2009
Consolidated Financial Statements

February 10, 2010

PRICEWATERHOUSECOOPERS

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February 9, 2010

Auditors' Report

To the Shareholders of
Air Canada

We have audited the consolidated statements of financial position of **Air Canada** as at December 31, 2009 and December 31, 2008 and the consolidated statements of operations, changes in shareholders' equity, comprehensive income (loss) and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Corporation as at December 31, 2009 and December 31, 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP[1]

Chartered Accountants

[1] Chartered accountant auditor permit No. 18144

"PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP/s.r.l./s.e.n.c.r.l., an Ontario limited liability partnership, or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate and independent legal entity.

Consolidated Statement of Operations

For the year ended December 31 (Canadian dollars in millions except per share figures)		2009	2008
Operating revenues			
Passenger		$ 8,499	$ 9,713
Cargo		358	515
Other		882	854
		9,739	11,082
Operating expenses			
Aircraft fuel		2,448	3,419
Wages, salaries and benefits		1,751	1,877
Airport and navigation fees		971	1,001
Capacity purchase with Jazz	Note 2D	973	948
Depreciation and amortization	Notes 3 & 4	660	694
Aircraft maintenance		759	659
Food, beverages and supplies		291	314
Communications and information technology		293	286
Aircraft rent		335	279
Commissions		186	194
Other		1,388	1,450
		10,055	11,121
Operating loss before under noted item		**(316)**	**(39)**
Provision for cargo investigations	Note 17	-	(125)
Operating loss		**(316)**	**(164)**
Non-operating income (expense)			
Interest income		14	57
Interest expense		(373)	(319)
Interest capitalized		4	37
Loss on assets	Note 3	(95)	(34)
Gain on financial instruments recorded at fair value	Note 15	95	92
Other		-	(3)
		(355)	(170)
Loss before the following items		**(671)**	**(334)**
Non-controlling interest		(15)	(12)
Foreign exchange gain (loss)		657	(655)
Recovery of (provision for) income taxes			
Current	Note 7	7	(1)
Future	Note 7	(2)	(23)
Loss for the year		**$ (24)**	**$ (1,025)**
Loss per share			
Basic and diluted	Note 12	$ (0.18)	$ (10.25)

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)		2009	2008
ASSETS			
Current			
Cash and cash equivalents	Note 2O	$ 1,115	$ 499
Short-term investments	Note 2P	292	506
		1,407	1,005
Restricted cash	Note 2Q	78	45
Accounts receivable	Note 18	701	702
Aircraft fuel inventory		63	97
Spare parts and supplies	Note 1C	64	20
Collateral deposits for fuel derivatives	Note 15	43	328
Prepaid expenses and other current assets	Note 18	295	206
		2,651	2,403
Property and equipment	Note 3	6,369	7,469
Intangible assets	Note 4	916	997
Deposits and other assets	Note 5	470	495
		$ 10,406	**$ 11,364**
LIABILITIES			
Current			
Accounts payable and accrued liabilities	Note 18	$ 1,215	$ 1,262
Fuel derivatives	Note 15	31	420
Advance ticket sales		1,288	1,333
Current portion of long-term debt and capital leases	Note 6	468	663
		3,002	3,678
Long-term debt and capital leases	Note 6	4,054	4,691
Future income taxes	Note 7	85	88
Pension and other benefit liabilities	Note 8	1,163	1,585
Other long-term liabilities	Note 9	455	370
		8,759	10,412
Non-controlling interest		201	190
SHAREHOLDERS' EQUITY			
Share capital	Note 11	532	274
Contributed surplus		1,825	1,797
Deficit		(727)	(703)
Accumulated other comprehensive loss	Notes 2L & 15	(184)	(606)
		1,446	762
		$ 10,406	**$ 11,364**

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)		2009	2008
Share capital			
Common shares, beginning of year		$ 274	$ 274
Shares issued under the pension MOUs	Note 8	28	-
Shares issued under the public offering	Note 11	230	-
Total share capital		532	274
Contributed surplus			
Balance, beginning of year		1,797	1,791
Fair value of stock-based compensation issued to employees recognized as compensation expense (recovery)	Note 10	2	(5)
Warrants issued under the credit facility	Note 6	7	-
Warrants issued under the public offering	Note 11	19	-
Proceeds from intercompany agreements	Note 18	-	11
Total contributed surplus		1,825	1,797
Retained earnings (deficit)			
Balance, beginning of year		(703)	322
Loss for the year		(24)	(1,025)
Deficit		(727)	(703)
Accumulated other comprehensive income (loss)			
Balance, beginning of year		(606)	56
Other comprehensive income (loss)		422	(662)
Total accumulated other comprehensive loss		(184)	(606)
Total deficit and accumulated other comprehensive loss		(911)	(1,309)
Total shareholders' equity		**$ 1,446**	**$ 762**

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

Consolidated Statement of Comprehensive Income (Loss)

For the year ended December 31 (Canadian dollars in millions)		2009	2008
Comprehensive income (loss)			
Loss for the year		$ (24)	$ (1,025)
Other comprehensive income (loss), net of taxes:			
Net losses on fuel derivatives under hedge accounting, net of taxes	Note 15	(1)	(605)
Reclassification of net realized losses (gains) on fuel derivatives to income, net of taxes	Note 15	423	(57)
		422	(662)
Total comprehensive income (loss)		**$ 398**	**$ (1,687)**

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)		2009	2008
Cash flows from (used for)			
Operating			
Loss for the year		$ (24)	$ (1,025)
Adjustments to reconcile to net cash from operations			
Depreciation and amortization		660	694
Loss on assets		95	34
Foreign exchange (gain) loss		(633)	822
Future income taxes		2	23
Excess of employee future benefit funding over expense		(368)	(316)
Provision for cargo investigations	Note 17	-	125
Non-controlling interest		15	12
Fuel and other derivatives	Note 15	41	(208)
Fuel hedge collateral deposits, net	Note 15	268	(322)
Changes in non-cash working capital balances		(234)	117
Other		11	(58)
		(167)	**(102)**
Financing			
Borrowings	Note 6	926	871
Shares issued under the public offering	Note 11	230	-
Warrants issued under the public offering and credit facility	Notes 6 & 11	26	-
Reduction of long-term debt and capital lease obligations		(1,237)	(992)
Other		-	5
		(55)	**(116)**
Investing			
Short-term investments		214	206
Additions to capital assets		(232)	(883)
Proceeds from contractual commitments	Note 1C	230	-
Proceeds from sale of assets	Note 3	103	38
Proceeds from sale-leaseback transactions	Note 3	552	708
Funding of Aveos letter of credit	Note 18	-	59
Other		(29)	62
		838	**190**
Increase (decrease) in cash and cash equivalents		**616**	**(28)**
Cash and cash equivalents, beginning of year		499	527
Cash and cash equivalents, end of year		**$ 1,115**	**$ 499**

Cash and cash equivalents exclude Short-term investments of $292 as at December 31, 2009 (2008 - $506).
The accompanying notes are an integral part of the consolidated financial statements.

1. BASIS OF PRESENTATION, NATURE OF OPERATIONS AND SIGNIFICANT EVENTS

A) BASIS OF PRESENTATION

The accompanying consolidated financial statements are of Air Canada (the "Corporation"). ACE Aviation Holdings Inc. ("ACE") holds a 27% ownership interest in the Corporation as at December 31, 2009. 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 and are now operated as divisions of Air Canada. These wind-ups had no impact on the consolidated financial statements.

Air Canada is Canada's largest domestic and international airline and the largest provider of scheduled passenger services in the Canadian market, the Canada-US transborder market as well as the international markets to and from Canada. Certain of the scheduled passenger services offered on domestic and Canada-US transborder routes are provided by Jazz Air LP ("Jazz") 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.

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, it operates its business in the outgoing leisure travel market (Caribbean, Mexico, USA, Europe, South America and Asia) by developing, marketing and distributing vacation travel packages and services through a network of independent travel agencies in Canada as well as through the Air Canada Vacations website, aircanadavacations.com.

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

C) SIGNIFICANT EVENTS

During 2009, the Corporation entered into the following transactions in an effort to mitigate the Corporation's liquidity risks as described in Note 15 (refer to Notes 3, 6 and 11 for additional detail on these financing activities):

During the fourth quarter of 2009

- Completed a share and warrant public offering for net proceeds of $249 (refer to Note 11 for further details);

During the third quarter of 2009

- Completed a secured term credit facility (the "Credit Facility") for financing proceeds of $600, less fees of $20. The Credit Facility is a five-year facility, with the first principal repayment due in August 2010, and currently bears interest at 12.75%. Under the Credit Facility, 10 million warrants were issued which entitle the debt holders to acquire up to 10 million shares in the Corporation, as further described in Note 6. As part of the transactions related to the closing of the Credit Facility, existing financing arrangements of $166 were repaid as follows:
  - The revolving credit facility, as further described in Note 6 (l), was repaid in the amount of $49. The rights of the lender under the revolving credit facility were assigned to the lenders under the Credit Facility;
  - The spare engine financing agreement, as further described in Note 6 (j), was partially repaid in the amount of $38. This represented the repayment related to 22 engines under a spare engine financing agreement, with 10 engines remaining under the agreement with a loan value of $72 as at December 31, 2009;
  - The Aeroplan Canada Inc. ("Aeroplan") loan, as further described below, was repaid in the amount of $79. Aeroplan is a participating lender under the Credit Facility.

- Extended or renewed labour agreements for 21 months with all of the Corporation's Canadian-based unions were completed by July 2009. The agreements provide for no increases to wage rates, no changes to group insurance coverage or benefits, or pension benefit levels during the contract extension or renewal periods;

- Pension funding agreements with all of the Corporation's Canadian-based unions (the "Pension MOUs") and the adoption of the *Air Canada Pension Funding Regulations, 2009* (the "Air Canada 2009 Pension Regulations"). The Air Canada 2009 Pension Regulations relieve the Corporation from making any special (past service cost) payments for 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 contributions shall equal the lesser of (i) $150, $175, and $225 in respect of 2011, 2012, and 2013, respectively and (ii) the maximum past service contributions permitted under the Income Tax Act. Pursuant to the Pension MOUs, on October 26, 2009 the Corporation 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 the sale of such shares held by the trust are to be contributed to the pension plans;

- An agreement with a supplier for non-refundable proceeds of $230 in consideration of various contractual commitments. For accounting purposes, the recognition of these proceeds was deferred in order to be applied to reduce the cost of these contractual commitments as they are incurred;

- Amendments to credit card processing agreements with one of its principal credit card processors to revise the levels of unrestricted cash (as defined per the agreement and generally based on the aggregate sums of Cash and cash equivalents and Short-term investments) required to be maintained as described further in Note 15;

- An extension of the repayment date of a short-term loan of $78 (US$75) entered into in 2008, which was originally due in 2009, to 2013. This loan is described in Note 6 (f);

- A memorandum of understanding with GE Capital Aviation Services (the "GECAS MOU") for the sale and leaseback of three Boeing 777 aircraft. The sale and leaseback transactions were substantially completed in early November 2009 and provided initial net cash proceeds of $95 (net of deposits), with additional net proceeds of $20 received in January 2010 upon completion of the remaining part of the transaction; and

- An agreement amending the terms of the Jazz CPA, effective August 1, 2009, which provides for a reduction to rates paid under the agreement.

During the second quarter of 2009

- A secured loan with Aeroplan for net proceeds of $79. This loan, as described above, was terminated in July 2009 pursuant to the transactions relating to the Credit Facility.

During the first quarter of 2009

- Financing arrangements secured by spare parts, spare engines and a Boeing 777 aircraft for aggregate proceeds of $267, net of fees of $8. The spare engine financing was partially repaid in July 2009, as described above;

- Sale lease-back of a Boeing 777 aircraft for aggregate proceeds of $172 and the required repayment of a debt obligation related to the aircraft of $128, which included a prepayment fee of $14;

- Repayment of pre-delivery financing of $83 on the Boeing 777 aircraft received during the first quarter; and;

During 2009, Air Canada entered into various inventory financing arrangements under which it acquired $117 of spare parts inventories in exchange for the issuance of bills of exchange. Subsequent to the arrangements, Air Canada completed various transactions in relation to certain bills of exchange resulting in gains of $4 being recorded in non-operating income (expense) in 2009. As at December 31, 2009, the remaining inventory is valued at $43 which represents its estimated net realizable value and the expected final payment due in 2010 under the financing arrangements is $11 (US$11).

In addition, during the year, the net return of collateral deposits on fuel derivatives amounted to $285, while the settlement of fuel derivative contracts in favour of counterparties amounted to $280 (refer to Note 15 for additional information on fuel price risk management activities).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A) PRINCIPLES OF CONSOLIDATION

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

B) USE OF ESTIMATES

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

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

C) PASSENGER AND CARGO REVENUES

Airline passenger and cargo advance sales are deferred and included in Current liabilities. Advance sales also include the proceeds from the sale of flight tickets to Aeroplan, a 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.

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, 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, include a variable component that is dependent on Jazz aircraft utilization, a fixed component and pass-through costs. 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 the last two years:

	2009	2008
Expenses from Jazz CPA	$ 973	$ 948
Pass through fuel expense from Jazz CPA	253	427
Pass through airport expense from Jazz CPA	196	201
Pass through other expense from Jazz CPA	35	38
	$ 1,457	**$ 1,614**

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.

As discussed in Note 1C, the Corporation entered into an agreement amending the terms of the Jazz CPA effective August 1, 2009. This amending agreement provides for (i) a reduction to rates paid under the Jazz CPA based on a reduction in the mark-up rate paid to Jazz on the first 375,000 block hours of annual flying from 16.7% to 12.5% and from 16.7% to 5% on annual block hours above 375,000; (ii) a reduction in Air Canada's commitment to Jazz's minimum fleet from 133 to 125 aircraft; (iii) a contract term extension of five years (from January 1, 2016 to December 31, 2020), during which the rates will be subject to a benchmarking review; and (iv) a commitment to work together on Jazz's turboprop fleet renewal strategy over the term of the contract.

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 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 $126 in 2009 (2008 - $115).

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

The Corporation provides certain services to related parties, namely ACE and Aveos Fleet Performance Inc. ("Aveos"), and 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 16 years for pension plans and between 10 and 11 years for post retirement and post employment benefit plans.

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

As described in Note 8, certain Corporation employees perform work for ACE and 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 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 provide for the grant of stock options and Performance Share Units (“PSUs’), as further described in Note 10.

The Corporation changed its accounting policy for awards of stock based compensation granted to Corporation employees with a graded vesting schedule. Prior to January 1, 2009, the fair value of stock options with a graded vesting schedule was recognized as compensation expense and a credit to Contributed surplus on a straight line basis over the applicable vesting period. Effective January 1, 2009, 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. The new accounting policy provides more reliable and relevant information about the effects of the transactions. 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.

The impact of the change in accounting policy for awards granted to Corporation employees with a graded vesting schedule was immaterial to any prior period and therefore no adjustments were made to such prior periods.

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.

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 AND HEDGE ACCOUNTING

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

Financial assets and financial liabilities, including derivatives, are recognized on the Consolidated Statement of Financial Position when the Corporation becomes a party to the contractual provisions of the financial instrument or non-financial derivative contract. All financial instruments are required to be measured at fair value on initial recognition except for certain related party transactions. Effective January 1, 2009, the Corporation adopted the recommendations of the Emerging Issues Committee of the CICA relating to Abstract EIC-173 Credit Risk and the Fair Value of Financial Assets and Financial Liabilities. Under this Abstract, the Corporation's own credit risk and the credit risk of the counterparty are taken into consideration in determining the fair value of financial assets and financial liabilities, including derivative instruments. The adoption of this guidance had no significant impact on the Corporation's consolidated financial statements as collateral deposits with fuel derivative counterparties and master netting arrangements are considered in determining whether a credit risk adjustment is required on the valuation of the derivatives. Measurement in subsequent periods is dependent upon the classification of the financial instrument as held-for-trading, held-to-maturity, available-for-sale, loans and receivables, or other financial liabilities. The held-for-trading classification is applied when an entity is "trading" in an instrument or alternatively the standard permits that any financial instrument be irrevocably designated as held-for-trading. The held-to-maturity classification is applied only if the asset has specified characteristics and the entity has the ability and intent to hold the asset until maturity. For financial instruments classified as other than held-for-trading, transaction costs are added to the initial fair value of the related financial instrument.

Financial assets and financial liabilities classified as held-for-trading are measured at fair value with changes in those fair values recognized in Non-operating income (expense). Financial assets classified as held-to-maturity, loans and receivables, or other financial liabilities are measured at amortized cost using the effective interest method of amortization.

The Corporation enters into interest rate, foreign currency, and fuel derivatives to manage the associated risks. Derivative instruments are recorded on the Consolidated Statement of Financial Position at fair value, including those derivatives that are embedded in financial or non-financial contracts. Changes in the fair 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 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.
- Aircraft related and other deposits are classified as held-to-maturity investments and are measured at amortized cost using the effective interest rate method. Interest income is recorded in net income, as applicable.
- Accounts receivable are classified as loans and receivables and are measured at amortized cost using the effective interest rate method. Interest income is recorded in net income, as applicable.
- Accounts payable, credit facilities, and bank loans are classified as other financial liabilities and are measured at amortized cost using the effective interest rate method. Interest income is recorded in net income, as applicable.

Effective January 1, 2009, the Corporation has adopted the enhanced disclosure requirements of amended CICA section 3862 *Financial Instruments – Disclosures.* Refer to Note 15 for 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.

Fuel Derivatives Under Hedge Accounting

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

Hedge accounting is discontinued prospectively when the derivative no longer qualifies as an effective hedge, or the derivative is terminated or sold, or upon the sale or early termination of the hedged item. The amounts previously recognized in AOCI are reclassified to fuel expense during the periods when the derivative matures. Refer to Note 15 for the impact of fuel derivatives during the year.

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 will 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 will be taken into fuel expense in the period in which the derivative was originally scheduled to mature.

M) FOREIGN CURRENCY TRANSLATION

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

N) INCOME TAXES

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

O) CASH AND CASH EQUIVALENTS

Cash includes $323 pertaining to investments with original maturities of three months or less at December 31, 2009 (2008 - $416). 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, 2009 is 0.29% (2008 - 2.06%).

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, 2009 is 0.53% (2008 - 2.90%).

Q) RESTRICTED CASH

The Corporation has recorded $78 (2008 - $45) 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 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 $74 related to spare parts and supplies consumed during the year.

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) using the effective interest rate method. Capitalized interest also includes financing costs charged by the manufacturer on capital commitments as described in Note 14.

U) INTANGIBLE ASSETS

Effective January 1, 2009 the Corporation adopted the new CICA accounting standard section 3064, *Goodwill and Intangible Assets* which provides guidance on the recognition, measurement, presentation and disclosure for goodwill and intangible assets, other than the initial recognition of goodwill or intangible assets acquired in a business combination. The Corporation's accounting policy for intangible assets is consistent with the new standard and as a result, no adjustment was recorded on transition.

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

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

V) IMPAIRMENT OF LONG-LIVED ASSETS

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

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

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

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

X) ASSET RETIREMENT OBLIGATIONS

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

Y) RELATED PARTY TRANSACTIONS

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

Z) VARIABLE INTEREST ENTITIES

Aircraft Leasing Transactions

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

Fuel Facilities Arrangements

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

Under AcG-15, the Corporation is the primary beneficiary of three of the Fuel Facility Corporations in Canada. Five of the Fuel Facility Corporations in which Air Canada participates in Canada that have not been consolidated have assets of approximately $181 and debt of approximately $162, which is the Corporation's maximum exposure to loss without taking into consideration any cost sharing and asset retirement obligations that would occur amongst the other contracting airlines. The Corporation considers this loss potential as remote.

AA) FUTURE ACCOUNTING STANDARD CHANGES

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

Business Combinations, Consolidated Financial Statements and Non-controlling Interests

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

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

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

3. PROPERTY AND EQUIPMENT

	2009		2008	
Cost				
Flight equipment, including spare engines (a)	$	5,866	$	6,235
Assets under capital leases (b)		1,959		1,940
Buildings, including leasehold improvements		688		643
Ground and other equipment		157		160
		8,670		8,978
Accumulated depreciation and amortization				
Flight equipment, including spare engines (a)		1,407		1,101
Assets under capital leases (b)		683		562
Buildings, including leasehold improvements		187		148
Ground and other equipment		62		49
		2,339		1,860
		6,331		**7,118**
Purchase deposits, including capitalized interest (c)		38		351
Property and equipment at net book value (d)	**$**	**6,369**	**$**	**7,469**

(a) Included in flight equipment as at December 31, 2009 are rotable parts, including spare engines with a cost of $821 (2008 - $798) less accumulated depreciation of $327 (2008 - $279) for a net book value of $494 (2008 - $519). Also included in flight equipment are 25 aircraft (2008 – 30 aircraft and 1 engine) which are leased to Jazz (Note 14) and third parties with a cost of $630 (2008 - $942) less accumulated depreciation of $253 (2008 - $289) for a net book value of $377 (2008 - $653).

(b) Included in capital leases as at December 31, 2009 are 40 aircraft (2008 - 41) with a cost of $1,893 (2008 - $1,874) less accumulated depreciation of $672 (2008 - $554) for a net book value of $1,221 (2008 - $1,320) and facilities with a cost of $66 (2008 - $66) less accumulated depreciation $11 (2008 - $8) for a net book value of $55 (2008 - $58).

(c) Includes $17 (2008 - $259) for Boeing B777/787 aircraft, $21 (2008 - $34) for equipment purchases and internal projects and nil (2008 - $58) for the aircraft interior refurbishment program. Refer to Note 6K relating to the financing of Boeing pre-delivery payments.

(d) Net book value of Property and equipment includes $798 (2008 - $836) consolidated for aircraft leasing entities and $165 (2008 - $150) consolidated for fuel facility corporations, both of which are consolidated under AcG-15.

As at December 31, 2009, flight equipment included 17 aircraft (2008 - 21) that are retired from active service with a net carrying value of $22 (2008 - $33).

Interest capitalized during 2009 amounted to $4 at an interest rate of 7.38% (2008 - $37 with $10 at an interest rate of 1 month US LIBOR plus 1.14%, $6 at an interest rate of 3 month US LIBOR plus 3.00%, $17 at an interest rate of 7.72%, and $4 of fees).

Depreciation of property and equipment in 2009 amounted to $602 (2008 - $646).

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 which closed during Quarter 1 2009 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 which closed during Quarter 4 2009 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.

During 2008:

- The Corporation received delivery of eight Boeing 777 aircraft. Three aircraft were financed with guarantee support from EXIM (Note 6). Five of the aircraft were financed under sale lease-back transactions with proceeds of $708. The resulting gain on sale of $81 was deferred and is being recognized as a reduction to Aircraft rent expense over the term of the leases. The leases are accounted for as operating leases with 12 year terms, paid monthly.

- The Corporation recorded an impairment charge of $38 on its fleet of B767-200 aircraft due to the revised retirement date of the aircraft.

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

- The Corporation sold an A319 aircraft for proceeds of $23 with a book value of $21, resulting in a gain on sale of $2.

4. INTANGIBLE ASSETS

	2009	2008
Indefinite life assets		
International route rights and slots	$ 329	$ 327
Air Canada trade name	298	298
Other marketing based trade names	31	31
	658	**656**
Finite life assets		
Star Alliance membership	131	131
Other contract and customer based	144	144
Technology based	254	279
	529	554
Accumulated depreciation and amortization		
Star Alliance membership	(37)	(32)
Other contract and customer based	(110)	(99)
Technology based	(124)	(82)
	(271)	(213)
Finite life assets, net	**258**	**341**
	$ 916	**$ 997**

The amortization of intangible assets in 2009 amounted to $58 (2008 - $48).

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. The Corporation is currently working towards the implementation of certain components of the solution such as web and fare technology but has suspended activity relating to the implementation of the reservation system.

5. DEPOSITS AND OTHER ASSETS

		2009	2008
Aircraft related deposits (a)		$ 189	$ 203
Restricted cash		121	65
Deposit related to the Pension and Benefits Agreement	Note 18	43	42
Asset backed commercial paper (b)		29	29
Aircraft lease payments in excess of rent expense	Note 2W	51	49
Other deposits		24	78
Other		13	29
		$ **470**	**$ 495**

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

(b) The Corporation has $37 ($29 net of a fair value adjustment) in non-bank sponsored ABCP. The carrying value as at December 31, 2009 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 2009.

6. LONG-TERM DEBT AND CAPITAL LEASES

		Base Currency	Final Maturity	Actual Interest Rate (%)	2009	2008
Embraer aircraft financing (a)		USD	2017-2021	2.15-8.49	$ 1,150	$ 1,425
Boeing aircraft financing (b)		USD	2019-2021	0.25-5.69	436	871
Boeing aircraft financing (c)		JPY	2020	0.46-0.47	205	270
Term Credit Facility (d)		CDN	2014	12.75	573	-
Aircraft leasing entities - debt (e)	Note 2Z				662	828
Term loan due 2013 (f)		USD	2013	6.21	78	190
Conditional sales agreements (g)		USD	2019	3.15-3.31	140	175
Fuel facility corporations - debt (h)	Note 2Z				136	125
Spare parts financing (i)		USD	2014	5.73	132	97
Spare engine financing (j)		USD	2013	3.65	72	95
Boeing pre-delivery payments (k)	Note 2Z	USD	2009		-	81
Revolving credit facility (l)		CDN			-	50
Canadian Regional Jet (m)		CDN	2012	2.13	17	25
GE loan (n)		USD	2015	3.19	17	24
Lufthansa cooperation agreement (o)		USD	2009		-	16
Long-term debt					**3,618**	**4,272**
Capital lease obligations (p)					904	1,082
Total debt and capital leases					**4,522**	**5,354**
Current portion					(468)	(663)
Long-term debt and capital leases					**$ 4,054**	**$ 4,691**

The Interest Rate in the table above is the actual rate as of December 31, 2009

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

(a) Embraer aircraft financing amounts to US$1,112 as at December 31, 2009 (US$1,163 as at December 31, 2008). Principal and interest is repaid quarterly until maturity and the financing has both fixed and variable interest rates. The fixed rate financing of US$847 bears interest at rates ranging from 6.39% to 8.49% and the variable rate financing of US$265 bears interest at a three month US LIBOR plus 1.9% (2.15% to 2.18%). 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 $1,591.

(b) Boeing aircraft financing amounts to US$430 as at December 31, 2009 (US$711 as at December 31, 2008), which is financed under loan guarantee support provided by 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$155 bears interest at rates ranging from 5.41% to 5.69% and the variable rate financing of US$275 bears interest at a three month US LIBOR (0.25% to 0.28%). The financing can be repaid at any time, in whole, with the payment of applicable fees. The financing is secured primarily by the 5 delivered aircraft with a carrying value of $632.

(c) Boeing aircraft financing amounts to JPY18,671 as at December 31, 2009 (JPY19,995 as at December 31, 2008), which is financed under loan guarantee support provided by the EXIM. Principal and interest is repaid quarterly until maturity and the financing bears interest at a three month JPY LIBOR (0.46% to 0.47%). The financing can be repaid at any time, in whole, with the payment of applicable fees. The financing is secured primarily by the 2 delivered aircraft with a carrying value of $234.

(d) 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. The terms of the Credit Facility permit, on or before the first anniversary and subject to satisfaction of certain conditions, Air Canada to request an increase to the facility by up to an additional $100 by obtaining new commitments from either the existing or new lenders. The Credit Facility is repayable in 16 consecutive quarterly instalments commencing in August 2010 of $30 with the final instalment of $120 due in July 2014. Any increase to the facility would increase, on a pro rata basis, the scheduled repayments, including the final payment.

The Credit Facility bears interest 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). The Credit Facility can be repaid at any time, in whole or in part, with the payment of applicable fees, subject to a minimum repayment of $10.

Air Canada's obligations under the Credit Facility are secured by a first priority security interest and hypothec over substantially all the present and after-acquired property of Air Canada and its subsidiaries, subject to certain exclusions and permitted liens. The Credit Facility contains customary representations and warranties and is subject to customary terms and conditions (including negative covenants, financial covenants and events of default). Financial covenants require the Corporation to maintain, as of the last business day of each month, unrestricted cash (as defined per the Credit Facility and generally based upon the aggregate sums of Cash and cash equivalents and Short-term investments) of $800 and a minimum EBITDAR (earnings before interest, income taxes, depreciation, amortization, aircraft rentals, certain non-operating income (expense) and special items) and an interest coverage ratio test determined as at the end of each fiscal quarter.

A requirement of the Credit Facility is that the Corporation maintain at all times unrestricted cash in accounts subject to securities control agreements equal to or greater than the lesser of (a) $800 and (b) 80% of unencumbered cash subject to a minimum of $500. The securities in such accounts would become restricted if the Corporation defaults on certain terms of the Credit Facility as described above.

Under the Credit Facility, Air Canada issued to the lenders, concurrently with the first drawdown, 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, have been included in Contributed surplus on the Consolidated Statement of Financial Position as at December 31, 2009 in the amount of $7.

(e) 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% (2008 - 8%). These aircraft have a carrying value of $798 (2008 - $836) and are charged as collateral against the debt by the owners thereof. The creditors under these leasing arrangements have recourse to the Corporation, as lessee, in the event of default or early termination of the lease. Aircraft related debt amounting to US$633 ($662) (US$676 ($828) as at December 31, 2008) is summarized as follows (in Canadian dollars):

	Final Maturity	2009	2008
Canadian Regional Jet	2010-2011	$ 211	$ 257
Boeing 767-300	2011-2016	141	185
Airbus 319	2011-2014	192	242
Airbus 321	2017	118	144
Total		**$ 662**	**$ 828**

(f) During 2008, the Corporation arranged for and received financing amounting to $190 (US$155). The first payment of US$80 matured and was repaid in January 2009. In July 2009, the maturity of the Term Loan due 2009 was extended to December 2013. The financing bears interest at one month LIBOR plus 5.98% (6.21% as at December 31, 2009 and 6.45% as at December 31, 2008) 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.

(g) US$133 principal outstanding (US$142 as at December 31, 2008) on acquisitions of two A340-500 aircraft financed through conditional sales agreements. Principal and interest is paid quarterly until maturity in 2019. The purchase price instalments bear interest at a three month LIBOR rate plus 2.9% (3.15% - 3.31% as at December 31, 2009 and 4.37% - 6.44% as at December 31, 2008). 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 $212 as at December 31, 2009.

(h) The Corporation is the primary beneficiary of certain Fuel Facility Corporations in Canada. The debts bear interest at rates ranging from 2.15% to 5.09%. Of the total debts of $136, $104 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 $165 as at December 31, 2009.

(i) US$132 principal outstanding to mature in 2014 (US$80 as at December 31, 2008), with quarterly repayments, 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%. 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 $265. The loan agreement contains a collateral value test, performed on a monthly basis. This test relates to all inventory collateral and the Corporation may be required to provide additional inventory collateral, cash collateral, letters of credit, prepay some of the loan or any combination of the above based on appraised values, as of the date of the test. Any amounts prepaid would be recorded as a reduction of the loan. This amount declines over time to nil upon the loan expiry. In January 2009 an additional $92 (US$75) principal was added under the original agreement with the same terms as described above. Financing fees totaling $6 were recorded in 2009 for these additional borrowings.

(j) US$70 principal outstanding to mature in 2013 (US$78 as at December 31, 2008), with quarterly repayments and a final payment at maturity of 50% of the original principal, at a floating interest rate equal to the three month LIBOR rate plus 3.40% as at December 31, 2009 (2008 – 5.13%). 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 $113.

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 2010 on the next anniversary, assuming the engines are worth nil and no additional collateral has been provided, is $65 (US$63). This amount declines over time to fifty percent of the original principal upon the loan expiry. In January 2009 an additional $46 (US$37) principal and 22 engines were added under the original agreement with the same terms as described above. Financing fees totaling $2 were recorded in 2009 for these additional borrowings. As discussed in Note 1C, the outstanding balance related to the additional financing was repaid in 2009.

(k) On October 30, 2007, the Corporation entered into an agreement with a syndicate of banks for the financing of pre-delivery payments ("PDP") for 10 of the 16 Boeing B777 aircraft contemplated in the Boeing Purchase Agreement. The PDP financing was a series of loans that are aircraft specific with a maximum aggregate commitment of up to $568 (US$575). The PDP loans had a term of five years, but could be prepaid upon the delivery of the aircraft without penalty. During 2009, the Corporation drew nil (2008 - $39 (US$39)) and prepaid $83 (US$66) towards 1 aircraft ($516 ($US501) towards 8 aircraft during 2008). This was the final repayment on the pre-delivery financing. At year-end 2009, the balance outstanding on the PDP loans was nil ($81 (US$66) as at December 31, 2008). The 2009 capitalized interest relating to this financing was nil (2008 - $10) at an interest rate of 30 day LIBOR plus 1.14% (1.61% as at December 31, 2008).

(l) As at December 31, 2008, the Corporation was a party to a $100 senior secured revolving credit facility (the "Revolving Credit Facility"). The Revolving Credit Facility had a one year term that could be extended at Air Canada's request for additional one-year periods on each anniversary of the closing, subject to prior approval of the lenders. The total amount available for borrowing under the Revolving Credit Facility was subject to a borrowing base restriction based on certain percentages of the values of eligible accounts receivable and eligible real property. As at December 31, 2008, the funds available under the Revolving Credit Facility were $50. The Revolving Credit Facility was secured by a first priority security interest and hypothec over the present and after-acquired personal property of Air Canada, subject to certain exclusions and permitted liens, and by a first priority charge and hypothec over certain owned and leased real property of Air Canada. Air Canada's obligations were guaranteed by 1209265 Alberta Ltd., a subsidiary of Air Canada, which provided a first priority security interest over its present and after-acquired personal property, subject to certain exclusions and permitted liens, as security for its guarantee obligations. The Revolving Credit Facility contained customary representations and warranties and was subject to customary terms and conditions (including negative covenants, financial covenants and events of default). Financial covenants required the Corporation to maintain, as of the last business day of each month, a minimum liquidity level of $900, which included the unused and available commitment under the facility, and an interest coverage ratio test determined as at the end of each fiscal quarter. During the second quarter, the financial covenant that required the Corporation to maintain as of the last business day of each month a minimum cash level of $900 including the unused and available commitment under the facility was reduced to $800. The interest rate margin for drawn amounts was, at the option of Air Canada, prime plus 13.00% or bankers' acceptances plus 14.00%. As discussed in Note 1C, in connection with the entering into of the Credit Facility described in (d), the Revolving Credit Facility was repaid in full in the amount of $49 during 2009. The rights of the lender under this Revolving Credit Facility were assigned to the lenders under the Credit Facility.

(m) As at December 31, 2009, the principal outstanding is $17 on four CRJ aircraft ($25 as at December 31, 2008). Principal and interest are paid quarterly to maturity in 2012. The financing bears interest at a floating rate of the 3 month Canadian bankers' acceptance rate plus 1.7%. The financing can be repaid at any time, in whole or in part, with the payment of applicable fees. The loan is secured by the aircraft with a carrying value of $23.

(n) US$16 principal outstanding to mature in 2015 (US$20 as at December 31, 2008), with quarterly repayments, at a floating interest rate equal to the six month LIBOR rate plus 2.75% pre-payable on any interest payment date after September 21, 2009, without the payment of applicable fees The next interest payment date is March 20, 2010. The debt is secured primarily by certain flight training equipment with a current carrying value of $33.

(o) As at December 31, 2008, US$13 principal outstanding which matured in 2009, with semi-annual repayments, at a fixed interest rate of 4.50% plus an annual 2.0% guarantee fee.

(p) Capital leases, related to facilities and 40 aircraft, total $904 ($83 and US$784) ($1,082 ($84 and US$815) as at December 31, 2008). The debt has a weighted average effective interest rate of approximately 8% and final maturities range from 2010 to 2033. During 2009, the Corporation recorded interest expense on capital lease obligations of $102 (2008 - $94).

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 23 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. Any amounts prepaid would be recorded as a reduction of the lease obligation. The Corporation contracts with certain third parties to provide residual value support for certain aircraft. If the Corporation is required under the loan to value test to prepay lease obligations, these amounts are recoverable from the third party residual value support provider upon lease expiry to the extent that the adjusted obligation taking into account prepayments is less than the residual value support. The maximum amount payable on July 1, 2010, assuming the related aircraft are worth nil, is $599 (US$572). The maximum payable amount declines over time to nil upon lease expiry. In July 2009 additional collateral of $8 in the form of cash deposits were made under the fair value test. As the Corporation does not expect to have to prepay any significant amounts based upon expectations of aircraft fair values into the future, the amortized cost of these capital lease obligations reflects the scheduled payments over the term to final maturity.

Interest paid on Long-term debt and capital leases in 2009 by the Corporation was $326 (2008 - $293).

Refer to Note 14 for the Corporation's 5 year principal and interest repayment requirements as at December 31, 2009.

7. FUTURE INCOME TAXES

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

	2009	2008
Liability		
Tax payable (a)	$ (10)	$ (10)
Future income tax liability (c)	(85)	(88)
	$ (95)	**$ (98)**

a) Taxes Payable

During 2007, Air Canada recorded a current income tax expense of $10 resulting from the Federal and Ontario harmonization of corporate taxes. Air Canada will have a cash tax payable of $10 that will be payable over a five year period beginning in 2010. The estimated amount payable in 2010 of $4 is included in Accounts payable and accrued liabilities and the remainder is recorded in Other long-term liabilities.

b) Valuation Allowance

The Corporation has determined that it is more likely than not that future income tax assets of $1,043 are not recoverable and have been offset by a valuation allowance. However, the future tax deductions underlying the future tax assets remain available for use in the future to reduce taxable income. The benefit of future income tax assets that existed at fresh start, and for which a valuation allowance is recorded, is recognized first to reduce to nil any remaining intangible assets (on a pro-rata basis) that were recorded upon fresh start reporting with any remaining amount as a credit to Shareholders' equity. The benefit of future income tax assets that arise after fresh start are recognized in the Consolidated Statement of Operations.

c) Future Income Tax Liability

It has been assumed that certain intangibles and other assets with nominal tax cost and a carrying value of approximately $658, 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 $85.

The future income tax assets and liabilities are as follows:

	2009	2008
Future tax assets		
Loss carry forwards	$ 689	$ 588
Post-employment obligations	322	466
Accounting provisions not currently deductible for tax	144	261
Deferred gains	24	40
Other	91	95
Total future tax assets	**1,270**	**1,450**
Future tax liabilities		
Book basis of capital over tax basis	153	217
Intangible assets	120	126
Other	39	38
Total future tax liabilities	**312**	**381**
Net future tax assets	**958**	**1,069**
Less valuation allowance (b)	1,043	1,157
Net recorded future income tax liability	**$ (85)**	**$ (88)**

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

	2009	2008
Recovery based on combined federal and provincial rates	$ (9)	$ (319)
Non-taxable portion of capital (gains) losses	(105)	68
Non-deductible expenses	7	53
Effect of tax rate changes on future income taxes	76	51
Other	(15)	23
	(46)	(124)
Valuation allowance (refer to (b) above)	41	148
Provision for (recovery of) income taxes	**$ (5)**	**$ 24**

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

	2009	2008
Current tax expense (recovery)	$ (7)	$ 1
Future income tax recovery relating to temporary differences	(115)	(176)
Future income tax expense from tax rate changes	76	51
Valuation allowance	41	148
Provision for (recovery of) income taxes	**$ (5)**	**$ 24**

Refer to Note 15 for future income taxes recorded in other comprehensive income related to fuel derivatives designated under fuel hedge accounting.

Income taxes recovered in 2009 by the Corporation were $5 (2008 – payments of less than $1).

The balances of tax attributes as at December 31, 2009, namely the balances of non-capital loss carry forwards, vary amongst different taxing jurisdictions. The following are the Federal tax loss expiry dates:

	Tax Losses
2014	$ 18
2026	3
2027	1,354
2028	1,093
2029	391
	$ 2,859

There are no net capital losses (2008 - 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 and were contractually assigned to Aeroplan.

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

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

Certain Corporation employees perform work for ACE and 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 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 ACE, Aveos, and Aeroplan for those employees contractually assigned. The cost recovery includes current service costs for pensions, past service cost to Aeroplan for pensions and a portion of post-employment and post-retirement benefits to ACE and Aveos, based on actuarial calculation for their specific employee group. This cost recovery amounted to $32 for the year ended December 31, 2009 (2008 - $40).

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, 2009, pending final determination of this matter. Aeroplan is now 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.

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

Pension Plan Cash Funding Obligations

As at January 1, 2009, based on the actuarial valuations which were used to determine certain pension funding requirements in 2009, the aggregate solvency deficit in the registered pension plans was $2,835. Based on preliminary actuarial valuations, as at January 1, 2010, the aggregate solvency deficit in the registered plans is estimated to be between $2,500 and $2,700. This preliminary estimated solvency deficit range includes the impact of the actual return on plan assets as shown below partially offset by a decrease in the discount rate used to value the benefit obligation which has the effect of increasing the benefit obligation. The final actuarial valuations for January 1, 2010 will be completed in the first half of 2010, but as described below, they will not impact the 2010 pension 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 Tax Act.

The Air Canada 2009 Pension Regulations were adopted in coordination with the Pension MOUs identified in Note 1C. 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 2009 amounted to $389.

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 $346 to the pension obligation and $28 to the pension expense. A decrease in the discount rate of 0.25% results in an increase of $346 to the pension obligation and $25 to the pension expense.

Expected Return on Assets Assumption

The expected long-term rate of return on assets assumption is selected based on the facts and circumstances that exist as of the measurement date and the specific portfolio mix of plan assets. Air Canada's management, in conjunction with its actuaries, reviews anticipated future long-term performance of individual asset categories and considers the asset allocation strategy adopted by Air Canada, including the longer duration in its bond portfolio in comparison to other pension plans. These factors are used to determine the average rate of expected return on the funds invested to provide for the pension plan benefits. The determination of the long term rate considers recent fund performance, including the significant drop in the value of plan assets during 2008 and the partial recovery in 2009, 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.

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	
	2009	**2008**	**2009**	**2008**
Change in benefit obligation				
Benefit obligation at beginning of year	$ 10,729	$ 12,150	$ 790	$ 899
Current service cost	123	203	50	62
Interest cost	760	706	54	52
Employees' contributions	78	83	-	-
Benefits paid	(724)	(677)	(58)	(57)
Plan amendments	-	2	-	-
Actuarial loss (gain)	1,015	(1,738)	33	(189)
Foreign exchange gain (loss)	(44)	-	(18)	23
	11,937	10,729	851	790
Change in plan assets				
Fair value of plan assets at beginning of year	9,717	11,747	-	-
Actual return (loss) on plan assets	1,296	(1,879)	-	-
Employer contributions	389	456	58	57
Employees' contributions	78	83	-	-
Pension MOUs share contribution	28	-	-	-
Benefits paid	(724)	(677)	(58)	(57)
Foreign exchange gain (loss)	(33)	(13)	-	-
	10,751	9,717	-	-
Deficit at end of year	**1,186**	**1,012**	**851**	**790**
Unrecognized past service costs	(2)	(2)	-	-
Unrecognized net actuarial gain (loss)	(1,079)	(479)	258	321
Valuation allowance against accrued benefit	15	9	**-**	**-**
Net benefit obligation	**$ 120**	**$ 540**	**$ 1,109**	**$ 1,111**
Weighted average assumptions used to determine the accrued benefit liability				
Discount rate	6.40%	7.35%	4.75 - 6.40%	6.25 - 7.35%
Rate of compensation increase (a)	2.50%	2.50%		

(a) As a result of pay awards, a rate of compensation increase of 0% plus merit was used for years 2009 and 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:

	2009	**2008**
Domestic registered plans	$ 496	$ 383
US, UK, and Japan	78	83
Supplementary plans	653	606
	$ **1,227**	$ **1,072**

The net deficit, on an accounting basis, at December 31, 2009 for pension benefits was $1,186 (2008 - $1,012). 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 largely offset by the higher than expected returns on plan assets.

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

	2009	2008
Pension benefits	$ 120	$ 540
Other employee future benefits	1,109	1,111
Net benefit obligation	**1,229**	**1,651**
Current portion	(66)	(66)
Pension and other benefit liabilities	**$ 1,163**	**$ 1,585**

The current portion of the net benefit obligation represents an estimate of other employee future benefits claims to be incurred during 2010. 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	
	2009	2008	2009	2008
Components of Net Periodic Pension Cost				
Current service cost	$ 123	$ 203	$ 50	$ 62
Interest cost	760	706	54	52
Actual loss (return) on plan assets	(1,296)	1,879	-	-
Actuarial loss (gain)	1,015	(1,738)	33	(189)
Plan amendments	-	2	-	-
Costs arising in the year	**602**	**1,052**	**137**	**(75)**
Differences between costs arising in the year and costs recognized in the year in respect of:				
Loss (return) on plan assets	460	(2,711)	-	-
Actuarial loss (gain)	(1,068)	1,742	(62)	172
Plan amendments	-	(2)	-	-
Increase in valuation allowance provided against accrued benefit asset	6	8	-	-
Net periodic benefit cost of plans	**-**	**89**	**75**	**97**
Amount charged to ACE, Aveos, and Aeroplan	(20)	(24)	(12)	(16)
Net defined benefit pension and other employee benefits expense	**$ (20)**	**$ 65**	**$ 63**	**$ 81**
Weighted average assumptions used to determine the accrued benefit cost				
Discount rate	7.35%	5.75%	6.25 - 7.35%	5.75 - 6.00%
Expected long-term rate of return on plan assets	7.15%	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 2009 and in 2010 was used in determining the net benefit pension expense and 2.50% 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 2009 (2008 - 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 $1 and the obligation by $18. 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 $23.

Composition of Pension Plan Assets

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

	2009	2008	Target Allocation (1)
Non-matched assets (mainly equities)	55.9%	52.9%	54.4%
Matched assets (mainly Canadian bonds)	43.4%	43.5%	45.6%
Cash and temporary investments	0.7%	3.6%	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 Master Trust Fund, as amended during 2009. 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, 2009, an additional 5% 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 $1 for the year ended December 31, 2009 (2008 - $1).

9. OTHER LONG-TERM LIABILITIES

			2009		2008
Unfavourable contract liability on aircraft leases (a)		$	31	$	37
Proceeds from contractual commitments (b)	Note 1C		107		-
Aircraft rent in excess of lease payments	Note 2W		41		56
Long-term employee liabilities (c)			33		35
Workplace safety and insurance board liabilities			40		37
Deferred gains on aircraft sale leasebacks			69		76
Other (d)			134		129
		$	**455**	**$**	**370**

(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:

		2009		2008
Beginning of year	$	54	$	66
Interest accretion		3		4
Charges recorded in wages, salaries, and benefits		30		21
Amounts disbursed		(26)		(37)
End of year		61		54
Current portion in Accounts payable and accrued liabilities		(28)		(19)
	$	**33**	**$**	**35**

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

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 $9 ($40 undiscounted) (2008 - $8 ($40 undiscounted)) representing the present value of the estimated decommissioning and remediation obligations at the end of the lease using an 8% (2008 - 8%) discount rate, with lease term expiry dates ranging from 2032 to 2039. This estimate is based on numerous assumptions including the overall cost of decommissioning and remediation and the selection of alternative decommissioning and remediation approaches.

10. STOCK-BASED COMPENSATION

Air Canada Long-Term Incentive Plan

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

	2009	2008
Compensation expense ($ millions)	$ 2	$ (3)
Number of stock options granted to Air Canada employees	2,330,000	11,000
Weighted average fair value per option granted ($)	$ 1.06	$ 1.99
Aggregated fair value of options granted ($ millions)	$ 2	$ -
Weighted average assumptions:		
Risk-free interest rate	1.73 - 3.14%	3.29%
Expected volatility	83.0 - 84.7%	34%
Dividend yield	0%	0%
Expected option life (years)	4.50	4.50

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

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

	2009		2008	
	Options	**Weighted Average Exercise Price/Share**	**Options**	**Weighted Average Exercise Price/Share**
Beginning of year	1,701,447	$ 19.14	1,720,092	$ 19.24
Granted	2,330,000	1.32	11,000	8.51
Forfeited	(67,973)	19.44	(29,645)	21.00
Outstanding options, end of year	**3,963,474**	**$ 8.66**	**1,701,447**	**$ 19.14**
Options exercisable end of year	**551,544**	**$ 19.60**	**362,253**	**$ 19.96**

		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**

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

Performance Share Units

The Long-term Incentive Plan also includes Performance Share Units (“PSUs”). The vesting term of PSUs is three years, generally commencing on January 1 of the year following granting, and incorporate performance vesting features based upon achieving 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 previously granted may only be redeemed for Air Canada shares purchased on the secondary market and/or equivalent cash. As outlined above, 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 Corporation.

The compensation expense related to PSUs in 2009 was less than $1. In 2008, previously recorded stock based compensation expense, related to PSUs, of $2 was reversed as management had determined that the performance vesting criteria would not be met.

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

	2009	2008
Beginning of year	1,671,068	551,251
Granted	11,591	1,125,092
Forfeited	(29,595)	(5,275)
Outstanding PSUs, end of year [(1)]	1,653,064	1,671,068

(1) As at December 31, 2009, all PSUs remain non-vested. Included in the total number of PSUs outstanding, 1,091,218 PSUs will entitle the employee to receive, at the discretion of the Corporation, Air Canada shares purchased on the secondary market and/or equivalent cash (2008 - 1,111,183). As at December 31, 2009, the liability related to these PSUs is less than $1.

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 2009, the Corporation recorded compensation expense of less than $1 (2008 - $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 **Outstanding shares**	**2009**	**2008**
Issued and outstanding		
Class A variable voting shares	56,586,112	15,475,659
Class B voting shares	221,560,947	84,524,341
Total issued and outstanding	**278,147,059**	**100,000,000**
Potential common shares		
Warrants (refer to note below)	90,250,000	-
Stock options	3,963,474	1,701,447
Performance share units	561,846	559,885
Total potential common shares	**94,775,320**	**2,261,332**

The changes during 2009 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, 2009 **Outstanding shares**		**Number of shares**	**Value**
Issued, beginning of year		100,000,000	$ 274
Shares issued under the pension MOUs	Note 8	17,647,059	28
Shares issued under the share and warrant public offering (refer to note below)		160,500,000	230
Issued, end of year		**278,147,059**	**$ 532**

Common Shares

As at December 31, 2009, 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, 2009 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	3.6
19-Oct-09	5,000,000	$1.44	19-Oct-13	3.8
27-Oct-09	80,250,000	$2.20	27-Oct-12	2.8
	90,250,000			

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(d) and 80,250,000 were issued in conjunction with the Share and Warrant Public Offering as described below.

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.

Accumulated Other Comprehensive Loss

Refer to Note 15 for the components of Accumulated other comprehensive loss.

12. EARNINGS PER SHARE

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

(in millions, except per share amounts)	2009	2008
Numerator:		
Numerator for basic earnings per share:		
Loss for the year	$ (24)	$ (1,025)
Adjusted numerator for diluted earnings per share	**$ (24)**	**$ (1,025)**
Denominator:		
Denominator for basic earnings per share:		
Weighted-average shares	132	100
Effect of potential dilutive securities:		
Contingently issuable shares	5	-
Warrants	-	-
Stock options	-	-
Performance share units	-	-
	5	-
Add back anti-dilutive impact	(5)	-
Adjusted denominator for diluted earnings per share	**132**	**100**
Basic loss per share	**$ (0.18)**	**$ (10.25)**
Diluted loss per share	**$ (0.18)**	**$ (10.25)**

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 to the date of their issuance on October 26, 2009.

Excluded from the 2009 calculation of diluted earnings per share were 3,724,659 (2008 - 1,701,447) outstanding options where the options' exercise prices were greater than the average market price of the common shares for the year. The 561,846 equity settled performance share units outstanding at December 31, 2009 (2008 - 559,885) were also excluded as management determined that the performance vesting criteria will not be met. 90,001,652 warrants were also excluded from the 2009 calculation of diluted earnings per share where 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	**2009**	**2008**
Canada	$ 3,591	$ 4,108
US Transborder	1,641	1,876
Atlantic	1,721	1,883
Pacific	829	995
Other	717	851
	$ 8,499	**$ 9,713**

Cargo revenues	**2009**	**2008**
Canada	$ 63	$ 97
US Transborder	14	18
Atlantic	127	212
Pacific	112	142
Other	42	46
	$ 358	**$ 515**

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, 2009, 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. During 2009, the Corporation and Boeing agreed to amend certain commercial terms, including revisions to delivery dates. The Corporation's first Boeing 787 aircraft is now scheduled for delivery in the second half of 2013.

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, 2009 approximates $4,812 (of which $3,117 is subject to committed financing, subject to the fulfillment of certain terms and conditions). US dollar amounts are converted using the December 31, 2009 noon day rate of CDN$1.0466. 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, 2009. Other capital purchase commitments relate principally to building and leasehold improvement projects.

	2010	2011	2012	2013	2014	Thereafter	Total
Capital Commitments	$ 74	$ 47	$ 121	$ 731	$ 979	$ 2,860	$ 4,812

Operating Lease Commitments

During 2009, the Corporation took delivery of its last two planned Boeing 777 aircraft, one of which was leased under an operating lease.

As at December 31, 2009 the future minimum lease payments under existing operating leases of aircraft and other property amount to $2,630 using year end exchange rates.

	2010	2011	2012	2013	2014	Thereafter	Total
Aircraft	$ 370	$ 334	$ 317	$ 295	$ 232	$ 754	$ 2,302
Other property	49	41	38	27	25	148	328
Total	**$ 419**	**$ 375**	**$ 355**	**$ 322**	**$ 257**	**$ 902**	**$ 2,630**

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 29 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:

2010	2011	2012	2013	2014	Thereafter	Total
$ 81	$ 80	$ 80	$ 80	$ 80	$ 553	$ 954

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 capacity purchase agreements with Jazz is approximately $732 (2008 - $764) and with other regional carriers is $29 (2008 - $30). As described in Note 2D and based upon amended terms as described in Note 1C, 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 a benchmarking exercise with other regional carriers planned to be completed in 2010.

Maturity Analysis

Principal and interest repayment requirements as at December 31, 2009 on Long-term debt and capital lease obligations are as follows:

Principal	2010	2011	2012	2013	2014	Thereafter	Total
Long-term debt obligations	$ 368	$ 655	$ 418	$ 495	$ 383	$ 1,360	$ 3,679
Capital lease obligations	100	101	110	119	94	380	904
	$ 468	**$ 756**	**$ 528**	**$ 614**	**$ 477**	**$ 1,740**	**$ 4,583**

Interest	2010	2011	2012	2013	2014	Thereafter	Total
Long-term debt obligations	$ 213	$ 177	$ 144	$ 109	$ 75	$ 167	$ 885
Capital lease obligations	80	71	62	50	41	118	422
	$ 293	**$ 248**	**$ 206**	**$ 159**	**$ 116**	**$ 285**	**$ 1,307**

Principal repayments in the table above exclude transaction costs of $61 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, 2009.

	2010	2011	2012	2013	2014	Thereafter	Total
Long-term debt obligations	$ 581	$ 832	$ 562	$ 604	$ 458	$ 1,527	$ 4,564
Capital lease obligations	180	172	172	169	135	498	1,326
Accounts payable and accrued liabilities	1,215	-	-	-	-	-	1,215
Fuel derivatives	31	-	-	-	-	-	31
	$ 2,007	**$ 1,004**	**$ 734**	**$ 773**	**$ 593**	**$ 2,025**	**$ 7,136**

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 2010 is $211. 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 2009, the Corporation purchased $249 from Aeroplan.

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Summary of Financial Instruments

	Carrying Amounts					
	December 31, 2009					December 31, 2008
	Financial instruments classification					
	Held for trading	Held to maturity	Loans and receivables	Liabilities at amortized cost	Total	
Financial Assets						
Cash and cash equivalents	$ 1,115	$ -	$ -	$ -	$ 1,115	$ 499
Short-term investments	292	-	-	-	292	506
Restricted cash	78	-	-	-	78	45
Accounts receivable	-	-	701	-	701	702
Collateral deposits for fuel derivatives	43	-	-	-	43	328
Deposits and other assets						
Restricted cash	121	-	-	-	121	65
Asset backed commercial paper	29	-	-	-	29	29
Aircraft related and other deposits	-	256	-	-	256	323
Derivative instruments						
Foreign exchange derivatives	-	-	-	-	-	64
Interest rate swaps	11	-	-	-	11	21
	$ 1,689	$ 256	$ 701	$ -	$ 2,646	$ 2,582
Financial Liabilities						
Accounts payable	$ -	$ -	$ -	$ 1,215	$ 1,215	$ 1,262
Current portion of long-term debt and capital leases	-	-	-	468	468	663
Long-term debt and capital leases	-	-	-	4,054	4,054	4,691
Derivative instruments						
Fuel derivatives [1]	31	-	-	-	31	15
Foreign exchange derivatives	4	-	-	-	4	-
	$ 35	$ -	$ -	$ 5,737	$ 5,772	$ 6,631

[1] The fuel derivatives above relate to fuel derivatives not designated under fuel hedge accounting. There are no fuel derivatives designated under hedge accounting as at December 31, 2009. As at December 31, 2008, fuel derivatives under hedge accounting had a fair value of $405 in favour of the counterparties and are described further below.

There have been no changes in classification of financial instruments since December 31, 2008.

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 $10 (2008 - $18), 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 (2008 - $11) 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

	2009	2008
Ineffective portion of fuel hedges	$ -	$ 83
Fuel derivatives not under hedge accounting	102	(9)
Cross currency interest rate swaps	-	4
Other	(7)	14
Gain on financial instruments recorded at fair value [(1)]	**$ 95**	**$ 92**

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

Risk Management

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

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

Interest Rate Risk

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

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

The ratio of fixed to floating rate 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. The ratio at December 31, 2009 is 59% fixed and 41% floating, including the effects of interest rate swap positions (58% and 42%, respectively as at December 31, 2008).

The following are the current derivatives employed in interest rate risk management activities and the adjustments recorded during 2009:

- During 2009, the Corporation entered into an interest rate swap agreement, with a term to November 2011, relating to the Credit Facility as described in Note 6, with an original notional value of $600 systematically declining as payments are made to $450 by the end of its two-year term. This swap converts the Credit Facility's bankers' acceptance rate setting from "in advance" to "in arrears minus 0.2%". The fair value of this contract as at December 31, 2009 was $1 in favour of the counterparty. This derivative instrument has not been designated as a hedge for accounting purposes and is recorded at fair value. During 2009, a loss of $1 was recorded in Gain on financial instruments recorded at fair value related to this derivative.
- As at December 31, 2009, 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 $92 (US$88) (2008 - $118 (US$96)). 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, 2009 was $12 in favour of the Corporation (2008 - $21 in favour of the Corporation). These derivative

instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During 2009, a loss of $9 was recorded in Gain on financial instruments recorded at fair value related to these derivatives (2008 - $14 gain).

Interest income includes $10 (2008 - $47) related to Cash and cash equivalents, Short-term investments, and Collateral deposits for fuel derivatives, which are classified as held for trading. Interest expense reflected on the Consolidated Statement of Operations relates to financial liabilities recorded at amortized cost.

Foreign Exchange Risk

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

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

The Corporation's cash inflows are primarily in Canadian dollars, while a large portion of its outflows are in US dollars. This unbalanced mix results in a US dollar shortfall from operations annually. In order to mitigate this imbalance, the Corporation has adopted the practice of converting excess revenues from offshore currencies into US dollars. In 2009, this conversion generated coverage of approximately 29% of the imbalance. The remaining 71% was covered through the use of a variety of foreign exchange derivatives, including spot transactions and USD 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 2009:

- As at December 31, 2009, the Corporation had outstanding foreign currency option agreements converting US dollars into Canadian dollars on $99 (US$95) which mature in 2010 (2008 - $632 (US$516) and $5 (EUR 3)). The fair value of these foreign currency contracts as at December 31, 2009 was $4 in favour of the counterparties (2008 - $64 in favour of the Corporation). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During 2009, a loss of $7 was recorded in Foreign exchange gain (loss) related to these derivatives (2008 - $327 gain).

Liquidity risk

Along with many airline carriers globally, Air Canada faced a number of significant challenges in 2008 and 2009 as a result of volatile fuel prices and the weakening demand for air travel. The recession put significant pressures on passenger and cargo revenues for many airlines, including Air Canada. At the same time, lower fuel prices in 2009 and capacity adjustments made in 2008 and 2009 provided some relief.

Management believes however that the significant events as described in Note 1C improve the Corporation's current liquidity position. Risks remain such as those related to the current economic environment, including risks related to market volatility in the price of fuel, foreign exchange and interest rates and increased competitive pressures, as well as risks relating to restrictive terms under the Corporation's financing, credit card processing and other arrangements and other risks identified. These notes to the financial statements contain information regarding the key liquidity risks being monitored by the Corporation (refer to information below regarding Market risks, Note 8 for information regarding pension funding obligations, Note 17 for information regarding contingencies including the Cargo investigations, Note 6 regarding covenants in financing arrangements and below for information regarding covenants in the Corporation's credit card agreements).

The H1N1 influenza virus may also adversely impact demand for air travel. The Corporation is continuing to monitor the H1N1 influenza virus risk. While the Corporation has developed contingency plans related to the H1N1 influenza virus risk, it is unable to predict the likelihood of this risk materializing or the impact on the Corporation to the extent this risk does materialize. The Corporation is also monitoring the impact on the demand for air travel of the new security measures imposed December 2009 by Canadian and U.S. government authorities on flights from Canada to the U.S.

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, 2009, Air Canada had Cash and cash equivalents and Short-term investments of $1,407, which represents 14% of 2009 operating revenues. Management continues to closely monitor the cash flows as part of its efforts to ensure the Corporation has adequate cash resources to meet its obligations and commitments when they become due.

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.

The Corporation uses derivative instruments to reduce market exposures from changes in foreign currency rates, interest rates, and fuel prices. The Corporation uses derivative instruments only for risk management purposes and not for generating trading profit. As such, any change in cash flows associated with derivative instruments is designed to be offset by changes in cash flows related to the risk being hedged.

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

Sensitivity Analysis

The following table is a sensitivity analysis for each type of market risk relevant to the significant financial instruments recorded by the Corporation as at December 31, 2009. 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	$ (7)	$ 7	$ -	$ -
Short-term investments	$ 3	$ (1)	$ 1	$ -	$ -
Aircraft related deposits	$ -	$ (8)	$ 8	$ -	$ -
Long-term debt and capital leases	$ (15)	$ 195	$ (195)	$ -	$ -
Fuel derivatives	$ -	$ -	$ -	$ 25	$ (22)
Foreign exchange derivatives	$ -	$ (6)	$ 5	$ -	$ -
Interest rate swaps	$ 1	$ -	$ -	$ -	$ -

(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% decrease or increase 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.

As at December 31, 2008, under the terms with one of its principal credit card processors, the processor was able to withhold payment of funds to Air Canada upon the occurrence of certain events ("triggering events"), which included unrestricted cash (as defined per the agreement and generally based on the aggregate sums of Cash and cash equivalents and Short-term investments) being less than $900 as at the end of any month and operating losses in excess of certain amounts. During 2009, the Corporation entered into amendments with this processor to amend certain credit card processing agreements under which the triggering events related to operating losses were removed, the levels of unrestricted cash required to be maintained by Air Canada were reduced to $800 and Air Canada provides the processor with deposits, to be accumulated over time, and security. The agreements provide that should Air Canada maintain unrestricted cash of more than $1,200 for two consecutive months, the unrestricted cash requirement increases to $1,100 at which time the processor will return to Air Canada all deposits and security previously provided by Air Canada. This occurred during the third quarter of 2009, and as a result, no deposit was provided under these processing agreements as at December 31, 2009. As long as unrestricted cash remains at or above $1,100 at each month-end, Air Canada will have no obligation to provide deposits or security to the processor. In addition, should the Corporation's unrestricted cash be less than $1,100 at any month-end, its obligation to provide deposits to the processor would be capped at an amount not to exceed $75, provided unrestricted cash is not less than $800. The current agreement expires in May 2010.

Credit Risk

Credit risk is the risk of loss due to a counterparty's inability to meet its obligations. As at December 31, 2009, the Corporation's credit risk exposure consists mainly of the carrying amounts of Cash and cash equivalents, Short-term investments and Accounts receivable as well as Collateral deposits for fuel derivatives extended to counterparties. Cash and cash equivalents and Short-term investments are in place with major financial institutions, the Canadian government, and major corporations. Accounts receivable are generally the result of sales of tickets to individuals, often through the use of major credit cards, through geographically dispersed travel agents, corporate outlets, or other airlines. Credit rating guidelines are used in determining counterparties for fuel hedging. In order to manage its exposure to credit risk and assess credit quality, the Corporation reviews counterparty credit ratings on a regular basis and sets credit limits when deemed necessary.

The Corporation has $43 in collateral deposits extended to fuel hedge counterparties. Credit risk related to these deposits is offset against the related liability to the counterparty under the fuel derivative.

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

Fuel Price Risk

In order to manage its exposure to jet fuel prices and to help mitigate volatility in operating cash flows, the Corporation enters into derivative contracts with financial intermediaries. The Corporation uses derivative contracts on jet fuel and other crude oil-based commodities, 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 2009, the Corporation purchased crude-oil call options. The premium related to these contracts was $6.

As of December 31, 2009, approximately 18% of the Corporation's anticipated purchases of jet fuel for 2010 are hedged at an average West Texas Intermediate ("WTI") capped price of USD$95 per barrel and approximately 10% is subject to an average floor price of US$96 per barrel. The Corporation's contracts to hedge anticipated jet fuel purchases over the 2010 period are comprised of crude-oil based contracts.

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, 2009.

Derivative Instruments	Term	Volume (BBLs)	WTI Weighted Average Floor Price (US$/bbl)	WTI Weighted Average Capped Price (US$/bbl)
Call options (a)	2010	1,835,000	n/a	$ 92
Swaps (a)	2010	1,070,000	$ 99	$ 99
Collars (a)	2010	1,180,000	$ 93	$ 95

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

During 2009, fuel derivative contracts cash settled with a fair value of $88 in favour of the counterparties ($129 in favour of the Corporation in 2008).

During 2009, the Corporation modified its fuel hedge portfolio with the termination of swap and put option contracts for $192, in favour of the counterparties. The collateral held by the counterparties covered the majority of the settlement amount, therefore minimal additional cash outflows resulted. Certain of these contracts were previously designated under hedge accounting. The value of the AOCL balance recognized in connection with these derivatives while designated under hedge accounting will be taken into fuel expense in the period where the derivative was scheduled to mature.

As at December 31, 2009, the net amount of existing losses reporting in AOCL that are expected to be reclassified to net income (loss) during the following 12 months is $183 before tax. Due to the discontinuation of hedge accounting effective the third quarter of 2009 (refer to Note 2L), the AOCL balance related to fuel hedging contracts will be completely depleted as of December 31, 2010.

The types of derivative instruments used by the Corporation within its hedging program, such as swaps and 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. As at December 31, 2009, the Corporation had extended $43 of collateral to counterparties (2008 – $328).

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

For the year ended December 31 (Canadian dollars in millions except per share figures)		2009	2008
Consolidated Statement of Operations			
Operating expenses			
Aircraft fuel	Realized effective gain (loss) on derivatives designated under hedge accounting	$ (419)	$ 79
Non-operating income (expense)			
Gain (loss) on financial instruments recorded at fair value	Ineffective gain (loss) on derivatives designated under hedge accounting	$ -	$ 83
	Fair market value gain (loss) on economic hedges	$ 102	$ (9)
Consolidated Statement of Comprehensive Income (Loss)			
	Effective gain (loss) on derivatives designated under hedge accounting	$ (1)	$ (605)
	Tax expense on effective gain	$ -	$ -
	Reclassification of net realized (gain) loss on fuel derivatives designated under hedge accounting to Aircraft fuel expense	$ 419	$ (79)
	Tax on reclassification	$ 4	$ 22

As at December 31 (Canadian dollars in millions)		2009	2008
Consolidated Statement of Financial Position			
Current assets	Collateral deposits for fuel derivatives	$ 43	$ 328
Current liabilities*	Fair market value of fuel derivatives designated under hedge accounting	n/a	$ (405)
	Fair market value of fuel derivatives economic hedges	$ (31)	$ (15)
Shareholders' equity (AOCL)	Net loss from fuel derivatives designated under hedge accounting (net of tax of 2009 - $1 and 2008 - $5)	$ (184)	$ (606)

* The balance is reflected within Current liabilities on the Consolidated Statement of Financial Position due to the counterparty's ability to terminate the derivatives at fair value at any time prior to maturity.

Financial Instrument Fair Values in the Consolidated Statement of Financial Position

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

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

Management estimated the fair value of its long-term debt based on valuation techniques taking into account market rates of interest, the current tightness in credit markets and current estimated credit margins applicable to the Corporation based on recent transactions. The current low market rates of interest partially offset any increase in credit margins observed in recent transactions. The estimated fair value of debt is approximately $4,200 as compared to its carrying value of $4,522, reflecting primarily the declines in fair values of aircraft financings completed in prior years.

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.

	December 31 2009	Fair value measurements at reporting date using: 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	$ 323	$ -	$ 323	$ -
Short-term investments	292	-	292	-
Restricted cash in short-term investments	70	-	70	-
Deposits and other assets				
Asset backed commercial paper	29	-	-	29
Derivative instruments				
Interest rate swaps	11	-	11	-
Total	**$ 725**	**$ -**	**$ 696**	**$ 29**

	December 31 2009	Fair value measurements at reporting date using: 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				
Fuel derivatives	$ 31	$ -	$ 31	$ -
Foreign exchange derivatives	4	-	4	-
Total	**$ 35**	**$ -**	**$ 35**	**$ -**

Financial assets held by financial institutions in the form of cash, restricted cash and collateral deposits for fuel derivatives 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. The carrying value as at December 31, 2009 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 2009.

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. As at December 31, 2008, the Corporation had pre-delivery financing arranged, which was related to future deliveries, and, as the aircraft had not yet been delivered, this debt was excluded from the capital base. The Company includes capitalized operating leases, which is a measure commonly used in the industry ascribing a value to obligations under operating leases. The value is based on annualized aircraft rent expense multiplied by 7.5, which is a factor commonly used in the airline industry. The measure used may not necessarily reflect the fair value or net present value related to the future minimum lease payments as the measure is not based on the remaining contractual payments and the factor may not recognize discount rates implicit in the actual leases or current rates for similar obligations with similar terms and risks. This definition of capital is used by management and may not be comparable to measures presented by other public companies.

The Corporation also monitors its ratio of adjusted net debt to net debt plus shareholders' equity. Adjusted net debt is calculated as the sum of Long-term debt and capital lease obligations, Non-controlling interest, capitalized operating leases, and Shareholders' equity less Cash and cash equivalents and Short-term investments.

The Corporation's main objectives when managing capital are:

- to structure repayment obligations in line with the expected life of the Corporation's principal revenue generating assets;
- to ensure the Corporation has access to capital to fund contractual obligations as they become due and to ensure adequate cash levels to withstand deteriorating economic conditions;
- to maintain an appropriate balance between debt supplied capital versus investor supplied capital as measured by the adjusted net debt to net debt plus equity ratio; and
- to 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:

	2009	2008
Long-term debt and capital leases	$ 4,054	$ 4,691
Current portion of long-term debt and capital leases	468	663
	4,522	5,354
Non-controlling interest	201	190
Capitalized operating leases	2,513	2,093
Less pre-delivery financing included in long-term debt	-	(81)
Adjusted debt and non-controlling interest	7,236	7,556
Shareholders' equity	1,446	762
Total Capital	**$ 8,682**	**$ 8,318**
Adjusted debt and non-controlling interest	**$ 7,236**	**$ 7,556**
Less Cash and cash equivalents and Short-term investments	(1,407)	(1,005)
Adjusted net debt and non-controlling interest	**$ 5,829**	**$ 6,551**
Adjusted net debt to adjusted net debt plus shareholders' equity ratio	**80.1%**	**89.6%**

The adjusted net debt and non-controlling interest amount has decreased by $722 in 2009 largely attributable to the impact of the appreciation of the Canadian dollar and the resulting impact on US dollar debt. The increase in the cash balance during the year was also a significant contributor driven by the completion of a share and warrant public offering and other transactions described in Note 1C.

17. CONTINGENCIES, GUARANTEES AND INDEMNITIES

Contingencies

Investigations by Competition Authorities Relating to Cargo

The European Commission, the United States Department of Justice and the Competition Bureau in Canada, among other competition authorities, are investigating alleged anti-competitive cargo pricing activities, including the levying of certain fuel surcharges, of a number of airlines and cargo operators, including Air Canada. Competition authorities have sought or requested information from Air Canada as part of their investigations. Air Canada is 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 including in the European Union where all formal procedural steps preceding a decision have been completed. Air Canada is also named as a defendant in a number of class action lawsuits that have been filed before the United States District Court and in Canada in connection with these allegations.

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

Porter Airlines Inc.

In February 2006, Jazz commenced proceedings before the Ontario Superior Court of Justice against Porter Airlines Inc. ("Porter") and other defendants (collectively the "Porter Defendants") after Jazz became aware that it would be excluded from operating flights from Toronto City Centre (Island) Airport (the "TCCA"). On October 26, 2007, the Porter Defendants counter-claimed against Jazz and Air Canada alleging various violations of competition law, including that Jazz and Air Canada's commercial relationship contravenes Canadian competition laws, and claiming $850 in damages. Concurrently with the Ontario Superior Court of Justice proceedings, Jazz commenced judicial review proceedings against the Toronto Port Authority ("TPA") before the Federal Court of Canada relating to Jazz's access to the TCCA. The Porter Defendants were granted intervener and party status in these proceedings. In January of 2008, Porter filed a defence and counterclaim against Jazz and Air Canada making allegations and seeking conclusions similar to those in the Ontario Superior Court counterclaim. On October 16, 2009, Jazz discontinued its suit in the Ontario Superior Court against Porter. However, Jazz is continuing its proceedings in the Federal Court of Canada against the TPA, to which Porter intervened. The counterclaim filed by Porter in the Ontario Court against Jazz and Air Canada has been stayed pending the outcome of the mirror counterclaim in the Federal Court. Management views Porter's counterclaims in both jurisdictions as being without merit.

Pay Equity

The Canadian Union of Public Employees ("CUPE"), which represents Air Canada's flight attendants, has 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. 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 significant material adverse effect on the financial position or the results of the Corporation.

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

Guarantees

Guarantees in Fuel Facilities Arrangements

The Corporation participates in fuel facility arrangements operated through Fuel Facility Corporations, along with other airlines that contract for fuel services at various major airports in Canada. The Fuel Facility Corporations operate on a cost recovery basis. The purpose of the Fuel Facility Corporations is to own and finance the system that distributes the fuel to the contracting airlines, including leasing the Land Rights under the land lease. The aggregate debt of the five Fuel Facility Corporations in Canada that have not been consolidated by the Corporation under AcG-15 is approximately $162 as at December 31, 2009 (2008 - $127), which is the Corporation's maximum exposure to loss without taking into consideration any cost sharing that would occur amongst the other contracting airlines. The Corporation views this loss potential as remote. Each contracting airline participating in a Fuel Facility Corporation shares pro rata, based on system usage, in the guarantee of this debt.

Indemnification Agreements

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

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

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

Under its general by-laws and pursuant to contractual agreements between the Corporation and each of its officers and directors, the Corporation has indemnification obligations to its directors and officers. Pursuant to

such obligations, the Corporation indemnifies these individuals, to the extent permitted by law, against any and all claims or losses (including amounts paid in settlement of claims) incurred as a result of their service to the Corporation.

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

18. RELATED PARTY TRANSACTIONS

At December 31, 2009, ACE holds a 27% ownership interest in Air Canada. Air Canada has various related party transactions with ACE and Aveos (formerly called ACTS Aero Technical Support & Services Inc. ("ACTS Aero")), which conducts the business previously operated by ACTS LP ("ACTS") prior to the sale of ACTS by ACE on October 16, 2007.

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

Related party trade balances, as outlined below, mainly arise from the provision of services, including the allocation of employee related costs, as further described in Note 8. Trade balances between the related parties have trade terms which generally require payment 30 days after receipt of invoice.

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

	2009	2008
Accounts receivable		
ACE	$ -	$ 2
Aveos	135	120
	$ 135	**$ 122**
Prepaid Maintenance		
Aveos	$ 9	$ 5
	$ 9	**$ 5**
Accounts payable and accrued liabilities		
ACE	$ 3	$ -
Aveos	92	99
	$ 95	**$ 99**
Long-term debt including current portion and value of warrants		
ACE	$ 150	$ -
	$ 150	**$ -**

Revenues and expenses with related parties are summarized as follows:

	2009	2008
Revenues		
Property rental revenues from ACE and Aveos	$ 31	$ 29
Revenues from information technology services to Aveos	6	15
Revenues from corporate services and other to ACE and Aveos	9	15
	$ 46	**$ 59**
Expenses		
Maintenance expense for services from Aveos	$ 514	$ 478
Recovery of wages, salary and benefit expense for employees assigned to ACE and Aveos	(228)	(277)
Interest expense for ACE's participation in the Credit Facility	8	-
Other expenses	-	1
	$ 294	**$ 202**

Summary of significant related party agreements

The Relationship between the Corporation and Aveos

Refer to the "Aveos Restructuring Plan" section below for a description of a restructuring plan announced by Aveos on January 26, 2010. Closing of Aveos restructuring transactions is expected to occur during the first quarter of 2010 and is dependant on completion of formal documentation and certain conditions. This restructuring would modify the terms of certain commercial agreements between Air Canada and Aveos, including terms of the Pension and Benefits Agreement and the Agreement with Aveos on Revised payment terms described below.

Pension and Benefits Agreement

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

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

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

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

During 2008, Air Canada, Aveos, and the union representing the employees assigned to Aveos continued discussions regarding the options under which certain unionized employees would commence employment directly with Aveos and the creation of a separate bargaining unit for those employees at Aveos. On January 8, 2009, these same parties entered into the Transition MOA in order to resolve certain remaining issues and in order to (i) facilitate the orderly transition of certain Air Canada employees to Aveos and (ii) to establish terms and conditions of employment that will apply to those Air Canada employees who elect to become employees of Aveos. In relation to the Transition MOA, the Corporation and Aveos also entered into certain ancillary agreements (the “Ancillary Transition Agreements”) to address commercial issues relating to the transition of employees contemplated by the Transition MOA. On March 5, 2009, the Corporation received the decision of the arbitrator seized with resolving five issues which remained outstanding following the execution of the Transition MOA. The Corporation and the IAMAW subsequently amended the Transition MOA, by establishing timelines for the steps for the transition and by providing for a date on which the employees who will transition to Aveos will become employees of Aveos, namely, April 1, 2011.

Non-Compete and Repair Schemes Transfer Agreement

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

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

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

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

Agreement with Aveos on Revised Payment Terms

Air Canada and Aveos entered into an agreement dated October 28, 2008 pursuant to which Air Canada has agreed to temporarily extend payment terms to Aveos under certain related party agreements. In exchange for the extended payment terms, certain letters of credit related to the Pension and Benefits Agreement, as described above, were cancelled. The cancellation of the letters of credit provided cash to Air Canada of approximately $40 and was offset by the impact of extended payment terms to Aveos of $22, for a net cash flow benefit of $18 to the Corporation. The extended payment terms to Aveos were originally scheduled to begin reducing in May 2009 with a corresponding return of the letters of credit to Aveos.

As a result of amendments, the payment terms were extended. The extended payment terms will be reduced starting in February 2010 with the expiration of the extended payment terms to be completed over the following six months. By July 2010, following expiration of the extended payment terms, the letters of credit would be reinstated to the levels then required under the Pension and Benefits Agreement between the two parties. Refer to the Aveos Restructuring Plan section below for a description of amendments which would be made to this Agreement pursuant to the restructuring.

Maintenance Agreements

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

Master Services Agreement (MSA)

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

General Services Agreements

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

Real Estate Agreements

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

Aveos Restructuring Plan

On January 26, 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 a preliminary agreement to settle certain issues and modify the terms of certain contractual arrangements in exchange for Air Canada receiving a minority equity interest in Aveos. The modified terms relating to the maintenance agreements are not expected to have a material impact on maintenance expense over their terms.

Closing of Aveos' recapitalization, including the related transactions between Air Canada and Aveos, is subject to completion of formal documentation and other conditions and is expected to occur during the first quarter of 2010. As part of these agreements, the Corporation would also agree to extend repayment terms on $22 of receivables (described above under *Agreement with Aveos on Revised Payment Terms*), due in 2010, over six years with annual repayments on a non-interest bearing basis, with such payments subject to satisfaction of certain conditions.

The terms of the Pension and Benefits Agreement (described above) would also be modified to defer the determination of pension assets and related solvency deficiencies of transferring unionized employees performing airframe maintenance services to April 2011. This would have the result of Air Canada assuming changes in the solvency deficiency for those affected employees from the date of the Pension and Benefits Agreement to the date of their transfer to Aveos, scheduled for April 2011. As part of the amendment, all letters of credit issued under the Pension and Benefits Agreement would be cancelled and a new letter of credit in a maximum amount of $20 would be 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 is liable under the PBA. This modification would result in a reduction to the outstanding deposit under Air Canada's letter of credit facility of approximately $20 in the first quarter of 2010.

The accounting for the above agreements will be determined upon closing.

The Relationship between the Corporation and ACE

Term Credit Facility

ACE is a participant lender in the Credit Facility as described in Note 6. ACE's participation in the Credit Facility represents $150 of the outstanding loan of $600 as at December 31, 2009. The participant lenders participate on a pro-rata basis with respect to any warrants and principal and interest payments. ACE's pro-rata share of interest expense reported during the year amounts to $8 and its pro-rata share of the warrants as reported in Contributed surplus is approximately $2.

Master Services Agreement

Air Canada provides certain accounting and administrative services to ACE in return for a fee. ACE terminated the majority of these service agreements in 2009.