Forfeited	(719,918)	19.63	(67,973)	19.44
Outstanding options, end of year	**3,287,931**	**$ 6.17**	**3,963,474**	**$ 8.66**
Options exercisable, end of year	**1,038,986**	**$ 14.42**	**551,544**	**$ 19.60**

		2010 Outstanding Options			2010 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	566,457	3	$ 21.00	566,457	$ 21.00
$11.08 - $18.60	2014	345,474	4	14.89	180,404	14.89
$8.51	2015	11,000	5	8.51	2,750	8.51
$0.97 - $1.59	2016	2,315,000	6	1.32	289,375	1.32
$1.78 - $1.91	2017	50,000	7	1.85	-	-
		3,287,931		**$ 6.17**	**1,038,986**	**$ 14.42**

		2009 Outstanding Options			2009 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	1,146,400	4	$ 21.00	429,900	$ 21.00
$11.08 - $18.60	2014	481,074	5	14.73	120,269	14.73
$8.51	2015	11,000	6	8.51	1,375	8.51
$0.97 - $1.59	2016	2,325,000	7	1.32	-	-
		3,963,474		**$ 8.66**	**551,544**	**$ 19.60**

Performance Share Units

The Long-term Incentive Plan also includes performance share units ("PSUs"). The vesting term of PSUs is three years and generally incorporates performance vesting features based upon achievement of earnings targets established over the vesting period. Subject to vesting and other conditions, each PSU entitles 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. Certain PSUs granted may only be redeemed for Air Canada shares purchased on the secondary market and/or equivalent cash at the discretion of the Board of Directors. The remaining PSUs may be redeemed for Air Canada shares issued from treasury or purchased on the secondary market and/or equivalent cash at the discretion of the Board of Directors.

The compensation expense related to PSUs in 2010 was $4 (2009 was less than $1).

A summary of the Long-term Incentive Plan performance share unit activity is as follows:

	2010	2009
Beginning of year	1,653,064	1,671,068
Granted	2,532,337	11,591
Forfeited	(595,952)	(29,595)
Outstanding PSUs, end of year [(1)]	3,589,449	1,653,064

[(1)] As at December 31, 2010, all PSUs remain non-vested. Included in the total number of PSUs outstanding, 3,586,949 PSUs will entitle the employee to receive, at the discretion of the Board of Directors, Air Canada shares purchased on the secondary market and/or equivalent cash (2009 – 1,091,218). As at December 31, 2010, the liability related to these PSUs is $5.

Refer to Note 15 for a description of derivative instruments used by the Corporation to hedge the cash flow exposure to the PSUs granted.

Employee Share Purchase Plan

Eligible employees can participate in the employee share purchase plan under which employees can 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 2010, the Corporation recorded compensation expense of less than $1 (2009 – less than $1).

11. SHAREHOLDERS' EQUITY

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

As at December 31		2010	2009
Issued and outstanding			
Class A variable voting shares		64,275,209	56,586,112
Class B voting shares		214,697,175	221,560,947
Total issued and outstanding		**278,972,384**	**278,147,059**
Potential common shares			
Warrants (refer to note below)		89,430,300	90,250,000
Stock options	Note 10	3,287,931	3,963,474
Performance share units	Note 10	2,500	561,846
Total potential common shares		**92,720,731**	**94,775,320**

The changes during 2010 in the number of issued and outstanding shares and their recorded value, net of issue costs, were as follows:

For the year ended December 31, 2010	Number of shares	Value
Issued, beginning of year	278,147,059	$ 532
Shares issued on the exercise of stock options	5,625	-
Shares issued on the exercise of warrants	819,700	2
Issued, end of year	**278,972,384**	**$ 534**

Common Shares

As at December 31, 2010, 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 (within the meaning of the *Canada Transportation Act*). 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.

Warrants

A summary of warrants outstanding as at December 31, 2010 is as follows:

Grant date	Number of Warrants Outstanding	Exercise Prices	Expiry Dates	Remaining Life (Years)
30-Jul-09	5,000,000	$1.51	30-Jul-13	2.6
19-Oct-09	5,000,000	$1.44	19-Oct-13	2.8
27-Oct-09	79,430,300	$2.20	27-Oct-12	1.8
	89,430,300			

During 2009, a total of 90,250,000 warrants were issued, of which 10,000,000 were issued in conjunction with the Credit Facility as described in Note 6(e) and 80,250,000 were issued in conjunction with the Share and Warrant Public Offering as described below. During 2010, a total of 819,700 warrants were exercised for cash consideration of $2.

Share and Warrant Public Offering

On October 27, 2009 Air Canada completed a bought deal public offering pursuant to which it sold to an underwriting syndicate 160,500,000 units (the "Units") of Air Canada at a price of $1.62 per Unit for aggregate gross proceeds to Air Canada of $260 (net proceeds of $249 after expenses and underwriter fees).

Each Unit is comprised of one Class A variable voting share (the "Variable Voting Shares") or one Class B voting share (the "Voting Shares", and, together with the Variable Voting Shares, the "Shares") of Air Canada, and one half of one share purchase warrant. Each whole share purchase warrant is defined as a "Warrant". Each Warrant will entitle the holder thereof to acquire one Variable Voting Share or one Voting Share (each, a "Warrant Share") at an exercise price of $2.20 per Warrant Share, at any time prior to 36 months following October 27, 2009. In the event that, prior to the time of expiry of the Warrants, the 20-day volume weighted average trading price of the Variable Voting Shares on the Toronto Stock Exchange ("TSX") is equal to or greater than $4.00 or the 20-day volume weighted average trading price of the Voting Shares on the TSX is equal to or greater than $4.00 (each, an "Acceleration Event"), Air Canada shall have the right, at its option, within 10 business days after the Acceleration Event, to accelerate the time of expiry of the Warrants.

The recorded values related to the Shares and Warrants were split based on their relative fair values. The value ascribed to Share capital was $230 and the value ascribed to Contributed surplus related to the Warrants was $19.

12. EARNINGS PER SHARE

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

(in millions, except per share amounts)	2010	2009
Numerator:		
Numerator for basic and diluted earnings per share:		
Net income (loss)	$ 107	$ (24)
Denominator:		
Weighted-average shares	278	132
Effect of potential dilutive securities:		
Contingently issuable shares	-	5
Warrants	13	-
Stock options	1	-
Performance share units	-	-
	14	5
Add back anti-dilutive impact	-	(5)
Adjusted denominator for diluted earnings per share	**292**	**132**
Basic earnings (loss) per share	**$ 0.38**	**$ (0.18)**
Diluted earnings (loss) per share	**$ 0.37**	**$ (0.18)**

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. Contingently issuable shares relate to the dilutive impact of the shares issued under the Pension MOUs, as described in Note 8, from the date of the agreement in July 2009 to the date of their issuance on October 26, 2009.

Excluded from the 2010 calculation of diluted earnings per share were 2,368,152 (2009 – 3,724,659) outstanding options where the options' exercise prices were greater than the average market price of the common shares for the year. The 2,500 equity settled performance share units outstanding at December 31, 2010 (2009 – 561,846) were also excluded as management determined that the performance vesting criteria will not be met. All outstanding warrants were included in the 2010 calculation of diluted earnings per share. In 2009 there were 90,001,652 warrants excluded from the calculation of diluted earnings per share as the warrants' exercise prices were greater than the average market price of the common shares for the year.

13. SEGMENT INFORMATION

A reconciliation of the total amounts reported by geographic region for Passenger revenue and Cargo revenue on the Consolidated Statement of Operations is as follows:

Passenger revenues	2010	2009
Canada	$ 3,790	$ 3,591
US Transborder	1,797	1,641
Atlantic	1,962	1,721
Pacific	1,087	829
Other	791	717
	$ 9,427	**$ 8,499**

Cargo revenues	2010	2009
Canada	$ 69	$ 63
US Transborder	17	14
Atlantic	164	127
Pacific	164	112
Other	52	42
	$ 466	**$ 358**

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, 2010, the Corporation has outstanding purchase commitments with The Boeing Company ("Boeing") for the acquisition of 37 Boeing 787 aircraft. The Corporation also has purchase rights for 18 Boeing 777, purchase options for 13 Boeing 787 aircraft and purchase rights for 10 Boeing 787 aircraft. In January 2011, Boeing announced that it had delayed the first delivery of the Boeing 787 aircraft from the first quarter of 2011 to the third quarter 2011. The Corporation's first Boeing 787 aircraft is currently scheduled for delivery in the second half of 2013. The potential impact of Boeing's January 2011 announcement on the Corporation's Boeing 787 aircraft deliveries, if any, has not yet been determined.

For the firm aircraft orders, the Corporation has financing commitments from Boeing and the engine manufacturer covering 31 of the 37 Boeing 787 aircraft. The financing terms for 28 out of the 31 covered aircraft is for 80% of the aircraft delivery price and the term to maturity is 12 years with straight-line principal repayments. For the remaining three out of the 31 covered aircraft, the financing under the commitment covers up to 90% of the capital expenditure and the term to maturity is 15 years with principal payments made on a mortgage style basis resulting in equal instalment payments of principal and interest over the term to maturity.

Capital Commitments

The estimated aggregate cost of the future firm Boeing 787 aircraft deliveries and other capital purchase commitments as at December 31, 2010 approximates $4,504 (of which $2,962 is subject to committed financing, subject to the fulfillment of certain terms and conditions). US dollar amounts are converted using the December 31, 2010 noon day rate of CDN$0.9946. 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, 2010. Other capital purchase commitments relate principally to building and leasehold improvement projects.

	2011	2012	2013	2014	2015	Thereafter	Total
Capital Commitments	$ 86	$ 112	$ 700	$ 932	$ 624	$ 2,050	$ 4,504

Operating Lease Commitments

As at December 31, 2010 the future minimum lease payments under existing operating leases of aircraft and other property amount to $2,217 using year end exchange rates.

	2011	2012	2013	2014	2015	Thereafter	Total
Aircraft	$ 335	$ 316	$ 295	$ 230	$ 178	$ 554	$ 1,908
Other property	47	39	38	36	32	117	309
Total	**$ 382**	**$ 355**	**$ 333**	**$ 266**	**$ 210**	**$ 671**	**$ 2,217**

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 25 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:

	2011	2012	2013	2014	2015	Thereafter	Total
Jazz flow-through leases	$ 76	$ 76	$ 76	$ 76	$ 74	$ 449	$ 827

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 commitment for the next 12 months under the Jazz CPA is approximately $749 (2009 - $732) and under the capacity purchase agreements with other regional carriers is $29 (2009 - $29). Based upon amended terms as described in Note 2D, the Jazz CPA expires December 31, 2020. The rates under the Jazz CPA are subject to change based upon, amongst other things, changes in Jazz's costs and the results of benchmarking exercises, which compare Jazz costs to other regional carriers, one of which is currently underway. The results of this benchmarking will be implemented with retroactive effect to January 1, 2010.

Maturity Analysis

Principal and interest repayment requirements as at December 31, 2010 on Long-term debt and capital lease obligations are as follows:

Principal	2011	2012	2013	2014	2015	Thereafter	Total
Long-term debt obligations	$ 514	$ 293	$ 363	$ 200	$ 1,103	$ 1,307	$ 3,780
Capital lease obligations	96	105	94	90	144	226	755
	$ 610	**$ 398**	**$ 457**	**$ 290**	**$ 1,247**	**$ 1,533**	**$ 4,535**

Interest	2011	2012	2013	2014	2015	Thereafter	Total
Long-term debt obligations	$ 218	$ 199	$ 186	$ 171	$ 126	$ 103	$ 1,003
Capital lease obligations	68	59	49	39	29	85	329
	$ 286	**$ 258**	**$ 235**	**$ 210**	**$ 155**	**$ 188**	**$ 1,332**

Principal repayments in the table above exclude transaction costs and discounts of $78 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, 2010 and does not include the impact of the loan facility with GE Japan as described in Note 6. If drawn upon, this loan facility will reduce the net cash flows by the amount of the related debt maturities refinanced in 2011 and 2012 of $125 and $43, respectively, offset by the principal and interest repayments under the loan facility.

	2011	2012	2013	2014	2015	Thereafter	Total
Long-term debt obligations	$ 732	$ 492	$ 549	$ 371	$ 1,229	$ 1,410	$ 4,783
Capital lease obligations	164	164	143	129	173	311	1,084
Accounts payable and accrued liabilities	1,182	-	-	-	-	-	1,182
	$ 2,078	**$ 656**	**$ 692**	**$ 500**	**$ 1,402**	**$ 1,721**	**$ 7,049**

Minimum Committed Purchase of Aeroplan Miles

The CPSA 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 2011 is $216. The annual commitment is based on 85% of the average total Aeroplan Miles® actually issued in respect of Air Canada flights or Air Canada airline affiliate products and services in the three preceding calendar years. During 2010, the Corporation purchased $262 from Aeroplan.

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Summary of Financial Instruments

	Carrying Amounts					
	December 31, 2010					December 31, 2009
	Financial instruments classification					
	Held for trading	Held to maturity	Loans and receivables	Liabilities at amortized cost	Total	
Financial Assets						
Cash and cash equivalents	$ 1,090	$ -	$ -	$ -	$ 1,090	$ 1,115
Short-term investments	1,102	-	-	-	1,102	292
Restricted cash	80	-	-	-	80	78
Accounts receivable	-	-	641	-	641	701
Collateral deposits for fuel derivatives	-	-	-	-	-	43
Deposits and other assets						
Restricted cash	130	-	-	-	130	121
Asset backed commercial paper	29	-	-	-	29	29
Aircraft related and other deposits	-	185	-	-	185	256
Derivative instruments						
Fuel derivatives	33	-	-	-	33	-
Share forward contracts	9	-	-	-	9	-
Interest rate swaps	13	-	-	-	13	11
	$ 2,486	$ 185	$ 641	$ -	$ 3,312	$ 2,646
Financial Liabilities						
Accounts payable	$ -	$ -	$ -	$ 1,179	$ 1,179	$ 1,215
Current portion of long-term debt and capital leases	-	-	-	505	505	468
Long-term debt and capital leases	-	-	-	3,952	3,952	4,054
Derivative instruments						
Fuel derivatives	-	-	-	-	-	31
Foreign exchange derivatives	3	-	-	-	3	4
	$ 3	$ -	$ -	$ 5,636	$ 5,639	$ 5,772

There have been no changes in classification of financial instruments since December 31, 2009.

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 $11 (2009 - $10), 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, $7 (2009 - $7) have 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

	2010	2009
Fuel derivatives not under hedge accounting	$ (11)	$ 102
Other	8	(7)
Gain (loss) on financial instruments recorded at fair value [(1)]	**$ (3)**	**$ 95**

[(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, share-based compensation risk and market risk through the use of various interest rate, foreign exchange, fuel and other derivative financial instruments. The Corporation uses derivative financial instruments only for risk management purposes, 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.

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, including the Corporation's own credit risk and the credit risk of the counterparty.

<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 obligations 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 but allows flexibility in the short-term to adjust to prevailing market conditions. The ratio at December 31, 2010 is 69% fixed and 31% floating, including the effects of interest rate swap positions (59% and 41%, respectively as at December 31, 2009).

The following are the current derivatives employed in interest rate risk management activities and the adjustments recorded during 2010:

- During 2010, the interest rate swap agreement relating to the Credit Facility as described in Note 6(e) was terminated. The fair value of this contract at termination was nil ($1 in favour of the counterparty at December 31, 2009). During 2010, a gain of $1 (2009 – loss of $1) was recorded in Gain on financial instruments recorded at fair value related to this derivative.

- As at December 31, 2010, the Corporation had two interest rate swap agreements in place with terms to July 2022 and January 2024 relating to two B767 aircraft financing agreements with an aggregate notional value of $80 (US$80) (2009 - $92 (US$88)). 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, 2010 was $13 in favour of the Corporation (2009 - $12 in favour of the Corporation). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During 2010, a gain of $6 was recorded in Gain on financial instruments recorded at fair value related to these derivatives (2009 - $9 loss).

Interest income includes $15 (2009 - $10) 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 an annual US dollar shortfall from operations. In order to mitigate this imbalance, the Corporation has adopted the practice of converting excess revenues from offshore currencies into US dollars. In 2010, this conversion generated coverage of approximately 32% of the imbalance. The remaining 68% was covered through the use of a variety of foreign exchange derivatives, including spot transactions and US dollar investments, 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 following are the current derivatives employed in foreign exchange risk management activities and the adjustments recorded during 2010:

- As at December 31, 2010, the Corporation had outstanding foreign currency option agreements to purchase US dollars against Canadian dollars on $223 (US$224) and Euro dollars against Canadian dollars on $15(EUR 11) which mature in 2011 (2009 - $99 (US$95)). The fair value of these foreign currency contracts as at December 31, 2010 was $3 in favour of the counterparties (2009 - $4 in favour of the counterparties). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During 2010, a gain of $2 was recorded in Foreign exchange gain (loss) related to these derivatives (2009 - $7 loss).

Stock-based Compensation Risk

The Corporation issues stock-based compensation to its employees in the form of stock options and PSUs as described in Note 10. Each PSU entitles the employees to receive a payment in the form of one Air Canada 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.

Stock-based compensation risk refers to the risk that future cash flows to settle the PSUs will fluctuate because of changes in the Corporation's share price. To hedge the exposure to the PSU plan, the Corporation entered into share forward contracts during 2010 to hedge 75% of the PSUs that may vest in 2011 and 2012, subject to the performance vesting criteria. The contracts were prepaid by the Corporation for $5, representing the initial price of $1.785 per share for 2,700,000 Air Canada common shares. The forward dates for the share forward contracts coincide with the vesting term of 825,000 PSUs in 2011 and 1,875,000 PSUs in 2012 and will be cash settled. These contracts were not designated as hedging instruments for accounting purposes. Accordingly, changes in the fair value of these contracts are recorded in Gain (loss) on financial instruments recorded at fair value in the period in which they arise. During 2010, a gain of $4 was recorded. As at December 31, 2010, the fair value of the share forward contracts is $9 in favour of Air Canada and is recorded in Deposits and other assets.

Liquidity risk

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 well as those assets being used as security in financing arrangements, seeking flexibility in financing arrangements, and establishing programs to monitor and maintain compliance with terms of financing agreements. The Corporation's principal objective in managing liquidity risk is to maintain a minimum unrestricted cash balance in excess of a target liquidity level of 15% of annual operating revenues. At December 31, 2010, Air Canada had Cash and cash equivalents and Short-term investments of $2,192, which represents 20% of 2010 operating revenues.

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

Market Risks

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: foreign exchange risk; interest rate risk; and other price risk, which includes commodity price risk.

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

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, 2010. The sensitivity analysis is based on a reasonably possible movement in the relevant risk factor. 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)	
	Income	Income		Income	
	1% increase	5% increase	5% decrease	10% increase	10% decrease
Cash and cash equivalents	$ 11	$ (13)	$ 13	$ -	$ -
Short-term investments	$ 11	$ (6)	$ 6	$ -	$ -
Aircraft related deposits	$ -	$ (5)	$ 5	$ -	$ -
Long-term debt and capital leases	$ (13)	$ 207	$ (207)	$ -	$ -
Fuel derivatives	$ -	$ -	$ -	$ 35	$ (22)
Foreign exchange derivatives	$ -	$ (19)	$ 8	$ -	$ -

(1) Due to currently low market rates of interest, a 1% decrease in interest rates was not considered a reasonable scenario within the forecast period, being one year.

(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% increase or decrease in the price of the underlying commodity.

Covenants in Credit Card Agreements

The Corporation has various agreements with companies that process customer credit card transactions. Approximately 85% 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.

The Corporation's principal credit card processing agreements for card processing services requirements in North America are scheduled to terminate at the end of May 2011. The Corporation's obligation to provide a deposit to the credit card processor under these agreements, as well as the amount of such deposit, are determined pursuant to a matrix measuring, on a quarterly basis, both a fixed charge coverage ratio for the Corporation and the unrestricted cash of the Corporation. The Corporation also has agreements with this processor for the provision of certain credit card processing services requirements for markets other than North America and for its cargo operations worldwide and such agreements contain deposit obligations similar to the obligations set forth above.

The Corporation has accepted a proposal from a new service provider for the provision of its principal credit card processing services requirements in North America for Visa and MasterCard for a five year term beginning at the expiry of the current agreements being replaced. The Corporation and the credit card processor have agreed to triggering events upon which the Corporation would be required to provide the credit card processor with deposits. The obligation to provide, and the amount of, deposits required would be based upon a matrix measuring, on a quarterly basis, both a fixed charge coverage ratio and unrestricted cash of the Corporation. The agreement between the Corporation and the credit card processor is subject to certain conditions, including conclusion of formal documentation.

Credit Risk

Credit risk is the risk of loss due to a counterparty's inability to meet its obligations. As at December 31, 2010, the Corporation's credit risk exposure consists mainly of the carrying amounts of Cash and cash equivalents, Short-term investments and Accounts receivable. 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. 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.

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

Fuel Price Risk

Fuel price risk is the risk that future cash flows arising from jet fuel purchases will fluctuate because of changes in jet fuel prices. 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 based on jet fuel, heating oil and crude oil. Heating oil and crude oil commodities are used due to the relative limited liquidity of jet fuel derivative instruments on a medium to long-term horizon since jet fuel is not traded on an organized futures exchange. The Corporation'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 instrument for speculative purposes.

During 2010:

- The Corporation recorded a loss of $11 in Gain (loss) on financial instruments recorded at fair value related to fuel derivatives ($102 gain in 2009).
- The Corporation purchased crude-oil call options and collars covering 2010 and 2011 fuel exposure. The cash premium related to these contracts was $43.
- Fuel derivative contracts cash settled with a net fair value of $27 in favour of the counterparties ($88 in favour of the counterparties in 2009).

As of December 31, 2010, approximately 20% of the Corporation's anticipated purchases of jet fuel for 2011 are hedged at an average West Texas Intermediate ("WTI") capped price of US$92 per barrel. The Corporation's contracts to hedge anticipated jet fuel purchases over the 2011 period are comprised of crude-oil based contracts. The fair value of the fuel derivatives portfolio at December 31, 2010 is $33 in favor of the Corporation ($31 in favour of the counterparties in 2009). The Corporation had no outstanding collateral deposits with its counterparties at December 31, 2010 ($43 in 2009).

The following table outlines the notional volumes per barrel along with the WTI weighted average floor and capped price for each year currently hedged by type of derivative instruments as at December 31, 2010.

Derivative Instruments	Term	Volume (bbls)	WTI Weighted Average Floor Price (US$/bbl)	WTI Weighted Average Capped Price (US$/bbl)
Call options	2011	4,400,000	n/a	$ 92
Collars	2011	705,000	$ 80	$ 92

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. The types of derivative instruments used by the Corporation within its hedging program, such as put options within collar structures, expose the Corporation to the potential of providing collateral deposits to its counterparties. 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.

From time to time, the Corporation may choose to adjust or restructure its hedging portfolio in light of market conditions. In 2010, the Corporation modified its fuel hedge portfolio with the termination of swap and collar contracts for $5, in favour of the counterparty. The collateral held by the counterparty was in excess of the settlement amount, and such excess was returned, resulting in a cash inflow for the Corporation. During 2009, the Corporation modified its fuel hedge portfolio with the termination of swap and put contracts for $192, in favour of the counterparties.

The Corporation discontinued applying hedge accounting effective the third quarter of 2009. Amounts that were deferred to Accumulated Other Comprehensive Loss ("AOCL") for derivatives previously designated under hedge accounting were taken into fuel expense in the period when the previously forecasted hedge transaction occurred. During 2010, $183 was reclassified from AOCL to Aircraft fuel expense ($419 in 2009). As at December 31, 2010, there are no amounts remaining in AOCL.

The following information summarizes the financial statement impact of fuel derivatives:

		2010	2009
Consolidated Statement of Operations			
Operating expenses			
Aircraft fuel	Realized effective loss on derivatives designated under hedge accounting	$ (183)	$ (419)
Non-operating income (expense)			
Gain (loss) on financial instruments recorded at fair value	Fair market value gain (loss) on economic hedges	$ (11)	$ 102
Consolidated Other Comprehensive Income (Loss)			
	Effective loss on derivatives designated under hedge accounting	n/a	$ (1)
	Reclassification of net realized loss on fuel derivatives designated under hedge accounting to Aircraft fuel expense	$ 183	$ 419
	Tax on reclassification	$ 1	$ 4

		2010	2009
Consolidated Statement of Financial Position			
Prepaid expenses and other currents assets	Collateral deposits for fuel derivatives	$ -	$ 43
	Fair market value of fuel derivatives	$ 33	$ -
Accounts payable and accrued liabilities	Fair market value of fuel derivatives	$ -	$ (31)
Shareholders' equity (AOCL)	Net loss from fuel derivatives designated under hedge accounting (net of tax 2010 - $nil and 2009 - $1)	$ -	$ (184)

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 and Short-term investments are classified as held for trading and therefore are recorded at fair value.

The carrying amounts of interest rate swaps, share forward contracts, 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 condition of any related collateral, the current conditions in credit markets and the current estimated credit margins applicable to the Corporation based on recent transactions. The estimated fair value of debt is approximately $4,400 as compared to its carrying value of $4,457.

Following is a classification of fair value measurements recognized in the Consolidated Statement of Financial Position using a fair value hierarchy that reflects the significance of the inputs used in making the measurements.

		Fair value measurements at reporting date using:		
	December 31 2010	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Financial Assets				
Held-for-trading securities				
Cash equivalents	$ 497	$ -	$ 497	$ -
Short-term investments	1,102	-	1,102	-
Deposits and other assets				
Asset backed commercial paper	29	-	-	29
Derivative instruments				
Fuel derivatives	33	-	33	-
Share forward contracts	9	-	9	-
Interest rate swaps	13	-	13	-
Total	**$ 1,683**	**$ -**	**$ 1,654**	**$ 29**

		Fair value measurements at reporting date using:		
	December 31 2010	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Financial Liabilities				
Derivative instruments				
Foreign exchange derivatives	$ 3	$ -	$ 3	$ -
Total	**$ 3**	**$ -**	**$ 3**	**$ -**

Financial assets held by financial institutions in the form of cash and restricted cash have been excluded from the fair value measurement classification table above as they are not valued using a valuation technique.

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. There is a limited private market to sell certain of these investments however management does not believe that this market qualifies as an active market and therefore has estimated the fair value of these investments using valuation techniques. The carrying value as at December 31, 2010 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 2010.

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 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 monitor 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 agreements.

The total capital as at December 31 is calculated as follows:

	2010	2009
Long-term debt and capital leases	$ 3,952	$ 4,054
Current portion of long-term debt and capital leases	505	468
	4,457	4,522
Non-controlling interest	169	201
Capitalized operating leases	2,595	2,513
Adjusted debt and non-controlling interest	7,221	7,236
Shareholders' equity	1,740	1,446
Total Capital	**$ 8,961**	**$ 8,682**
Adjusted debt and non-controlling interest	**$ 7,221**	**$ 7,236**
Less Cash and cash equivalents and Short-term investments	(2,192)	(1,407)
Adjusted net debt and non-controlling interest	**$ 5,029**	**$ 5,829**
Adjusted net debt to adjusted net debt plus shareholders' equity ratio	**74.3%**	**80.1%**

The adjusted net debt and non-controlling interest amount has decreased by $800 in 2010 largely attributable to cash flow from operations.

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 have investigated or are investigating alleged anti-competitive cargo pricing activities, including the levying of certain fuel surcharges, of a number of airlines and cargo operators, including Air Canada. Competition authorities have sought or requested information from Air Canada as part of their investigations. Air Canada has been cooperating with these investigations, which are likely to lead, or have led, to proceedings against Air Canada and a number of airlines and other cargo operators in certain jurisdictions. Air Canada is 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. Air Canada has been or may be named as a defendant or may otherwise be implicated in these or other lawsuits or proceedings in connection with these allegations.

During 2008, Air Canada recorded a provision of $125 as a preliminary estimate. This was only an estimate based upon the status of the investigations and proceedings at that time and Air Canada's assessment as to the potential outcome for certain of them. This provision did not address the proceedings and investigations in all jurisdictions, but only where there was sufficient information to do so. On November 9, 2010, Air Canada announced that the European Commission issued a decision finding that 12 air cargo carriers (including groups of related carriers) had infringed European Union competition law in the setting of certain cargo charges and rates for various periods between 1999 and 2006. Air Canada was among the carriers subject to the decision and a fine of 21 Euros (approximately C$29 at an exchange rate of $1.3970) was imposed on Air Canada. The amount of the fine is covered by the $125 provision taken by Air Canada in 2008. Air Canada is appealing this decision and filed an application for annulment of the decision before the European General Court. In the first quarter of 2011, Air Canada will pay the fine, as required, pending the outcome of the appeal.

As a result of the decision by the European Commission and a further review of proceedings and investigations in other jurisdictions, Air Canada recorded a net reduction to the provision for cargo investigations of $46 in 2010. The revised provision does not address the proceedings and investigations in all jurisdictions, but only where there is sufficient information to do so. Air Canada has determined it is not possible at this time to predict with any degree of certainty the outcome of all proceedings and investigations. As stated above, Air Canada is appealing the decision issued by the European Commission and, if and as appropriate, based on the outcome of any updates regarding this appeal as well as developments regarding proceedings and investigations in other jurisdictions, may adjust the provision in its results for subsequent periods as required.

Billy Bishop Toronto City Airport

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 Billy Bishop Toronto City Airport. 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. On October 16, 2009, Jazz discontinued its suit in the Ontario Superior Court against Porter.

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's access to the Billy Bishop Toronto City Airport. The Porter Defendants were granted intervenor 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. In March 2010, Jazz discontinued its proceedings in the Federal Court of Canada against the TPA. On May 14, 2010, Porter filed a discontinuance of its counterclaim before the Federal Court of Canada.

The counterclaim filed by Porter in the Ontario Superior Court of Justice against Jazz and Air Canada was stayed pending the outcome of the mirror counterclaim in the Federal Court but in January 2011 Porter filed proceedings to have the stay lifted to reactivate the counterclaim. Management views Porter's counterclaim as being without merit.

In the first quarter of 2010, Air Canada filed legal proceedings with the Federal Court of Canada seeking to challenge the process announced by the TPA to allocate flight capacity or slots at the TCCA. On July 21, 2010, the Federal Court of Canada dismissed Air Canada's challenge and Air Canada is appealing this decision before the Federal Court of Appeal.

Pay Equity

The Canadian Union of Public Employees ("CUPE"), which represents Air Canada's flight attendants, filed 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 Air Canada for investigation and an investigation is proceeding. Air Canada 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 that it is not possible at this time to predict with any degree of certainty the final outcome of the Commission's investigation.

Mandatory Retirement

Air Canada is engaged in a number of proceedings involving challenges to the mandatory retirement provisions of certain of its collective agreements, including the Air Canada-Air Canada Pilots Association collective agreement which incorporate provisions of the pension plan terms and conditions applicable to pilots requiring them to retire at age 60. Air Canada is defending these challenges. At this time, it is not possible to determine with any degree of certainty the extent of any financial liability that may arise from Air Canada being unsuccessful in its defense of these proceedings, though any such financial liability, if imposed, would not be expected to be material.

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 material adverse effect on the financial position or the results of the Corporation.

With respect to 44 aircraft leases, the difference between the reduced rents as a result of the implementation of the Plan of Reorganization, Compromise and Arrangement under the Companies' Creditors Arrangement Act ("CCAA") on September 30, 2004 and amounts which would have been due under the original lease contracts will be forgiven at the expiry date of the leases if no material default has occurred by such date. In the event of a material default which does not include any cross defaults to other unrelated agreements (including unrelated agreements with the counterparties to these aircraft leases), 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 additional liability would be recorded only at the time management believes the amount is likely to be incurred.

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 $171 as at December 31, 2010 (2009 - $162), 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

In the ordinary course of the Corporation's business, the Corporation enters into a variety of agreements, some of which may provide for indemnifications to counterparties that may require the Corporation to pay for costs and/or losses incurred by such counterparties. The Corporation cannot reasonably estimate the potential amount, if any, it could be required to pay under such indemnifications. Such amount would also depend on the outcome of future events and conditions, which cannot be predicted. While certain agreements specify a maximum potential exposure, certain others do not specify a maximum amount or a limited period. Historically, the Corporation has not made any significant payments under these indemnifications.

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 certain liabilities that arise from third party claims, which may relate to services performed by the service provider.

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

During 2010, ACE announced that it had concluded a public secondary offering on a bought deal basis of 44,000,000 Class B voting shares of Air Canada for aggregate gross proceeds to ACE of $162. Air Canada did not receive any of the proceeds from this offering. In accordance with the Registration Rights Agreement between Air Canada and ACE, the expenses of the offering of less than $1 were paid by Air Canada. After giving effect to this offering and ACE's resulting ownership interest in Air Canada of approximately 11%, ACE and Air Canada are no longer related parties. ACE was a participant lender in the Credit Facility as described in Note 6. ACE's pro-rata share of interest expense to the time the facility was repaid was $13.

As a result of the Aveos Restructuring Plan described below and the change in equity interests in Aveos, Air Canada and Aveos are no longer related parties.

Aveos Restructuring Plan

During the first quarter of 2010, Aveos reached an agreement with its lenders and equity holders on the terms of a consensual restructuring plan to recapitalize the company. As part of this recapitalization, Air Canada and Aveos entered into agreements to settle certain issues and modify the terms of certain contractual arrangements in exchange for Air Canada receiving a minority equity interest in Aveos. This restructuring modified the terms of certain commercial agreements between Air Canada and Aveos, including terms of the Pension and Benefits Agreement and an agreement with Aveos on revised payment terms. The modified terms relating to maintenance agreements are not expected to have a material impact on maintenance expense over their terms.

As part of these agreements, the Corporation also agreed to extend repayment terms on $22 of receivables, due in 2010, over six years with annual repayments on a non-interest bearing basis, with such payments subject to satisfaction of certain conditions. This agreement is now referred to as the Term Note.

The terms of the 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 Aveos operation and who became employees of Aveos on October 16, 2007 and (ii) those unionized employees of Air Canada who were assigned to the Aveos operation pursuant to general services agreements between Air Canada and Aveos for the assignment of unionized employees from Air Canada to Aveos were also modified to defer the determination of pension assets and related solvency deficiencies of transferring unionized employees performing airframe maintenance services to April 2011. This has the result of Air Canada assuming changes in the solvency deficiency for those affected employees from October 16, 2007, being the date of the Pension and Benefits Agreement, to April 1, 2011. As part of the amendment, all letters of credit issued under the Pension and Benefits Agreement were cancelled and a new letter of credit in the amount of $20 was issued by Air Canada in favour of Aveos to secure the payment of all compensation payments owing by Air Canada to Aveos in respect of pension, disability, and retiree liabilities for which Air Canada would be liable under the Pension and Benefits Agreement. This modification resulted in a reduction to the outstanding deposit under Air Canada's letter of credit facility of $23 in 2010. Until such future time as the assets and obligations under the Air Canada pension and other employee and retiree benefit arrangements 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 by Air Canada to Aveos, and as such, the modifications to the Pension and Benefits Agreement have no accounting consequence in the current period.

As a result of the above agreements, Air Canada's equity investment in Aveos was recorded at $49, based upon its estimated fair value. The Term Note of $22 was recorded at its estimated fair value of $11, based on the present value of expected cash flows on a discounted basis. Other trade receivables from Aveos of $4 were settled. For accounting purposes, $34 for consideration of agreement amendments is deferred and will be amortized over the terms of the amended agreements with Aveos of four years, on average. This accounting treatment recorded in the first quarter of 2010 is summarized as follows:

Share consideration received	**$**	**49**
Allocated to:		
Term Note	$	11
Trade receivables settled		4
Agreements and contract amendments		34
	$	**49**

The investment in Aveos common shares is recorded in Deposits and other assets and is carried at cost. The Term Note is also recorded in Deposits and other assets and is carried at amortized cost.

Aveos Certification Order

On January 31, 2011, the Canada Industrial Relations Board issued an order determining that the sale of Air Canada's former aircraft, engine and component maintenance and repair business had occurred within the meaning of the Canada Labour Code, and establishing Aveos as a distinct employer, bound by separate collective agreements. The issuance of this order triggers the commencement of the process by which certain employees will transition from Air Canada to employment with Aveos.

Pursuant to this order and a related separation program, Air Canada may be required to provide up to a maximum of 1,500 separation packages to IAMAW-represented Aveos employees employed as of the date of the order (with each package including up to a maximum of 52 weeks of pay), in the event that such employees are permanently laid off or terminated as a direct result of Aveos ceasing to be the exclusive provider of airframe maintenance services to Air Canada prior to June 30, 2015. These packages will also be made available at any time up to June 30, 2013, in the event of an insolvency, liquidation or bankruptcy involving Aveos resulting in the cancellation of Air Canada-Aveos contracts and in the termination or permanent layoff of IAMAW-represented employees. The current expiry date of the airframe maintenance services agreement is June 30, 2013. The accounting for the separation program will be determined in the first quarter of 2011.