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ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED	*Sean F. Dunphy* and *Ashley John Taylor*, for Air Canada
AND IN THE MATTER OF SECTION 191 OF THE *CANADA BUSINESS CORPORATIONS ACT*, R.S.C. 1985, c. C-44, AS AMENDED	*Peter J. Osborne* and *Peter H. Griffin*, for the Monitor
AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF AIR CANADA AND THOSE SUBSIDIARIES LISTED ON SCHEDULE "A"	*Howard Gorman*, for the Ad Hoc Unsecured Creditors Committee
APPLICATION UNDER THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED	*Aubrey Kauffman*, for the Ad Hoc Committee of Various Creditors
	Jay Swartz, for Deutsche Bank
	Mark Gelowitz, for Trinity Time Investments
	Robert Thornton and *Gregory Azeff*, for GE Capital Aviation Services Inc.
	J. Porter, for Cerberus
	Kevin McElcheran, for CIBC
	Murray Gold, for CUPE
	Ian Dick, for AG Canada
	James Tory, for Air Canada Board
	Joseph J. Bellissimo, for the Aircraft Lessor/Lender Group
	Terri Hilborn, for Unionized Retiree Committee
	William Sasso and *Sharon Strosberg*, for Mizuho International, PLC
	Jim Dube, for Deutsche Lufthansa A.G.
	HEARD: January 16, 2004

FARLEY J.:

[1] These reasons deal with three matters which the court was asked to approve Air Canada (AC) entering into various agreements; simply put they were as follows:

(1) the Merrill Lynch (ML) indemnity;

(2) the entering into the amendments to the Trinity Agreement; and

(3) the Global Restructuring Agreements (GRA).

ML Indemnity

[2] There was no opposition to this. The court was advised that such an indemnity was customarily given and that the terms of this particular one were such as is normally given. I therefore approve AC granting such an indemnity to ML.

Trinity Amendments

[3] As I understood the submissions this morning, Mizuho a member of the Unsecured Creditors Committee (UCC) was the only interested party which spoke out against the Trinity amendments. It continues to be dissatisfied with the process by which Trinity was selected as the equity plan sponsor. I merely point out, once again, that this process was not of the Court's choosing but rather one which AC commenced on notice to the service list and as to which there were no objections before Trinity was selected on November 8, 2003 (together with the "fiduciary out" provision contained in its proposal). Aside from the court approvals envisaged by that process, the court only became involved when it was appreciated that there were some difficulties with the practical implementation of the process.

[4] I further understand that the Ad Hoc Committee of Various Creditors (CVC) withdrew its opposition yesterday along with its cross motion. The UCC (one assumes on some majority basis) supported the Trinity Amendments but indicated that, as a sounding board, it wished to continue sounding that it still had concerns about aspects of corporate governance and management incentives.

[5] I have no doubt, if adjustments in any particular area make sense between the signatories (AC and Trinity) and to the extent that any beneficiaries are involved, that such adjustments will be made for everyone's overall benefit (everyone in the sense of AC including all of its stakeholders including creditors, labour, management, pensioners, etc.) not only for the short term interests but the long term interests of AC emerging from these CCAA proceedings as an ongoing viable enterprise on into the future, well able to serve the public (both Canadian and foreign). A harmonious relationship with trust and respect flowing in all directions amongst the stakeholders will be to everyone's long term advantage. With respect to corporate governance though, I am able to make a more direct observation. A director, no matter who nominates that person, owes duties and obligations to the corporation, not the nominator: see *820099 Ontario Ltd. v. Harold E. Ballard Ltd.* (1991), 3 B.L.R. (2d) 113 at 123 (Ont. Gen. Div.), aff'd (1991), 3 B.L.R. (2d) 113 (Div. Ct.).

[6] There was no evidence to show that the Board of AC in exercising its fiduciary duties did not properly consider on a quantitative and qualitative basis the factors (on a pro and con basis)

relating to whether Cerberus had provided a Superior Proposal (as that was defined in section 9 of the Trinity Agreement approved earlier by this Court). Indeed there was no complaint from

Cerberus in this respect. The Board's letter to me of December 22, 2003 carefully reviewed the considerations which the Board (with the assistance of Seabury and ML, together with the general oversight and views of the Monitor) gave in their deliberations with their ultimate decision that the Cerberus December 10, 2003 proposal was not a Superior Proposal with the result that the Board has selected Trinity to be the equity program sponsor in accordance with the Trinity amended deal. I approve AC executing the Trinity amended deal and implementing same, with the recognition and proviso that there may be further amendments/adjustments which may be entered into subject to the guidelines of my discussion above. I note in particular that the UCC helpfully pointed out that section 7.3 still needs to be modified, and that is being worked on. The Air Canada Pilots Association observed that there still needed to be some fine-tuning at para. 22 of its factum noting that: "These matters of the detailed implementation of the Amended Trinity Investment Agreement can all be resolved by good faith negotiations between Air Canada, Trinity and affected stakeholders, with the assistance and support of the Monitor"; I did not have the benefit of any submissions in this regard (para.22) nor was any expected to either be given or taken as the parties all appreciated that this was not to be an exercise in "nitpicking".

[7] At paragraph 71 of its 19th report, the Monitor stated:

> 71. The Monitor is of the continuing view that the Equity Solicitation Process must be completed as soon as possible. The restructuring process and many other restructuring initiatives have been delayed by approximately two months as a result of the continued uncertainty concerning the selection of the equity plan sponsor. The equity solicitation process must be concluded so that the balance of the restructuring process can be completed before the expiry on April 30, 2004 of the financing commitments from each of Trinity, GECC and DB pursuant to the Standby Agreement. The Monitor recommends that this Honourable Court approve the Company's motion seeking approval of the Amended Trinity Investment Agreement.

[8] I would therefore approve the Trinity amendments so that AC can proceed to enter into and implement the Amended Trinity Investment Agreement. I note that this approval is not intended to determine any rights which third parties may have.

GRA

[9] As with the previous approvals, I take the requirement under the CCAA is that approval of the Court may be given where there is consistency with the purpose and spirit of that legislation, a conclusion by the Court that as a primary consideration, the transaction is fair and reasonable and will be beneficial to the debtor and its stakeholders generally: see *Northland Properties Ltd. v. Excelsior Life Ins. Co. of Canada* (1989), 73 C.B.R. (N.S.) 195 at 201 (B.C.C.A.). In *Re Canadian Red Cross Society* (1998), 5 C.B.R. (4th) 299 (Ont. Gen. Div.), Blair J. at p. 316 adopted the principles in *Royal Bank of Canada v. Soundair Corp.* (1991), 7 C.B.R. (3d) 1 (Ont. C.A.) as an appropriate guideline for determining when an agreement or transaction should be approved during a CCAA restructuring but prior to the actual plan of reorganization being in place. In *Re Sammi Atlas Inc.* (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div.), I observed at p. 173 that in considering what is fair and reasonable treatment, one must look at the creditors as a whole (i.e. generally) and to the objecting creditors (specifically) and see if rights are

compromised in an attempt to balance interests (and have the pain of the compromise equitably shared) as opposed to the confiscation of rights. I think that philosophy should be applicable to the circumstances here involving the various stakeholders. As I noted immediately above in *Sammi*, equitable treatment is not necessarily equal treatment.

[10] The Monitor's 19th report at paragraphs 20-21 indicates that:

> 20. The GRA provides the following benefits for Air Canada:
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> - The retention of a significant portion of its fleet of core aircraft, spare engines and flight simulators, which are critical to its ongoing operations;
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> - The restructuring of obligations with respect to 106 of 107 Air Canada and Jazz air operating, parked and undelivered aircraft (effective immediately for 12 GECC-managed aircraft and upon exit from CCAA for the remaining 94 GECC-owned aircraft, except as indicated below), including lease rate reductions on 51 aircraft (of which 3 aircraft have been returned as of the current date), cash flow relief for 29 aircraft, termination of the Applicants' obligations with respect to 20 parked aircraft (effective immediately), the cancellation of 4 future aircraft lease commitments and the restructuring of the overall obligations with respect to 2 aircraft. Obligations with respect to the last remaining aircraft remain unaffected as it is management's view that this lease was already at market;
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> - Exit financing of approximately US$585 million (the "Exit Facility") to be provided by GECC upon the Company's emergence from CCAA;
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> - Aircraft financing up to a maximum of US$950 million (the "RJ Aircraft Financing") to be provided by GECC and to be used by Air Canada to finance the future purchase of approximately 43 regional jet aircraft; and
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> - The surrender of any distribution on account of any deficiency claims under the CCAA Plan with respect to GECC-owned aircraft only, without in any way affecting GECC's right to vote on the Plan in respect of any deficiency claim.
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> 21. In return for these restructuring and financing commitments, the GRA provides for the following:
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> - Payment of all current aircraft rent by Air Canada to GECC, during the interim period until emergence from CCAA proceedings, at contractual lease rates for GECC-owned aircraft and at revised lease rates for GECC-managed aircraft;

- The delivery of notes refinancing existing obligations to GECC in connection with 2 B747-400 cross-collateralized leases (the "B747 Restructuring) including one note convertible into equity of the restructured Air Canada at GECC's option;

- The delivery of stock purchase warrants (the "Warrants") for the purchase of an additional 4% of the common stock of the Company at a strike price equal to the price paid by any equity plan sponsor; and

- The cross-collateralization of all GECC and affiliate obligations (the "Interfacility Collateralization Agreement") on Air Canada's emergence from CCAA proceedings for a certain period of time.

The Monitor concluded at paragraph 70:

> 70. The Monitor notes that, if considered on their own, the lease concessions provided to Air Canada by GECC pursuant to the GRA differ substantially from those being provided by other aircraft lessors. In addition, the Monitor notes that GECC has benefitted from the cross collateralization on 22 aircraft pursuant to the CCAA Credit Facility and Interfacility Collateralization Agreement, particularly as it relates to the settlement of Air Canada's obligations to GECC under the B747 Restructuring. However, the Monitor also notes that the substantial benefits provided to Air Canada under the GRA including the availability of US $585 million of exit financing and US$950 million of regional jet aircraft financing are significant and critical to the Company's emergence from CCAA proceedings in an expedited manner. In the Monitor's view the financial benefits provided to Air Canada under the GRA outweigh the costs to the Applicants' estate arising as a result of the cross collateralization benefit provided to GECC under the CCAA Credit Facility and Interfacility Collateralization Agreement. Accordingly, the Monitor recommends to this Honourable Court that the GRA be approved.

[11] The GRA was opposed by the UCC (again apparently on some majority basis as one of its members, Cara, was indicated as being in favour and I also understand that Lufthansa was also supportive); the UCC's position was supplemented by separate submissions by another of its members, CIBC. I agree with the position of the UCC that the concern of the court is not with respect to the past elements of the DIP financing by GE and the cross-collateralization of 22 aircraft that agreement provided for. I also note the position of the UCC that it recognizes that the GRA is a package deal which cannot be cherry picked by any stakeholder nor modified by the Court; the UCC accepts that the GRA must be either taken as a package deal or rejected. It suggested that GE, if the court rejects the GRA as advocated by the UCC, will not abandon the field but rather it will stay and negotiate terms which the UCC feels would be more appropriate. That may be true but I would observe that in my view the delay and uncertainty involved would likely be devastating for AC. Would AC be able to meet the April 30, 2004 deadline for the Trinity deal which requires that the GRA be in place? What would the effect be upon the booking public?

[12] I note that the UCC complains that other creditors are not being given equal treatment. However, counsel for another large group of aircraft lessors and financiers indicated that they had no difficulty with the GRA. Indeed, it seems to me that GE is in a somewhat significantly different position than the other creditors given the aforesaid commitment to provide an Exit Facility and an RJ facility. Trinity and Deutsche Bank (DB) with respect to their proposed inflow of $1 billion in equity would be subordinate to GE; this new money (as opposed to sunk old money of the UCC and as well as that of the other creditors) supports the GRA. I note as well although it is "past history" that GE has compromised a significant portion of its $2 billion claim for existing commitments down to $1.4 billion, while at the same time committing to funding of large amounts for future purposes, all at a time when the airline industry generally does not have ready access to such.

[13] With respect to the two 747 LILOs (lease in, lease out), there is the concession that AC will enjoy any upside potential in an after marketing while being shielded from any further downside. GE has also provided AC with some liquidity funding assistance by deferring some of its charges to a latter period post emergence. Further it has been calculated that as to post filing arrears, there will be a true up on emergence and assuming that would be March 31, 2004, it is expected that there would be a wash as between AC and GE, with a slight "advantage" to AC if emergence were later. I pause to note here that emergence sooner rather than later is in my view in everyone's best interests – and that everyone should focus on that and give every reasonable assistance and cooperation.

[14] With respect to the snapback rights, I note that AC would be able to eliminate same by repaying the LILO notes and the Tranche Loans and AC would be legally permitted to eliminate this concern 180 days post emergence. I recognize that AC would be in a much stronger functional and psychological bargaining position to obtain replacement funding post emergence than it is now able to do while in CCAA protection proceedings. I would assume that such a project would be a financial priority for AC post emergence and that timing should not prevent AC from starting to explore that possibility in the near future (even before emergence). I also note that GE anticipates that the snapback rights would not likely come into play, given, I take it, its analysis of the present and future condition of AC and its experience and expertise in the field. I take it as a side note that GE from this observation by it will not have a quick trigger finger notwithstanding the specific elements in the definition of Events of Default; that of course may only be commercial reality – and that could of course change, but one would think that GE would have to be concerned about its ongoing business reputation and thus have to justify such action. Snapback rights only come into existence upon emergence, not on the entry into the GRA.

[15] I conclude that on balance the GRA is beneficial to AC and its stakeholders; in my view it is fair and reasonable and in the best interests of AC. It will permit AC to get on with the remaining and significant steps its needs to accomplish before it can emerge. The same goes for the Trinity deal. I therefore approve AC's entering into and implementing the GRA, subject to the same considerations as to completing the documentation and making amendments/adjustments as I discussed above in Trinity Amendments.

[16] Orders accordingly.

J. M. Farley

Released: January 16, 2004