24. FINANCIAL INSTRUMENTS

A summary of Weston's and Loblaw's outstanding derivative instruments is as follows:

Notional Amounts

	Notional Amounts Maturing in 2008	2009	2010	2011	2012	Thereafter	**2007 Total**	2006 Total
Cross currency basis swaps	$ 140	$ 31	$ 174	$ 56	$ 166	$ 533	**$ 1,100**	$ 1,060
Interest rate swaps receivable	$ 240	$ 140	$ 50	$ 200			**$ 630**	$ 630
Interest rate swaps payable						$ 150	**$ 150**	$ 150
Equity swaps and forwards associated with stock-based compensation			$ 206	$ 35	$ 25	$ 162	**$ 428**	$ 421
Equity forward associated with the forward sale of Loblaw common shares						$ 692	**$ 692**	$ 649
Electricity forward contract	$ 9	$ 8	$ 8	$ 8			**$ 33**	$ 42

Notional amounts do not represent assets or liabilities and are therefore not recorded on the consolidated balance sheet. The notional amounts are used in order to calculate the payments to be exchanged under the contracts.

Cross Currency Basis Swaps

Loblaw enters into cross currency basis swaps to manage its exposure to fluctuations in the foreign currency exchange rate on a portion of its United States dollar denominated cash, cash equivalents and short term investments.

Loblaw entered into cross currency basis swaps to exchange United States dollars for $1.1 billion (2006 – $1.1 billion) Canadian dollars, which mature by 2017. Cross currency basis swaps totalling $590 are designated in a cash flow hedge and the remaining undesignated $510 are classified as held-for-trading financial assets. Currency adjustments receivable or payable arising from these swaps are settled in cash on maturity. At year end, a cumulative unrealized foreign currency exchange rate receivable of $270 (2006 – $165) was recorded in other assets (see note 15).

Interest Rate Swaps

Loblaw enters into interest rate swaps to manage a portion of its exposure to fluctuations in interest rates. Loblaw's interest rate swaps convert a notional $630 (2006 – $630) of its floating rate available-for-sale cash equivalents and short term investments to average fixed rate investments at 5.60% (2006 – 5.60%), which mature by 2011. At year end, the fair value of these interest rate swaps of $9 was recorded in other assets (see note 15) and the unrealized fair value gain of $6, net of income taxes and minority interest, was deferred in accumulated other comprehensive loss, related to these interest rate swaps. When realized, these unrealized gains are reclassified to net earnings. Prior to January 1, 2007, these unrealized gains or losses were not recognized on the consolidated balance sheet.

During 2007, Loblaw terminated hedge accounting for its interest rate swaps previously designated as a cash flow hedge of the variable interest rate exposure on commercial paper. These interest rate swaps converted a notional $150 (2006 – $150) of floating rate commercial paper debt to an average fixed rate debt of 8.37% (2006 – 8.37%) which matures by 2013. As a result of this termination, the cumulative loss of $1, net of income taxes and minority interest, in accumulated other comprehensive loss was reclassified to net earnings. At year end, the fair value of these interest rate swaps of $28 was recorded in other liabilities (see note 19). Prior to January 1, 2007, these unrealized gains or losses were not recognized on the consolidated balance sheet.

Equity Swaps and Forwards ($, except where otherwise indicated)

In 2007, Weston had cumulative outstanding equity swaps in its common shares of 1,686,700 (2006 – 1,686,700) at an average forward price of $103.17 (2006 – $103.17). In 2007, Loblaw had cumulative outstanding equity forwards in its common shares of 4.8 million (2006 – 4.8 million), at a cumulative average forward price of $53.14 (2006 – $51.43) including $8.27 (2006 – $6.56) per common share of interest expense net of dividends that has been recognized in net earnings from continuing operations and will be paid at termination. These swaps and forwards allow for several methods of settlement including net cash settlement. These equity swaps and forwards change in value as the market prices of the underlying common shares change and provide a partial offset to fluctuations in Weston's and Loblaw's stock-based compensation costs, including RSU plan expense. The partial offset between the Company's stock-based compensation costs, including RSU plan expense, and the equity derivatives is effective when the market prices of Weston and Loblaw common shares exceed the exercise price of the related employee stock options. When the market prices of Weston and Loblaw common shares are lower than the exercise price of the related employee stock options, these equity derivatives will provide a partial offset only to RSU plan expenses. The amount of net stock-based compensation cost recorded in operating income is mainly dependent upon the number of unexercised stock options and RSUs and their vesting schedules relative to the number of underlying common shares on the equity derivatives and the level of and fluctuations in the market prices of the respective underlying common shares. At year end, the fair value of these Weston swaps of $83 million (2006 – $47 million) was recorded in other liabilities and the fair value, interest and dividends of these Loblaw forwards of $91 million (2006 –$13 million) was also recorded in other liabilities (see note 19). During 2007, a fair value loss of $100 million (2006 – $48 million) was recorded in operating income related to these equity swaps and forwards (see note 23).

In 2001, Weston entered into an equity forward sale agreement based on 9.6 million Loblaw common shares at an original forward price of $48.50 per Loblaw common share which, under the terms of the agreement, had increased to a forward price of $72.06 (2006 – $67.64) per Loblaw common share as at December 31, 2007. The forward matures in 2031 and will be settled in cash as follows: Weston will receive the forward price and will pay the market value of the underlying Loblaw common shares at maturity. The obligation of Weston under this forward is secured by the underlying Loblaw common shares. Weston entered into this forward to partially offset any repayment risk associated with its Series A, 7.00% and Series B Debentures. Further, if the market value of the underlying Loblaw common shares exceeds the obligation of Weston under this forward, a portion of the proceeds from a future sale of these shares may be used to satisfy the obligation under this forward contract upon termination or maturity. Weston recognizes a non-cash charge or income, which is included in consolidated interest expense and other financing charges, representing the fair value adjustment of Weston's forward sale agreement for 9.6 million Loblaw common shares. The fair value adjustment of the forward contract is a non-cash item resulting from fluctuations in the market price of the underlying Loblaw common shares that Weston owns. Weston does not record any change in the market price associated with the Loblaw common shares that it owns. At maturity, if the forward price is greater than the market price, Weston will receive a cash amount equal to the difference. If the forward price is less than the market price, Weston will pay a cash amount equal to the difference. Any cash paid under the forward contract could be offset by the sale of Loblaw common shares. At year end, the fair value of this equity forward sale agreement based on 9.6 million Loblaw common shares of $365 million (2006 – $181 million) was recorded in other assets (see note 15). During 2007, a fair value gain of $141 million (2006 – $73 million) was recorded in interest expense and other financing charges related to this forward (see note 6).

Electricity Forward Contract

Loblaw entered into an electricity forward contract to minimize price volatility and to maintain a portion of its electricity costs in Alberta, Canada at approximately 2006 rates. This electricity forward contract has an initial term of five years and expires in December 2011. Commencing January 1, 2007, Loblaw is required to measure its electricity forward contract at fair value in accordance with Section 3855. At year end, the fair value of this Loblaw forward contract of $5 was recorded in other assets (see note 15). During 2007, a loss in value of $2 was recorded in operating income. Prior to January 1, 2007, this non-financial derivative instrument was not recognized on the comparative consolidated balance sheet and therefore gains and losses due to fair value changes in the contract were also not recognized in the consolidated statement of earnings.

Commodity Derivatives

The Company uses commodity futures and options to manage its anticipated exposure to fluctuations in commodity prices. At year end, the fair value of the commodity futures of $21 (2006 – $1) was recorded in accounts receivable. During 2007, a fair value gain of $19 (2006 – nil) was recorded in operating income relating to futures which were not designated in a cash flow hedge while a fair value gain of $1 was deferred in accumulated other comprehensive loss relating to futures which were designated in a cash flow hedge. At year end, the fair value of the commodity options was not significant nor was the 2007 fair value gain related to these options.

Fair Value of Derivative Instruments

The fair value of derivative instruments is the estimated amount that the Company would receive or pay to terminate the instrument agreement at the reporting date. The fair values have been determined by reference to prices available from the markets on which the instruments trade and prices provided by counterparties. Commencing January 1, 2007, the fair value of all derivative instruments approximated their carrying value and are recorded on the consolidated balance sheet. Prior to January 1, 2007, the interest rate swaps were not recorded on the comparative consolidated balance sheet. The fair value of the unrecorded unrealized interest rate swap receivable was $17 at December 31, 2006.

The following table summarizes the change in fair value of financial assets and financial liabilities, including non-financial derivatives, classified as held-for-trading, recognized in 2007 in net earnings, before income taxes and minority interest.

	2007	
	Designated as held-for-trading	Required to be classified as held-for-trading
Cash equivalents and short term investments	$ 76	
Electricity forward		$ 2
Interest rate swaps		5
Cross currency basis swaps		(79)
Commodity futures fair value adjustment		(19)
Equity forward sale agreement based on 9.6 million Loblaw common shares		(183)
Equity swaps and forwards associated with stock-based compensation		112
Exchangeable shares of Domtar (Canada) Paper Inc.[1]	44	
Fair value loss (gain)	$ 120	$ (162)

(1) The impact of this fair value adjustment on operating income is substantially offset by the re-measurement of the Debentures, as discussed previously.

Fair Value of Other Financial Instruments

The fair values of accounts receivable, bank indebtedness, commercial paper, accounts payable and accrued liabilities and short term bank loans approximate their carrying values given their short term maturities. See note 18 for the carrying values and fair values of long term debt.

The equity investment in Loblaw franchises is measured at cost because there are no quoted market prices in an active market and these investments are classified as available-for-sale.

Foreign Currency Exchange Rate Risk

At year end, the Company had $1.4 billion (2006 – $1.2 billion) in cash and cash equivalents and $603 (2006 – $610) in short term investments, the majority of which are denominated in United States dollars and are held or managed by Glenhuron.

Loblaw is exposed to foreign currency exchange rate variability on its cash, cash equivalents and short term investments. To manage this risk, Loblaw designates a portion of its cross currency basis swaps in a cash flow hedge of the exposure to fluctuations in the foreign currency exchange rate on a portion of its United States dollar denominated cash equivalents and short term investments. The remaining undesignated cross currency basis swaps economically hedge exposure to fluctuations in the foreign currency exchange rate on the remaining United States dollar denominated cash, cash equivalents and short term investments.

During 2007, the unrealized foreign currency exchange loss of $79 before income taxes and minority interest, related to the cash equivalents and short term investments classified as available-for-sale was recognized in accumulated other comprehensive loss and was partially offset by the unrealized foreign currency exchange rate gain of $72 before income taxes and minority interest relating to the designated cross currency basis swaps also deferred in accumulated other comprehensive loss. The unrealized foreign currency exchange loss of $76 on the designated held-for-trading cash, cash equivalents and short term investments is partially offset in operating income by the unrealized foreign currency exchange rate gain of $79 relating to the cross currency basis swaps which are not designated in a cash flow hedge. During 2007, Loblaw realized a foreign currency exchange gain of $46 relating to cross currency basis swaps that matured or were terminated.

The Company's consolidated financial statements are expressed in Canadian dollars but a significant portion of its Weston Foods business occurs in United States dollars through its net investment in self-sustaining foreign operations, primarily in the United States ("U.S. net investment"). The U.S. net investment is translated into Canadian dollars at the foreign currency exchange rate in effect at each balance sheet date. As a result, the Company is exposed to exchange rate gains and losses which are recorded in other comprehensive loss with the offset in the reported Canadian dollar value of the related assets and liabilities included in the U.S. net investment. During 2007, the Canadian dollar appreciated relative to the United States dollar, resulting in a reduction of the Company's U.S. net investment and a corresponding increase in other comprehensive loss of $508. In addition, revenues and expenses of these self-sustaining foreign operations are translated into Canadian dollars at the average foreign currency exchange rate for the year. An appreciating Canadian dollar relative to the United States dollar will negatively impact the year-over-year change in reported sales, operating income and net earnings, while a depreciating Canadian dollar relative to the United States dollar will have the opposite impact.

Credit Risk

The Company is exposed to credit risk resulting from the possibility that counterparties may default on their financial obligations, or if there is a concentration of transactions carried out with the same counterparty or of financial obligations which have similar economic characteristics such that they could be similarly affected by changes in economic conditions. Exposure to credit risk relates to derivative instruments, cash equivalents and short term investments, amounts receivable from Weston Foods customers and suppliers, *PC* Bank's credit card receivables and accounts receivable from independent franchisees, associates and independent accounts.

The Company may be exposed to losses should any counterparty to the Company's financial or non-financial derivative agreements fail to fulfill its obligations. The Company has sought to minimize potential counterparty risk and losses by conducting transactions for its derivative agreements with counterparties that have at minimum a long term "A" credit rating from a recognized credit rating agency and by placing risk adjusted limits on its exposure to any single counterparty for its financial derivative agreements. The Company has internal policies, controls and reporting processes, which require ongoing assessment and corrective action, if necessary, with respect to its derivative transactions. In addition, principal amounts on cross currency basis swaps and equity swaps and forwards are each netted by agreement and there is no exposure to loss of the original notional principal amounts on the interest rate swaps and equity swaps and forwards.

Credit risk associated with the Company's cash equivalents and short term investments results from the possibility that a counterparty may default on the repayment of a security. The Company attempts to mitigate this risk through policies and guidelines that require issuers of permissible investments to have at minimum a long term "A" credit rating from a recognized credit rating agency, that specify minimum and maximum exposures to specific issuers, and that specify the type of instruments to be held by the Company.

Weston Foods performs ongoing credit evaluations to assess the financial condition of its new and existing suppliers and customers for amounts receivable from these counterparties.

Loblaw's exposure to credit risk from *PC* Bank's credit card receivables and receivables from independent franchisees, associates and independent accounts results from the possibility that customers may default on their payment obligation. *PC* Bank manages the credit card receivable risk by employing stringent credit scoring techniques, actively monitoring its credit card portfolio and reviewing techniques and technology that can improve the effectiveness of the collection process. In addition, these receivables are dispersed among a large, diversified group of credit card customers. Loblaw accounts receivable from independent franchisees, associates and independent accounts are actively monitored on an ongoing basis and settled on a frequent basis in accordance with the terms specified in the applicable agreements.