

## Air Canada/OSFI Pension Funding Relief Protocol

May 14, 2004

**WHEREAS** the Office of the Superintendent of Financial Institutions (“**OSFI**”) is responsible for the administration of the *Pension Benefits Standards Act, 1985* (the “**PBSA, 1985**”), to which Air Canada’s 10 registered pension plans (each, a “**Plan**” and collectively, the “**Plans**”) are subject;

**AND WHEREAS** the PBSA, 1985 and its regulations from time to time (the “**Regulations**”) set out the required funding and solvency standards that must be met by federally regulated private pension plans, with any solvency deficiency to be funded by the making of equal annual payments over a maximum of 5 years;

**AND WHEREAS** section 8 of the PBSA, 1985 provides that all contributions due or accrued to a pension plan are subject to a deemed trust;

**AND WHEREAS** in March 2003, the Superintendent of Financial Institutions (the “**Superintendent**”) issued directions to Air Canada which OSFI takes the position resulted in approximately \$346,616,000.00 (plus the \$34 million referred to below) being subject to a deemed trust by virtue of the PBSA, 1985 as at January 1, 2004;

**AND WHEREAS** on April 1, 2003 Air Canada and certain of its affiliates filed for protection under the *Companies’ Creditors Arrangement Act* (the “**CCAA**”);

**AND WHEREAS** Air Canada and representatives of the Plans’ beneficiaries (the “**Pension Beneficiary Group**”) have agreed to the Air Canada 10-Year Solvency Pension Funding Relief Proposal dated February 18, 2004 (the “**Proposal**”), and have requested that OSFI recommend amendments to the Regulations allowing for the payment of the Plans’ solvency deficiencies over 10 years as opposed to the current maximum of 5 years. The Proposal also requests that the solvency deficiencies be paid in accordance with a schedule of special payments with variable annual payments as opposed to equal annual payments;

**AND WHEREAS** Air Canada agreed in the Proposal to request the approval of the court to remit approximately \$34 million in special payments to 3 of the Plans upon execution of this Protocol, and this amount will be applied to the deficit calculation as at January 1, 2004 as if such payments had been made prior to that date;

**AND WHEREAS** OSFI indicated in the principles issued to Air Canada and the parties to the Plans on October 23, 2003 (the “**Principles**”) that it was willing to propose amendments to the funding provisions of the Regulations, provided a proposal by Air Canada and the other parties to the Plans met certain principles to OSFI’s satisfaction;

**AND WHEREAS** the Principles identify the added risk to the Plan beneficiaries of an extended funding schedule;

**AND WHEREAS** in light of: (a) the terms of the Proposal; (b) the agreement by Air Canada to provide promissory notes on the terms set forth below; and (c) the undertaking from Air Canada that it would make additional special payments in respect of 2005 and 2006 above the amounts set out in the Proposal, OSFI recognizes that the assertion of Air Canada, the Pension Beneficiary Group and the CCAA Monitor that efforts to enforce the purported deemed trust amounts would jeopardize the emergence of Air Canada from CCAA protection and result in immediate loss to the Plan beneficiaries, such that a modified payment schedule and provision of security for the \$346,616,000.00 would be acceptable under certain circumstances;

**AND WHEREAS** the parties wish to agree to a payment schedule over 10 years to implement the funding relief, an aggregate estimate of which is set forth in the attached Schedule 2, and which will be broken down by Plan and specify the capital portion applicable to each payment (such replacement schedule the "Initial Schedule"):

**NOW THEREFORE** Air Canada and OSFI agree as follows:

1. From the date of this Protocol until the earlier of December 31, 2004 and the time of emergence by Air Canada from the current CCAA proceedings or any other termination of the CCAA proceedings, neither party will initiate, continue or support any action or proceeding or otherwise take any steps to prove or disprove the existence or validity of, or make demand for payment under any deemed trust. Air Canada agrees that during the CCAA proceedings it will apply to the court for approval to remit its current service contributions to the Plans in accordance with the requirements of the PBSA, 1985 and the Regulations.
2. Air Canada and OSFI agree as follows: (a) OSFI shall review and process the Plan amendments referenced in paragraphs 9 and 10 of the Proposal upon submission thereof by Air Canada. Air Canada agrees to cooperate and provide OSFI with any information that is required in order to facilitate the review; (b) the aggregate amount which Air Canada will remit to the Plans by way of solvency special payments in respect of 2005 and 2006 shall be increased by \$20 million per year from the amounts described in the Proposal, with a reduction of equivalent value applied proportionately over the last 5 years of the funding relief period, as reflected in the Initial Schedule; (c) promptly after execution of this Protocol, Air Canada will apply to the court for approval to remit approximately \$34 million to the Plans referenced in the Proposal plus interest from the due date to the date of remittance; and (d) to take such steps as the parties mutually agree are necessary to implement a substitution of the entire amount of any deemed trust that may exist as of or may have arisen prior to the date of emergence from CCAA protection. For greater certainty: (a) OSFI agrees and acknowledges that upon implementation of the terms of this Protocol, there shall be no deemed trust under the PBSA, 1985 in respect of any purported special payments or other contributions by reference to which the \$346,616,000.00 has been computed; and (b) Air Canada agrees and acknowledges that the current requirements under the PBSA, 1985 relating to the application of a

deemed trust to future payments and other amounts that become due or accrue to the Plans from Air Canada will remain unchanged.

3. OSFI will propose to the Government of Canada an amendment to the Regulations required to implement this Protocol.
4. Upon emergence from the CCAA proceedings, Air Canada will issue to the trustee of each Plan a secured promissory note (each a “**Note**” and collectively, the “**Notes**”), such Notes to have an aggregate principal amount of \$346,616,000.00. The principal amount of the Note relating to each Plan will be as set forth in Schedule 1 to this Protocol. The Notes shall be held by a collateral agent (the “**Collateral Agent**”) pursuant to the terms of a collateral agency agreement between such Collateral Agent and the trustee of each Plan. Such agreement shall set forth, inter alia, the ranking and the enforcement of the Notes and the GSA (as defined below).
5. The terms of the Notes and the security documentation will include the following:
  - (a) each Note will be non-interest bearing until it is accelerated in accordance with its terms, from which date it will bear interest at the effective rate used in the last filed solvency valuation for the relevant Plan;
  - (b) all of the Notes will be secured by second ranking security in the form of a general security agreement and equivalent instruments as required in any relevant jurisdiction (collectively the “**GSA**”) in favour of the Collateral Agent over all of Air Canada’s property, assets and undertakings, but shall not extend to property, assets and undertakings that are: (i) specifically charged to or leased from third parties; (ii) charged or given as security or are placed in trust, as required by law; or (iii) excluded or released in accordance with the general security agreements concerning the Senior Debt. Without limiting the generality of the foregoing, the GSA shall not extend to any asset, property or undertaking (including all aircraft, engines or related parts and equipment) which are the subject of, or pledged as security for, now or in the future, any asset-specific secured financing or leasing including: (i) any purchase money security transaction; (ii) any sale and financing/leaseback transaction; (iii) any aircraft or aircraft improvement lessor financing; (iv) any capitalized lease obligations; (v) any existing or future receivables financing or financing pursuant to any other asset securitization transaction; (vi) any existing or future deposit or reimbursement obligation to secure or support any letters of credit, hedging arrangements or swaps (whether in relation to the items enumerated in this paragraph or not); and (vii) any guarantee, obligation or liability, direct or indirect, of Air Canada supporting the obligation of any third party for indebtedness or obligations of the kind described in 5(b)(i) through 5(b)(vi) above (collectively, the “**Asset-Specific Secured Financings**”). The GSA shall also include provisions to ensure compatibility with standard industry swapping arrangements relating to aircraft, engines and spare parts. The GSA shall be registered in each jurisdiction in which the

security delivered under the GECAS Financing (as defined below) general security agreement is registered;

- (c) the Notes and GSA will be subordinated and postponed to: (i) the GECAS Financing (as defined below); (ii) any refinancing of 5(c)(i) above whether in whole or in part, which refinancing is secured on a first priority basis on the property, assets and undertakings of Air Canada whether on a general security agreement basis or an asset-specific basis; and (iii) any guarantee, obligation or liability, direct or indirect, of Air Canada supporting the obligations in 5(c)(i) and 5(c)(ii) above (5(c) (i) through 5(c)(iii) above collectively referred to as the “**Senior Debt**”);

For the purpose of this Protocol, the GECAS Financing shall be defined as all obligations to GECC Entities under the Exit Restructuring Documents as both terms are defined in the Global Restructuring Agreement dated July 1, 2003 among GECC, the other GECC-affiliated entities signatory thereto and Air Canada, Air Canada Capital Ltd. and Simco Leasing Ltd., a copy of which definitions has been provided by Air Canada to OSFI;

- (d) for clarification, it is intended that the Notes and the GSA shall not be subordinated to any other obligation of Air Canada, other than the Senior Debt and any Asset-Specific Secured Financing to the extent of the value of the secured assets. It is further intended that the Notes and the GSA shall not be subordinated to any unsecured creditor, including unsecured creditor claims arising as a result of a deficiency in an Asset-Specific Secured Financing or any unsecured supplier or trade creditor;
- (e) until the Senior Debt is paid in full, without the consent of all the holders of Senior Debt, neither the holders of the Notes nor the Collateral Agent will be entitled to: (i) take any action to accelerate, ask, demand, sue for, take or receive from Air Canada, by set-off or in any other manner the whole or any part of the principal amount of the Notes; or (ii) take any action in respect of any remedy it may have under the GSA. Nothing in this paragraph 5(e) restricts or limits Air Canada’s obligation to make payments to the Plans in accordance with the PBSA, 1985 and the applicable Regulations, and Air Canada agrees that the Notes and GSA will include such a covenant;
- (f) the Notes and GSA shall not include any negative or positive covenants which would affect or restrict whatsoever Air Canada’s ability to obtain, finance, refinance or make any payments, whether constituting principal, interest, distributions, dividends or otherwise in respect of any financing, whether secured or unsecured. Air Canada shall provide audited consolidated financial statements of the company and its subsidiaries upon request by OSFI, but no earlier than their public release. Nothing in this paragraph 5(f) restricts or limits Air Canada’s obligation to make payments to the Plans in

accordance with the PBSA, 1985 and the applicable Regulations, and Air Canada agrees that the Notes and GSA will include such a covenant;

- (g) the principal amount of each Note will be reduced by the capital portion of any special payments established in accordance with the Initial Schedule and remitted to the associated Plan (or deemed remitted as a result of a reduction in the required special payments due to net experience gains, subject to paragraph 9(d) of this Protocol). The Initial Schedule as of January 1, 2004 and the capital portion of such special payments under the Initial Schedule shall be set out in Schedule 2 to this Protocol;
- (h) the full principal amount of each Note will be automatically due and payable upon customary insolvency events of default or any event of default under the Senior Debt entitling the holder to accelerate payment. In addition, failure to remit a special payment in accordance with the PBSA, 1985 and the applicable Regulations will result in the acceleration of the Note up to the amount of such payment that was due but not remitted. Subject to the provisions of this Protocol, the Superintendent and OSFI are not precluded or restricted from taking any actions in respect of non-compliance with the PBSA, 1985 and the Regulations. In respect of the non-remittance of funds, where actions undertaken by the Superintendent or any other party result in remittance in full of outstanding payments plus interest, the principal amount of the Note shall be reduced by an amount representing the capital portion associated with the recovered special payment established in accordance with the Initial Schedule;
- (i) subject to paragraph 5(e), in the event a Plan is terminated: (i) the principal amount of the related Note outstanding shall not exceed the deficit upon wind-up; and (ii) Air Canada shall remit to such Plan, in accordance with the schedule of payments then in effect, the amount necessary to pay off such Note;
- (j) the Collateral Agent shall, upon request of the holders of the Senior Debt, execute, acknowledge and deliver such further instruments and documents (the "**Subordination Agreements**") in confirmation of the subordination contemplated hereunder as may reasonably be requested by the holders of the Senior Debt. Air Canada agrees to pay the reasonable expenses associated with such requests;
- (k) Air Canada shall complete all necessary registrations of the Notes and GSA. Air Canada shall also pay all reasonable costs, charges and expenses, including all reasonable legal fees, incurred to complete these registrations, this Protocol and the other definitive documents contemplated by this Protocol and implement this Protocol;

- (l) Air Canada shall notify OSFI and the Plan trustee of any further subordination of the Notes or GSA or assignments of any Senior Debt;
  - (m) on emergence from CCAA, Air Canada shall provide OSFI with: (i) a standard legal opinion for secured financings in respect of the Notes and GSA; and (ii) a revised collateral analysis; and
  - (n) the GECC Entities and any other Senior Debt holder shall be entitled to enforce the subordination provisions of each Note as if a party to the Note.
6. Consent to the proposed funding relief by the Plan beneficiaries will be determined substantially in the manner described in the March 5, 2004 submission to OSFI by Air Canada and the Pension Beneficiary Group.
7. The reports on the actuarial valuation as of January 1, 2004 in respect of each Plan shall be filed no later than September 30, 2004. Air Canada shall provide to OSFI, prior to the filing date, any information concerning each Plan that OSFI may reasonably request. Air Canada shall prepare the valuation reports in accordance with this Protocol. OSFI may request additional calculations, where reasonably required for implementation of this Protocol.
8. Subject to the other provisions of this Protocol, Air Canada shall fund the Plans in accordance with Schedule 2 even in the event the aggregate solvency deficiency as shown in the reports referred to in paragraph 7 of this Protocol is less than the current estimate of \$1.241 billion, it being understood and agreed that the capital portions of the payments in the Initial Schedule shall not be materially different from the amounts set forth in the attached Schedule 2.
9. In addition to the foregoing, the proposed amendments to the Regulations implementing the funding relief described in this Protocol will provide the following with respect to each Plan during the period it is subject to the funding relief:
- (a) the solvency assets of the Plan shall be valued using market value. Smoothing of assets will not be permitted;
  - (b) except for those amendments described in paragraphs 9 and 10 of the Proposal, amendments to the Plan which increase pension or other benefits will be restricted. Amendments that increase benefits will require the authorization of the Superintendent. In the event that such authorization is given or benefit increases are granted on an ad hoc basis, funding of any resulting new solvency deficiency will be subject to the general rules in the Regulations, e.g. at present the requirement to be funded over a maximum of 5 years;
  - (c) actuarial losses and increases in a solvency deficiency not resulting from a situation described in paragraph 9(b) above will be funded over the greater of 5 years and the number of years remaining in the 10-year funding schedule, i.e. to December 31, 2013;

- (d) during the first 2 years of the Initial Schedule, actuarial gains cannot be applied to reduce the special payments. However, during this period Air Canada may apply actuarial gains to reduce the amortization period or reduce future special payments on a pro rata basis for the remaining number of years provided that actuarial gains shall not be used to reduce special payments to the extent that such special payments for a particular year do not pay down the deficit;
  - (e) subject to the requirements of the *Income Tax Act*, contribution holidays will not be permitted;
  - (f) Air Canada may opt out of the funding relief. If the Plan does not have a surplus on the date of opting out and less than 5 years remain on the Initial Schedule, the deficit shall not be reamortized but rather the special payments according to the then applicable schedule and restrictions on Plan amendments and solvency valuations based on market value will continue; alternatively, Air Canada may fully remit all special payments remaining on these schedules. If 5 or more years remain on the Initial Schedule, a valuation will be performed and the existing funding rules will apply. If the Plan does have a surplus on the date of opting out, the balance of the associated Note shall be deemed to be nil;
  - (g) Air Canada shall comply with the disclosure provisions of paragraph 3 of the Proposal and shall cooperate with OSFI on the development and dissemination to Plan beneficiaries of reasonable additional communications on the Plan's financial status.
10. As set out in paragraph 4 of the Proposal, Air Canada will not make an application for a refund of surplus from any Plan if any of the Plans are being funded in accordance with the funding relief Regulations. For greater certainty, Air Canada may not withdraw surplus during such period under a surplus-sharing agreement with Plan beneficiaries.
11. The implementation of this Protocol is conditional upon: (a) amendments to the Regulations consistent with this Protocol being registered with the Clerk of the Privy Council prior to Air Canada's emergence from CCAA. The amendments will take effect upon Air Canada's emergence from CCAA protection, provided that they will apply to all Plan actuarial valuations as of January 1, 2004; (b) this Protocol and the proposed funding relief Regulations (or a summary thereof) being submitted to and receiving the consent of the Plan beneficiaries through the process referenced in paragraph 6 of this Protocol; (c) the approximately \$34 million in special payments to 3 of the Plans referenced in paragraph 2 of this Protocol and all current service contributions required to be remitted to the Plans prior to emergence from CCAA protection under the PBSA, 1985 and the Regulations, being so remitted; (d) definitive documentation, including the final version of Schedule 2, the Notes, the GSA, the Collateral Agency Agreement and the Subordination Agreements being

completed to the reasonable satisfaction of the parties; and (e) Air Canada emerging from CCAA on or prior to December 31, 2004. In the event that these conditions are not met, this Protocol becomes null and void unless waived by the Superintendent.

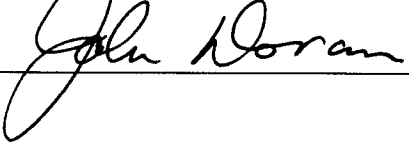
12. It is acknowledged that this Protocol cannot bind the Government of Canada from making any changes to the law and does not otherwise bind or fetter the exercise of discretion by the Superintendent under the PBSA, 1985 and the Regulations.



**AIR CANADA**

Per:   
President &  
Chief Executive Officer

**OFFICE OF THE SUPERINTENDENT  
OF FINANCIAL INSTITUTIONS**

Per: 

## Schedule 1

### Principal Amount of Each Promissory Note

Air Canada Pension Plan	\$ 225,896,000
Air Canada Pension Plan - Pilots	\$ 30,526,000
Air Canada Executive Pension Plan	\$ 1,104,000
CAIL Executive Pension Plan	\$ 193,000
CAIL Management Pension Plan	\$ 7,618,000
CAIL CALDA Pension Plan	\$ 187,000
CAIL CAW Pension Plan	\$ 6,244,000
CAIL CUPE Pension Plan	\$ 18,418,000
CAIL IAMAW Pension Plan	\$ 23,611,000
CAIL Pilots Pension Plan	\$ 32,818,000
<u>TOTAL</u>	<u>\$ 346,616,000</u>

## Schedule 2

### Schedule of Special Payments and Capital Portions Thereof\*

(in millions)

	<u>Special Payment</u>	<u>Capital Portion</u>
2004	\$ 65	\$ 2
2005	\$ 85	\$ 23
2006	\$ 201	\$ 143
2007	\$ 181	\$ 130
2008	\$ 181	\$ 136
2009	\$ 184	\$ 146
2010	\$ 184	\$ 153
2011	\$ 184	\$ 161
2012	\$ 184	\$ 169
2013	\$ 184	\$ 178
<b>Total</b>	<b>\$ 1,633</b>	<b>\$ 1,241</b>

\*These amounts are aggregate estimates only, assuming an aggregate solvency deficiency of \$1.241 billion as of January 1, 2004. Air Canada will forward a final Schedule 2 setting out the precise amounts, by Plan, to OSFI as soon as practicable.