

**Update Of Chapter A (Description of Company Operations)¹
of The Periodic Report For 2006 ("The Periodic Report")
of "Bezeq" – The Israel Telecommunications Corp. Ltd.
(hereinafter: "The Company")**

In this report, which contains an update of the chapter regarding the description of the Group's business from the periodic report for 2006, the Group has included forward-looking information, as defined in the Securities Law 5728-1968 (hereinafter: the "Securities Law") with respect to both itself and the market. Such information includes forecasts, targets, appraisals and assessments which apply to future events or matters the realization of which is not certain and is not under the Group's control. Forward-looking information in this report will usually be identified specifically, or by employing statements such as "the Company expects", "the Company assesses", "it is the Company's intention", and similar statements.

Forward-looking information is not a proven fact and is based only on the Group's subjective assessment, based, inter alia, on a general analysis of the information available at the time of drafting of this report, including public announcements, studies and surveys, and they contain no undertakings as to the correctness or completeness of the information contained therein, and the Group does not independently check the correctness thereof.

In addition, the realization and/or otherwise of the forward-looking information will be affected by factors that cannot be assessed in advance, and which are not within the control of the Group, including the risk factors that are characteristic of its operations as set out in this report, and developments in the general environment, and external factors and the regulation that affects the Group's operations, as set out in this report.

1. Description of General Development of Group Operations

Section 1.1 – Group Activity and Description of its Business Development

Section 1.1.5 – Mergers and acquisitions

With respect to the merger of the Company and DBS (sub-section A) – on May 15, 2007, the Company filed an appeal against the decision of the Antitrust Commissioner in which the Commissioner objected to the Company's merger with DBS. The Antitrust Commissioner has submitted her response to the appeal and the file has been set down for hearing of evidence in January 2008.

The Company's and DBS's petition to the High Court of Justice against the Minister of Communications regarding restrictions imposed upon the Company's investments in DBS was set aside. Contemporaneous with those proceedings, the Ministry of Communications gave notice, at the time, of its intention to forfeit NIS 10 million out of the Company's guarantee. In this regard, see also Note 8(c)(2) to the Financial Statements of the Company for the period ended September 30, 2007.

With respect to the agreement for the purchase of the operations of Tadiran Telecom – Communications Services in Israel (Limited Partnership) (the "**Partnership**") by the subsidiary BezeqCall Communications Ltd. (which has, in the meantime, merged into the subsidiary Bezeq International Ltd.) – in April 2007, the agreement was rescinded in light of the decision of the Antitrust Authority not to allow the transaction, and following notice by the Partnership of a decision to rescind the agreement.

Section 1.4 – Distribution of Dividends

On September 19, 2007, a special general meeting of the shareholders of the Company² approved the board of directors' recommendation of August 13, 2007 to pay a cash dividend to the shareholders in the sum total of NIS 760 million (constituting NIS 0.2917415 per share). The dividend was paid on October 15, 2007

¹ The update is pursuant to Article 39A of the Securities Regulations (Periodic and Immediate Reports), 5730-1970, and includes material changes or innovations that have occurred in the corporation in any matter which must be described in the Periodic Report. The update relates to the periodic report of the Company for 2006 and relates to the section numbers used in Chapter A (Description of Company Operations) in that periodic report.

² On this matter, see also the immediate report of the Company dated November 8, 2007, concerning ratification of the resolution of the general meeting on September 19, 2007.

2. Fixed-Line Domestic Communications –

“Bezeq” – The Israel Telecommunications Corp. Limited (“the Company”)

Section 2.1 – General information on areas of operation

On June 1, 2007, the Communications (Telecommunications and Broadcasts) (Payments for Telecommunications Services) Regulations, 5767-2007 and the Communications (Telecommunications and Broadcasts) (Calculation and Linkage of Payments for Telecommunications Services) (Amendment) Regulations, 5767-2007 came into force. Under the above regulations, and based on the draft tariff update set out in the Communications (Telecommunications and Broadcasts) (Calculation and Linkage of Payments for Telecommunications Services) Regulations, 5763-2003, reduction of the Company's supervised tariffs as of June 1, 2007, is expected to be at an average rate of approximately 3.13%. This reduction is based on a reduction of approximately 0.1% in the consumer price index less the average rationalization coefficient at a rate of approximately 3.038%. Likewise, the Communications (Telecommunications and Broadcasts) (Payments for Interconnect) (Amendment) Regulations, 5767-2007 came into force on the same date, prescribing that the reduction of interconnect tariffs as of June 1, 2007 is at a rate of approximately 4.01%. The aforesaid tariff update is expected to have a substantial adverse effect on the Company's revenues from services the tariffs for which are under supervision as aforesaid.

On June 7, 2007, the Communications (Telecommunications and Broadcasts) (Payments for Telecommunications Services) (Amendment) Regulations, 5767-2007 were signed, under which as of October 1, 2007, the criterion for entitlement to reduced service fees shall be amended from a criterion of reduced service to entitlement granted to whomever receives a pension under the Assurance of Income Law, 5741-1980 – the National Insurance Office has provided the Company with details of this – and has a single subscriber telephone line registered in his name in an apartment that is used for residential purposes only. This change is not expected to have a substantial effect on the Company's revenues.

Section 2.1.3 – Changes in scope of operations in the field, and in profitability

	First nine months of 2007	First nine months of 2006	Q3 2007	Q2 2007	Q1 2007	Q4 2006	Q3 2006
Revenues (NIS millions)	4,260	4,360	1,425	1,393	1,442	1,439	1,465
Operating Profit (NIS millions)	939	951	327	243	369	(198)	363
Number of active subscriber lines as at the end of the period (thousands)	2,767	2,813	2,767	2,778	2,797	2,808	2,813
Average monthly income per line (NIS)*.	76.3	80.7	75.5	75.3	78.2	79.0	81.2
No. of outgoing use minutes (millions)	11,514	12,782	3,848	3,753	3,914	4,005	4,257
No. of incoming use minutes (millions)	3,250**	2,725	1,137	1,069	1,045	990	967
Number of ADSL subscribers as at the end of the period (thousands)	942	867	942	924	912	892	867
Average monthly revenue per ADSL subscriber (NIS).	58.2***	57	58.8***	58.5	57.3	57.0	56.6

* Not including revenues from transmission and data communication services, services to communications providers, contractor work and others, and revenue from incoming traffic.

** The increase in incoming minutes stems from a 90% increase in traffic minutes from domestic carriers in competition with Bezeq.

*** The increase in average monthly revenue per ADSL subscriber stems from value added services (not from an increase in prices).

Section 2.1.9 – Structure of competition in the areas of operation and changes thereto

Competition in this sector is also dependent upon the recommendations formulated by the Gronau Commission regarding the communications industry in Israel, and on the way in which those recommendations are adopted and applied. (See update to section 2.6 below)

Section 2.2 – Products and Services

The Company is in the throes of setting up a Data Center website, which shall enable the provision of a total solution for customers, in terms of back up and survivability services. The service planned is following a large increase in demand by customers for DRP sites (disaster recovery program – a program for continuing working in the event of disaster) and for true back-up of information at all organizational levels. This site is expected to provide the Company's customers with a variety of solutions, including: hosting of the organization's central site, taking into account needs of survivability, electricity, air conditioning, etc., backing up organizational information on a reliable and protected system so that when necessary, it will be possible to recover the information required, remote back-up of organizational information, full DRP to the organization's central site, storage of the organization's important information in a protected underground site. The Data Center service is planned to be launched during the month of December 2007.

Section 2.2.2 – Telephony

As part of the Company's marketing strategy, it is working intensively to develop and introduce new services in both the private and commercial sectors. During the second quarter of 2007, the Company launched a broad variety of services, the most prominent of which, in the field of telephony, is: the short message service (SMS) in the voice service field, music streamer (an electronic music player) in the field of terminal equipment. The Company plans to continue launching additional products in accordance with market trends and customer requirements.

With respect to the unified telephone call center, on October 15, 2007, the Company submitted an application to the Antitrust Authority requesting exemption from the approval for the restraint of trade arrangement between the Company and the cellular carriers and domestic fixed-line licensees regarding the operation of the 144 information service and the unified information service for the telephone numbers of the Company and other carriers, 1344, and the unified website that provides corresponding services. The application was submitted on grounds of caution and in light of a letter from the Antitrust Authority of September 9, 2007, which gave notice that the Antitrust Authority viewed the agreement the subject of the application to be an arrangement in restraint of trade.

Section 2.2.3 – Internet access services

For changes in the number of the Company's ADSL subscribers and average monthly income per ADSL subscriber, see the update to section 2.1.3 above.

On November 5, 2007, the Company received a letter from the Director General at the Ministry of Communications, concerning provision of broadband access service for ISPs without a telephone subscriber line ("naked ADSL"). According to the letter, the Ministry of Communications is considering splitting the broadband access service from the telephony service, i.e. to require the Company to offer access service to ISPs without its provision being conditional also on the purchase of a subscriber telephone line. The Company was requested to submit its remarks by November 29, 2007 to an amendment to the ADSL service file proposed by the Ministry of Communications, and is considering its response. See also the update to Section 2.16.2 below.

Section 2.2.5 D – IP-Centrex

The Company has submitted a service portfolio to the Ministry of Communications with respect to this service.

Section 2.3 – Split of revenues and profits of products and services

For updates of the split of the Company's revenues by product and service, see Note 12B to the financial statements of the Company for the period ended September 30, 2007.

Section 2.5 – Marketing, distribution and service

Section 2.5.1 – the Company operates 17 points of sale and service (BezeqStores) around the country.

Section 2.6 – Competition

With respect to the Commission for Formulation of Recommendations regarding Policy and Rules of Competition in the Field of Communications in Israel (the "**Gronau Commission**"), the Company's main position as expressed in a document submitted to the Commission on April 11, 2007 was: a regulatory horizon for the communications market in general and for the Company in particular as a condition of continued investment in upgrading the Company's infrastructure; providing tariff flexibility and absolute freedom in marketing service packages; cancelling structural separation and corporate separation and amending the Company's license so as to permit the Company to provide IPTV services. Note that the Company's positions are developing and changing with time. .

The Commission's recommendations, which are supposed to relate to matters that are of the greatest substance to the communications market and to the Company, might bring about changes in the rules of competition employed to date, and the Company estimates that it will be harmed by the committee's recommendations, but is unable to estimate the trends or the influences that these may have.

Section 2.6.1 – Telephony

With respect to the petition filed by the Company to the High Court of Justice regarding breach of the duty of structural separation by HOT – on April 1, 2007, the Company received a ruling of the Court, following the consent of the parties, that the Ministry of Communications would make a decision within 6 months regarding structural separation of HOT. After receipt of the Ministry's decision, the parties will submit an updated notice in that regard to the Court, following which, a decision will be made as to continued handling of the petition.

On May 2, 2007, the Company contacted the Ministry of Communications, requesting that it be informed as to the full exercise of the Ministry of Communications' instruction to HOT (based on the Ministry's notice to the High Court of Justice) to appoint separate chief executive officers to HOT Telecom and HOT Cable Communications Systems, without any the one being administratively subordinate to the other, and to make the entire administrative level of HOT Telecom subordinate to the chief executive officer to be appointed to that corporation, no later than May 1, 2007. On May 21, 2007, the Director General of the Ministry of Communications responded to the Company that HOT had informed the Ministry that it was intending to act in order to implement the provisions regarding appointment of separate chief executive officers. The Company repeated this request on June 5, 2007, and asked to know the timetable for implementing the provision.

On July 10, 2007, the Company wrote to the State Attorney's Office expressing an objection to amendment of the license of HOT which would permit it to market a parcel of services including HOT Telecom service and broadcasting services provided by HOT's broadcasting company, and asked that it be cancelled. The State Attorney's Office rejected the Company's claims in a letter dated July 12, 2007.

On October 8, 2007, a supplementary notice was received from the State to the effect that the Minister of Communications had decided, based on the recommendation of professional staff at the Ministry, and in accordance with a recommendation of the chairman of the Commission for Formulation of Recommendations regarding Policy and Rules of Competition in the Field of Communications, Prof. Gronau, not to alter the existing structural separation format for HOT Telecom at this stage. It was further noted that this issue would be examined once again after the submission of the Gronau Commission's recommendations as part of an examination of the entire issue of the question of structural separation in the field of communications. On November 8, 2007, the Company filed an application in the High Court of Justice for amendment of the petition so as to include the Company's reservations about the amendment to HOT's license as noted above.

With respect to the grant of special general licenses for the provision of domestic fixed line communications services to various communications providers, the providers which received such licenses have commenced providing the services in accordance with their licenses.

Sections 2.6.1 and 2.6.2

As seen from the reports of HOT – Cable Communications System Ltd., HOT's telephony and internet subscriptions continue to increase.

For the provision of VOB services by the subsidiary Bezeq International Ltd., see update to section 4.1.5 below.

Section 2.6.4 – Competition by cellular companies

With respect to the refusal of the Antitrust Commissioner to alter the monopoly declaration pertaining to the Company in the field of fixed-line telephony services, the Company is examining its continued handling of the matter.

Section 2.6.5 – VOD service provision policy

In July 2007 an amendment to the Communications Law was authorized enabling additional content providers, apart from HOT, to provide a service supplying content upon subscriber demand, over an broadband access network, using IP technology. The significance of this amendment is that subsidiaries of the Company (except for DBS) will not be entitled to provide this service. In this regard, see also the updates to sections 5.4 and 5.6.5 below.

Section 2.6.6A – Numbering and number portability

The Company is preparing for the operational implications of implementation of the number portability program. In the Company's assessment, the extent of harm to its revenues as a result of implementation of the program is expected to be substantial, but it cannot, at this stage, assess the actual extent.

Implementation of the number portability program in full requires compliance with all of the requirements on the part of all communications providers (domestic fixed-line carriers, cellular carriers and international carriers). Indications have been received to the effect that some of the carriers are still not in compliance with all of the technical threshold requirements for the commencement of implementation of the program, and therefore, there is a fear regarding implementation of the program at a total integration level on the date prescribed (December 1, 2007).

The chairman of the Forum of Carriers regarding Number Portability warned that in his assessment, the present timetable will not permit completion of the necessary examinations between the carriers to a sufficient extent and level of certainty, and recommended that an application be made to the Minister of Communications asking for a window of one additional month for examinations which would, in his view, enable the extent and severity of the problems to be significantly reduced, even if it would not solve them entirely. The chairman of the Forum added that the launch of portability under the present timetable imposes a risk which does not reasonably need to be taken. In response to the warning of the chairman of the Carriers Forum published, *inter alia*, in the media, the Director General of the Ministry of Communications sought to clarify unequivocally to the chairman of the Forum, on behalf of the Minister of Communications, that the date for number portability would be December 1, 2007 and that should any carrier not be in compliance with that date, the Ministry would employ the full severity of the law, and would employ all legal measures available to it.

The Company's representatives informed the representatives of the Ministry of Communications, as part of the Ministry's supervision regarding preparations to implement the portability program, that the Company would be ready to implement number portability on time (December 1, 2007). However, given the brief timetable for running tests, and the dependence upon suppliers and other carriers for its readiness to implement the plan on schedule, it is impossible to foresee how the program will be implemented when first operated. Problems that arise as a result of these constraints could also have adverse affects on the financial results of the Company.

This information includes forward-looking information based on the Company's assessments. The actual outcome might be substantially different from the above assessments, if there is a change in any one of the factors taken into account in these assessments.

On May 24, 2007, the Company received a notice from the Director General of the Ministry of Communications, stating that he is considering imposing a financial sanction on the Company under Chapter G1 of the Communications Law, 5742-1982, in respect of violation of the duty to provide number portability commencing 1.9.06, as follows:

1. For the period from September 1, 2006 to the date of the Director General's notice – a financial sanction of NIS 2,031,750.
2. For the period from May 25, 2007 to November 30, 2007 or until the date of remedy of the alleged violation (whichever is earlier) by the Company – NIS 6,450 for each additional day the violation continues.

3. For the period from December 1, 2007 (which is, according to the notice, the reasonable date required by the relevant licensees to remedy the alleged violation) until the date of remedy of the alleged violation – a financial sanction as described in sections 37B(b) and 37C(a) of the Communications Law after Amendment 36. [It is noted that according to the provisions of those sections, the rate of the relevant sanction is 7 times the penalty laid down in section 61(a)(4) of the Penal law (which is NIS 202,000), plus 0.25% of the annual income of the Company, plus a financial sanction of one fiftieth of such sanction for each day on which the violation continues.]

The subsidiaries Pelephone Communications Ltd. ("Pelephone") and Bezeq International Ltd. ("Bezeq International"), received similar notices. As noted in the Company's Periodic Report for 2006, the Company and Pelephone (together with other cellular companies) petitioned the High Court of Justice on this matter, contending, *inter alia*, that it was the Ministry of Communications which had not prepared a number portability plan as required by the provisions of the law. On July 5, 2007, the Company replied to the notice of the Director General of the Ministry of Communications, setting out its position that the Company's position was not in breach of the provisions of the Law or the license, that the matter is pending before the High Court of Justice, and that in any event, in these circumstances, it would be unreasonable to impose sanctions on the Company, including in light of the date prescribed by the Ministry of Communications as being reasonable in this regard for implementation of number portability (December 1, 2007). Pelephone and Bezeq International also responded to the notice of the Ministry of Communications.

With respect to the petition to the High Court of Justice – the court decided to accede to the application of some of the petitioners to dismiss the date of the hearing set down for October 2007, *inter alia*, in light of the fact that the hearing on the petition might be reduced in scope or might even become unnecessary. The date of the hearing was set down for December 20, 2007.

Section 2.6.6.B – Infrastructure of other potential competitors

On September 24, 2007, the Ministry of Communications published a hearing regarding the frequency allocation policy for broadband wireless access networks. Under the Ministry of Communications' document, the Minister of Communications intends to publish a policy for the allocation of frequencies for broadband wireless access networks (WiMAX), as set out in the draft policy attached to the document. The Company intends to submit a response within a few days. Note that the Company submitted a position in the past regarding the previous policy document published by the Ministry in this regard on January 31, 2006, to the effect that there are no grounds for allocating these frequencies, which are a limited State resource, to carriers with special licenses that are not under a duty to provide universal service.

Section 2.6.7 – The Company's preparations for coping with intensifying competition

With respect to sub-section (g) regarding agreements with business customers – on April 11, 2007, following the setting aside of the Company's petition to the High Court of Justice, the Ministry of Communications forfeited the sum of NIS 8 million out of the guarantee deposited by the Company under the provisions of its general license.

Section 2.6.8 – Negative factors affecting the Company's competitive status

Competition – the extent to which competition affects the Company depends, as aforesaid, on the recommendations of the Gronau Commission on communications in Israel, and on the manner in which such will be adopted and applied, and the Company is unable to assess what these might be.

With respect to the Company's lack of flexibility with regard to marketing campaigns – on April 26, 2007, an additional sum of NIS 7 million was forfeited out of the above guarantee. This forfeit followed a decision by the High Court of Justice dated April 10, 2007 not to award an interim injunction in a petition filed by the Company, which has not yet been heard, against the Minister of Communications and the Director General of the Ministry of Communications, against forfeiture of the guarantee and the setting aside of the Company's appeal against such, with respect to a campaign under which call minutes were given to subscribers of the Company who purchased terminal equipment (the "Spring Campaign").

Section 2.7 – Property, plant & equipment

Section 2.7.1 – Fixed-line domestic telecommunications infrastructure (and section 2.6.7(j) and 2.19.2 – Network

With respect to sub-section (a) (switches) – during 2008, the Company's Nortel switches are due to be upgraded to a new ISN09 switch. This upgrade is supposed to enable continued use of the Company's switching network, which is based on Nortel's switches, until the end of 2008, subject to the conditions of the agreement with Nortel. Should the Company be required to continue holding the switches beyond the above date, this will entail substantial additional expense.

Section 2.7.4 – Real estate

With respect to sub-section (c) – the total number of properties sold by the Company over the years (both before and after the settlement agreement) amounts to approximately 40 properties (in whole or in part) out of the leased properties which were privatized in the agreement for the transfer of assets, such that as at the date of this update to the periodic report, the group of leased properties numbers approximately 180 properties.

With respect to sub-section (d) – during the first half of 2007, the Company sold an additional 7 real estate properties, of a total area of approximately 10,900 sqm of land plus approximately 4.730 sqm built-up, at a total sum of approximately 7.68 million dollars. In the third quarter of 2007, the Company did not sell any real estate assets.

Likewise, during the first quarter of 2007, sale of the Hillel Station premises has been completed (as set out in the Company's immediate report dated November 15, 2006). The area of the premises is approximately 956 dunams, and the consideration received for sale of it is approximately \$ 20.8 million.

Further to the reexamination done by management of the Company with respect to the realization of the Company's real estate assets, the board of directors approved the continued procedure of sale of real estate assets that are not active and/or that can be relatively easily vacated, without incurring significant expense, in accordance with the list presented to it. Likewise, the board of directors approved a detailed work procedure regarding sale of the Company's real estate assets, and procedures for the approval of such transactions. The board of directors has resolved to postpone improvements to the Company's assets at this stage.

The Company is working to realise its real estate assets.

Section 2.9 – Human resources

Section 2.9.1 – organizational structure, and employees according to organizational structure

A. Appointment of a new chairman and transfer of authority for subsidiaries to the board of directors.

On September 4, 2007, Shlomo Rodav was appointed to the position of chairman of the board of directors of the Company. On the same date, the board of directors of the Company resolved, pursuant to section 50(a) of the Companies Law, 5759-1999, and pursuant to sections 119 and 121.1 of the Companies Regulations, that the powers of the CEO with respect to corporations held directly or indirectly by the Company (including Pelephone Communications Ltd., Bezeq International Ltd., DBS Satellite Services (1998) Ltd., Walla! Communications Ltd., Bezeq On-Line, Bezeq Gold Holdings Ltd. and BezeqCall Ltd.) would be transferred to the board of directors, and that decisions regarding implementation of the aforesaid would be passed later on.

B. Negotiations – progress of implementation of new collective agreement.

Management of the Company is negotiating with employee representatives mainly with respect to the progress towards completing implementation of the new organizational structure, in accordance with the new special collective agreement of December 5, 2006 regarding the moving forward of retirement dates and an option for the Company to change the mix of retirees who are supposed to retire under that agreement by 2008 (by increasing the number of those taking early retirement over those retiring with severance pay) (see also section 2.17.4(f) of the periodic report for 2006).

C. Appointments which constitute a change in organizational structure

On June 28, 2007, a VP Economics and Budgets was appointed to the Company, whose areas of responsibility are economics, budgeting and control, and collection, which had previously been under the responsibility of the Deputy CEO and CFO. The VP Economics and Budgets reports to the Deputy CEO and the CFO, and to the Acting CEO of the Company.

In mid- August 2007, the new Company Secretary of the Company took office, reporting to the Chairman of the Board of Directors. This function was handled, since October 2005 and until entry of the Company Secretary into office, by the Company's General Counsel.

Section 2.9.2 – Personnel according to employment framework

During the first nine months of 2007, the number of employees in the Company fell from 8,096 as at December 31, 2006 to 7,658 as at October 1, 2007 (a net reduction of 438 employees) as a result of retirement of employees from the Company (concurrently with an intake of needed employees such as service representatives).

Note that of the 975 employees who are supposed to end their employment in the Company under the collective agreement of December 5, 2006 between 2006 and 2008 under early retirement plans or increased severance pay plans (see section 2.17.4(f) of the periodic report for 2006), to date the numbers of employees who have left the Company under the plans is as follows:

Period	Retirements in the period	Cumulative retirements
Up to March 31, 2007	399	399
Up to June 30, 2007	275	674
Up to September 30, 2007	52	726

Section 2.9.6 – Employee remuneration schemes

On September 25, 2007, the board of directors resolved to approve an outline on a policy for the compensation of senior employees and officers in the Bezeq Group, whereby the Company will act for compensation by way of an allocation of stock options for those senior employees in the Company and the subsidiaries upon whom it decides. Such compensation would constitute a mechanism for retaining managers and an appropriate incentive for them, taking into account the salary policy, the position of each manager, his status, his abilities and his contribution to the subsidiary in which he works and to the Group. Subject to any law, the Company will publish an immediate report and detailed description of the stock options plan, after its approval by the board of directors.

In October 2007, the audit committee and the board of directors approved the issue of options to the two directors elected from amongst the employees, under the employee option scheme that was approved and that will come into force in March 2007³. The issue requires the consent of the general meeting. In this regard, see also the Company's immediate report of October 29, 2007.

Section 2.9.7 – Company officers and senior executives

As at the date of publication of this report, there are 16 directors acting in the Company⁴ and 14 members of senior management. Note that following the departure of the CEO of the Company on April 30, 2007, an Acting CEO has been acting in the Company (between April 30, 2007 and June 26, 2007, this position was held by Ika Abravanel, and as of that date, Avi Gabbay has held this position). Likewise, on September 4, 2007, the office of the chairman of the board of directors, Dov Weissglas, terminated and on the same date, Shlomo Rodav was elected by the general meeting as director, and by the board of directors, as chairman.

Commencing August 1, 2007, the Company's VP Regulations was appointed also as internal compliance officer for antitrust affairs.

During the third quarter of 2007, the Deputy CEO and CFO, VP Human Resources, VP Commercial Division and VP Private Division also gave notice of termination of their employment at the Company.

³ An issue of 59,574 options for shares in the Company at an exercise price of NIS 2.9991 per share. The total value of the benefit is approximately NIS 237,006. All data as at October 21, 2007. See also the Company's immediate report of October 29, 2007.

⁴ Including two external directors and two employee-directors.

New officers have been appointed in place of the above officers (apart from the Deputy CEO and CFO, who remains in office).

With respect to bonuses for officers – following the recommendations contained in the report of the external examiner, Dr. Yoram Danziger, dated April 26, 2007 (see update to section 2.20 below), on May 22, 2007, the board of directors of the Company approved bonuses for officers for 2006 in the total sum of NIS 1,059,566. In addition, the board of directors at the same meeting approved the award of bonuses to officers for 2005 in the total sum of NIS 210,000. In the opinion of the board of directors, award of these bonuses does not constitute an extraordinary transaction, as that term is defined in the Companies Law, 5759-1999.

In addition, on May 22, 2007, the board of directors, having received the consent of the Audit Committee in its meetings of May 15, 2007 and May 22, 2007, approved the award of bonuses to a number of officers. The Company reported these bonuses in an immediate report on May 22, 2007.

With respect to the bonuses unlawfully paid to the former CEO of the Company, Mr. Yacov Gelbard, for 2005 and 2006, his obligation to return those bonuses to Pelephone and to the Company still remains. The Company resolved that if the bonuses are not returned to the Company, it will institute all available legal measures to collect this debt.

Some of the officers will repay the Company the difference (if any) between the bonuses they received in the past and the bonuses approved for them as aforesaid. The total repayment is approximately NIS 590,000 (all of the sums set out above are in gross terms – before tax).

In this regard, see also the Company's immediate report dated May 22, 2007.

Section 2.10 – Raw Materials and Suppliers, Purchase of Equipment and Suppliers

Section 2.10.2 – At the date of this report, the Company has no supplier from which it purchases more than 5% of its total purchases in any area of operation.

Section 2.13 – Finance

Section 2.13.4 – Sums of credit received after December 31, 2006

During the period between May 27, 2007 and July 16, 2007, the Company raised approximately NIS 1,200 million via sale of 1,070 million par value debentures (Series 5) of the Company. The sale of the debentures was effected by the subsidiary Bezeq Gold (Holdings) Ltd. (“**Bezeq Gold**”) and the aforesaid consideration was transferred to the Company as repayment of the loan granted by the Company to Bezeq Gold, for the purpose of purchasing the above debentures. This fundraising was effected at an average interest rate of 3.71% (the debentures are linked to the CPI). See update to section 2.13.7 below.

Section 2.13.6 – Credit rating

On May 1, 2007, Maalot announced that following discoveries and following the examination report submitted by the external examiner (see update to section 2.20 below) regarding subtraction of property plant and equipment at Pelephone, at this stage, no change is expected to be made to the rating of the Company's undertakings. In this regard, see also the update to section 3.15.6 below.

Section 2.13.7 – Estimate of raising funds in the coming year (2007) and sources of financing

On May 14, 2007, the board of directors of the Company approved the raising of debt of up to NIS 1,200 million during 2007, for the purpose of repayment of an existing debt of the Company. The Company completed this fundraising as set out in the update to section 2.13.4 above. Note that on August 8, 2007, the Company repaid the principal of the Eurobonds which it had issued in 2000, in the total sum of EUR 293 million.

Section 2.15 – Environmental protection

The new Non-Ionized Radiation Regulations which were approved on October 23, 2007 by the Interior and Environmental Protection Committee of the Knesset, and which are required to be approved by the Ministers, prescribe payment of commissions for the filing of an application for a permit for a radiation source. Following approval of the Regulations, the Company is expected to be required to pay commissions, in a not substantial sum, expected to be spread over a number of years.

Section 2.15.2 – The Non-Ionized Radiation Law, 5766-2006 (the “Radiation Law”)

During the first half of 2007, the Company acted for issue by the Commissioner for Non-Ionized Radiation in the Ministry of the Environment (the “**Commissioner**”) of operating permits, in accordance with the Non-Ionized Radiation Law which came into force at the beginning of 2007. Following this activity, the Company received operating permits for the communications installations that it operates, with a few exceptions in respect of which there is still a radiation permit in force under the Pharmacists Regulations. The Company is acting to receive operating permits under the Radiation Law for these few installations as well. Note that the Commissioner may require building permits as a condition of the continued force of the operating permits for the communications installations (including broadcast installations) granted by the Commissioner. Likewise, the Commissioner may require an affidavit regarding an exemption from a building permit for “wireless access installations” which are under a “class permit” granted to the Company by the Commissioner. See also updated to section 2.16.11 below.

Section 2.16 – Limitation and regulation of Company activities

Section 2.16.2 – The Company’s general license

With respect to measurement of the Company’s market share, and the review dates: On April 22, 2007, a letter was received from the Ministry of Communications stating that the Ministry had commenced the process, however, it was not able to effect a quantitative review at a sufficiently reliable level, because the Company had not yet provided amended data in the format that it requested. When the data is provided, the Ministry will continue its review. On July 15, 2007, the Company responded to another letter from the Ministry of Communications (dated June 13, 2007) alleging that it disputed the objections of the Ministry of Communications regarding the data provided by the Company to the Ministry, and that in any event, such objections ought not postpone the review. Later on, the Company provided the data requested in a format acceptable to both parties.

According to a government decision, the Minister of Communications was instructed to do all acts required so that no later than December 31, 2007, a general licensee for the provision of domestic fixed line telecommunications services will not be permitted to make provision of broadband access to the internet conditional upon the provision of basic telephone services. This resolution, if and to the extent that it is passed, could have a substantial effect on the Company and on its tariff structure, and these effects cannot be assessed at this stage. See also the update to Section 2.2.3 above.

Section 2.16.7 – Antitrust Laws

With respect to the Antitrust Commissioner’s investigation of May 2006 regarding suspicion of abuse of monopolistic status following industrial action by employees of the Company during the course of a labor dispute, the Antitrust Authority announced that the investigation into the matter had ended. However, on May 27, 2007 the Company received notice from the Antitrust Authority (the “**Authority**”) stating that the Antitrust Commissioner (the “**Commissioner**”) is considering a determination, pursuant to her authority under Section 43(a)(5) of the Antitrust Law, 5748-1988 (the “**Law**”), that the Company abused its status, contrary to the provisions of Section 29A of the Law, in view of the findings of an investigation carried out in recent months by the investigations department of the Authority. The notice states that the Commissioner is considering determining that –

1. In the first half of 2006, and in particular in April and May 2006, the Company’s employees imposed sanctions concerning delay in the performance of works or not performing works for the connection or expansion of an existing connection of domestic operators to the Company’s network.
2. During the afternoon of May 17, 2006, an existing connection between HOT Telecom and the Company’s network was disconnected and was not repaired, due to sanctions of Company employees, until the night of May 18, 2006.
3. The Company failed to act as required in order to prevent or minimize these events and the harm to domestic operators, competition and the public.
4. In this way, the Company abused its status, in contravention of Section 29A of the Law.

It is noted that under Section 43(e) of the Law, such a determination by the Commissioner, if and insofar as made, will serve as *prima facie* evidence of the contents of the determination in any legal proceedings.

On September 24, 2007 the Company provided its position, in which it claimed, *inter alia*, that the prohibitions on a monopolist against unreasonably refusing and abusing its status in the market do not apply to a monopolist acting as employer under a labor dispute with its employees.

For the request for an exemption from approval of an arrangement in restraint of trade regarding telephone number information services, see update to section 2.2.2 above.

On October 18, 2007, the Company provided the Antitrust Authority with data and documents at the Authority's request, with respect to the alleged transfer of information to a subsidiary.

Section 2.16.8 – The Telegraph Ordinance

With respect to the disputes with the Ministry of Communications regarding frequency levies and the Ministry's requirement that the Company pay such – following clarification proceedings with the Ministry with respect to such disputes, most of them have been resolved. The principal sum remaining in dispute is for fees in Judea, Samaria and Gaza, and amounts, as at September 30, 2007 to approximately NIS 46 million.

Section 2.16.9 – Proposed legislation regarding termination of contractual relations

On May 14, 2007, another hearing was held in the Economics Committee of the Knesset, but the statute has not yet received the full approval of the Committee.

Section 2.16.11 – Construction of communications installations – NOP 36

With respect to sub-section (a) – NOP 36A – with respect to “wireless access installations”, there are a number of initiatives for cancelling the exemption from a building permit. If the Company is required to issue an affidavit regarding an exemption from a building permit as set out in the update to section 2.15.2 and/or if the exemption from building permit is cancelled, this might have substantial adverse implications which the Company is unable to assess at this stage. For the implications to Pelephone, see update to section 3.18.3.3 below.

With respect to sub-section (c) – NOP 36B – the draft of NOP 36B of September 1, 2007 includes not only the Company's broadcast installations but also microwave installations the safety range of which is greater than 10 m, which were originally included in NOP 36A, and the process of issue of the building permits under which are less complex. Likewise, this draft includes a cancellation of provisions which prescribed that the licensing procedures for broadcast installations the safety range of which is not more than 10 m, or the land area required for which is not greater than 300 sqm, be in accordance with NOP 36A and not NOP 36B. The Company is working with the Ministry of Communications and the Ministry of the Interior to cancel these amendments and to put this class of installations back within the application of NOP 36A.

In addition, that draft proposes that NOP 36B include a provision under which a building permit will not be given to all of the broadcast installations included in NOP 36B unless the party applying for the building permit submits a deed of indemnity for all of the compensation under section 197 of the Planning and Building Law, if a ruling is made against the Local Committee. The Company is working with the Ministry of Communications and the Ministry of the Interior to cancel this provision.

With respect to sub-section (d) – General – if the Company is required to take out a building permit for communications installations (including broadcast installations), this might have substantial adverse implications which the Company is unable at this stage to assess. The aforesaid information is forward-looking information, based on the Company's assessments. The actual outcome might be substantially different from the above assessments, if any of the factors taken into account in these assessments changes.

Section 2.16.12 – Bill to amend section 13 of the Communications Law

A bill authorized to amend the Communications Law was published on December 3, 2006. The amendment, *inter alia*, gives the Minister of Communications authority to give instructions to a licensee in the event of a fault or significant cessation of the provision of communications services, not in circumstances of emergency.

Section 2.16.13 – Restrictions and supervision on the Company's activities regarding the Government Resolution relating to the proposed amendment of the Communications Law

To the best of the Company's knowledge, the Ministry of Finance is initiating an amendment to the Second Authority for Television and Radio Law, 5750-1990, the purpose of which is that the Second Authority for Television and Radio will set up and operate a terrestrial broadcasting set-up based on digital technology, backed up by a digital satellite system for distributing the television broadcasts of the television broadcast franchisees freely to the public at large in Israel, and nationally, so that such distribution will be effected no later than December 1, 2008.

Section 2.17 – Substantial agreements

Section 2.17.4(f) – new collective agreement of December 5, 2006 – for the negotiations between management of the Company and employee representatives regarding bringing forward the date for implementation of the change in the organizational structure and the dates of retirement of employees, see the update to section 2.9.1 above.

Section 2.17.5 – management agreement – on July 29, 2007, a management agreement was signed between the Company and a corporation owned and controlled by the shareholders of Ap.Sb.Ar. Holdings Ltd. The agreement is in force as of October 11, 2005, and the main points of it are set out in the periodic report for 2006.

Section 2.18 – Legal proceedings

For updates on the subject of legal proceedings, see Note 8 to the financial statements of the Company for the period ended September 30, 2007.

Section 2.20 – Event or matter outside the normal course of business

Sub-section (b) – appointment of external examiner

At the request of the Securities Authority, on April 26, 2007, the Company published the final report of the external examiner and on April 30, 2007, the Company published an immediate report setting out a series of resolutions passed by the board of directors following the examination report.

On July 1, 2007, pursuant to the requirements of the Securities Authority, the Company published an immediate report setting out details of the steps taken by the Company following the report of the external examiner. This report relates, *inter alia*, to adoption of new working procedures for the board of directors.

On September 4, 2007, members of the board of directors were elected by the annual general meeting of shareholders of the Company including a number of new members, and on the same date, the board of directors appointed a new chairman for the Company (see also update to section 2.9.1 above). It was also resolved to set up committees of the board of directors, as well as their nature and composition. In addition, the Company approved the appointment of new directors of the subsidiaries.

- A. On June 7, 2007, a special general meeting of the shareholders of the Company was convened at the request of the Government Companies Authority, which discussed the examination report of the external examiner Dr. Yoram Danziger, and the implications thereof. During the course of this discussion, the Company provided a review of its operations following the findings set out in the report. The meeting took place in order to discuss the report, and no resolutions were passed at it. In this regard, see also the Company's immediate report of June 7, 2007.
- B. Note that on May 1, 2007, an application was received at the offices of the Company pursuant to Article A of Chapter 3 of Part V of the Companies Law, 5759-1999 (derivative claim), sent by a plaintiff claiming to be a public shareholder in the Company. According to the applicant, in his final report the external examiner indicates a long list of failures and deficiencies relating directly to the procedures of the board of directors, the committees of the board and the members of the board of directors and the former CEO of the Company, and the significance of a large portion of the findings of the report is that those directors and other officers of the Company who were involved in passing the various resolutions in the Company prima facie breached their duty of care and/or trust. Therefore, the application requests that the Company take legal steps against the directors and other officers of the Company who were responsible for such. On July 19, 2007, the Company gave notice to the applicant of its decision to dismiss the application with respect to submission of the derivative claim, *inter alia* on the grounds that the claim in this matter was not to the Company's benefit and for the reason that the Company was, is and will continue to act to

fix the defects disclosed by the report of the external examiner. In this regard, see also Note 8 to the financial statements of the Company for the period ended on September 30, 2007.

- C. It should be further noted that on May 13, 2007, a claim was received at the offices of the Company together with an application to recognize it as a class action, submitted by a plaintiff who claimed to have purchased shares in the Company in 2006. The claim was filed against the Company, two former CEOs of the Company, directors acting at the time relevant to the claim or at present on the Company and against Ap. Sab. Ar. Holdings Ltd, which holds 30% of the shares of the Company. The claim relates to the allegation that the financial statements of the Company for 2004 and 2005 included substantial information that was false and misleading, including with respect to the annual profit, property plant & equipment and shareholders' equity, in light of the Company's notice in an immediate report dated March 26, 2007 regarding a retroactive subtraction of approximately NIS 320 million in property plant & equipment which was not in use by the subsidiary Pelephone Communications Ltd. According to the Plaintiff, he suffered damage as a result of publication of the misleading information, *inter alia* because he had purchased shares at a higher price than that which he would have purchased had the aforesaid information been available on the market on the date on which the plaintiff purchased the shares. The Group which the plaintiff seeks to have the claim apply to is a group of plaintiffs who purchased shares of the Company in the course of trade on the stock exchange during the period between March 5, 2005 (the first day following publication of the report for 2004) and March 26, 2007 (the date of publication of the aforesaid immediate report), and held shares after March 26, 2007. The sum of the personal claim is NIS 194 and the total sum of the claim for the group is NIS 56.5 million.
- D. For re-approval of bonuses for 2005 and 2006, see update to section 2.9.7 above.

Section 2.21 – Risk Factors

A risk factor of large consequence – implementation of the number portability program – is added to the list of risk factors. In this regard, see update to section 2.6.6A above.

3. Cellular – Pelephone Communications Ltd. (“Pelephone”)

Section 3.1 Information on the area of operation

Section 3.1.5.3 Technological changes

On October 25, 2007, the Board of Directors of the Company approved a resolution of the board of directors of Pelephone regarding the setting up of a network using HSPA / UMTS technology for a total sum of approximately one billion shekels. Following the resolution, the general meeting of Pelephone approved the set-up of the network. Ericsson was chosen as supplier of the system. The new network is expected to commence operations at the beginning of 2009. Investment in the network will be over a period of four years.

Section 3.7 – Competition

Section 3.7.2

As part of an examination by the Ministries of Finance and Communications of the question of operation of virtual operators in Israel (MVNO), the Ministry of Communications has hired the services of a consulting firm and has requested that the carriers provide it with information on the cellular sector, for use in this examination. The Ministry of Communications has asked the consulting firm to submit its conclusions by the end of June 2007. After receiving the conclusions, and prior to making a final decision on the matter, the Ministry is expected to hold a hearing for the carriers. Pelephone, with the assistance of a consulting firm hired for this purpose, is getting ready to present its position to the Ministry of Communications, and is preparing a response to the expected hearing.

During the month of June 2007, Pelephone, Cellcom and Partner entered into an agreement with a joint consultation company in accordance with the consent of the Antitrust Commissioner, for the purpose of obtaining advice regarding competition in the cellular market in Israel, and on the issue of MVNO, pending the Ministry's hearing. Recently, the Ministry of Communications accepted the report of the consultancy company hired by it to look into the issue of introduction of MVNO. According to the recommendations of the report, there is no need for the Ministry of Communications to intervene in the matter at this stage. The Ministry of Communications has not published a hearing regarding introduction of MVNO. Likewise, during discussions by the Government on the Arrangements Law, the statutory amendments proposed regarding the creation of tools for enforcing the right of a virtual carrier to use a cellular network were also made.

In discussions of the State budget for 2008, the government decided that the Ministry of Communications should grant an MVNO license commencing December 31, 2007 to those who wish for one. If an MVNO license is granted and that licensee negotiates with the carriers but no positive outcome is achieved after a period of 6-9 months and it can be proven that this is the result of anti-competitive conduct of the existing carriers, then the Minister of Communications will consider intervening on the question of the introduction of MVNO into the market by exercise of his authority.

Section 3.7.3

On May 24, 2007, Pelephone received notice from the Ministry of Communications stating that it was considering imposing a financial sanction on Pelephone for alleged breach of the obligation to provide number portability as of September 1, 2006, as follows:

- A. For the period between September 1, 2006 and the date of the notice of the Director General of the Ministry, a financial sanction in the sum of NIS 2,031,750.
- B. For the period between May 25, 2007 and November 30, 2007, or up to the date of remedy by Pelephone of the alleged breach (whichever is the earlier) – the sum of NIS 6,450 for each additional day during which the breach continues.
- C. For the period between December 1, 2007 (which is, according to the provisions of the notice, the reasonable date necessary for the relevant licensees with respect to amendment of the alleged breach) and until the date of remedy of the alleged breach – the financial sanction set out in sections 37B(b) and 37C(a) of the Communications Law (note that under the provisions of those sections, the rate of the relevant sanction is seven times the fine set out in section 61(a)(4) of the Penal Law (which is NIS 202,000) plus 0.25% of the Pelephone's annual revenues, plus

a financial sanction in the sum of one fiftieth of such sanction for each day on which the breach continues).

According to the provisions of the notices of the Ministry of Communications, Pelephone was given an opportunity to make its own claims to the CEO of the Ministry of Communications by June 24, 2007. As set out in the financial statements for December 31, 2006, Pelephone (together with the other cellular companies) petitioned the High Court of Justice, alleging, *inter alia*, that it was the Ministry of Communications that had not prepared the number portability program as required under the provisions of the Law. On July 5, 2007, Pelephone submitted its response to the aforesaid hearing. As at the date of drafting this update, the Ministry's response to the response submitted has not yet been received.

Pelephone is preparing for the operational and marketing implications of implementation of the number portability program, and it expects harm to its revenues as a result of implementation of the program. At this stage, it is not possible to assess the scope of the harm.

This information includes forward-looking information, based on Pelephone's assessments. The actual outcome might be substantially different from the above assessments, if there is a change in any of the factors taken into account in making these assessments.

On this matter, see also the update of Section 2.6.6(a).

Section 3.7.4

During the month of September 2007, the Ministry of Communications published a hearing regarding the policy of allocation of frequencies for the activation of WiMAX technology. Under the proposed policy, preference is to be given in this allocation to new carriers and to the smallest cellular carrier in the market (Mirs). Pelephone has not yet submitted its response to this hearing.

Section 3.15 – Financing

Section 3.15.6 – Credit rating

On May 1, 2007, Maalot, which rates all of the Company's debenture series, announced that following recent discoveries and following the examination report submitted by the external examiner (see update to section 2.20 above) regarding reduction of property plant and equipment at Pelephone, at this stage, no change is expected to be made to the rating of Pelephone's undertakings (see also update to section 2.13.6 above).

Section 3.17 – Environmental protection

During the course of 2007, Pelephone has been adjusting its broadcast sites on the basis of an annual plan to comply with the requirements of the Non-Ionized Radiation Law, 5766-2005. In this context, Pelephone is receiving new operations permits for broadcast sites, in force for five years. With respect to certain kinds of broadcast installations that have a very slight effect on the environment, such as internal transmissions, Pelephone has received new class permits, which are in force for five years. See the update to section 3.18.3.3 below.

Section 3.18 – Restriction and supervision of Pelephone's activities

The Minister for the Environment has submitted the Non-Ionized Radiation Regulations, 5767-2007 to the Interior and Environmental Protection Committee of the Knesset. The Regulations have been made and approved by the Committee, but have not yet come into force. Pursuant to the wording of the Regulations approved by the Committee, the Regulations are expected to adversely affect the construction and operation of broadcast centers in several ways, including the following: significant reduction of the possibility of using access facilities in areas of high population density; more stringent processes for obtaining radiation permits for existing and new broadcast installations, and for effecting changes to the operation thereof; imposition of payment of fees for the construction and operation of existing and new broadcast installations.

Recently, there have been delays and difficulties in handling renewals of construction and operation permits as required under the Non-Ionized Radiation Law, 5766-2006 and the method of implementation of such by the Commissioner for Radiation at the Ministry of the Environment. Should these delays and difficulties not be resolved within a reasonable period of time and permits not be given for installations, this will give rise to the need to terminate broadcast from several installations,

so long as no other solution is found. Should the above conditions exist, this will have an adverse affect on the data in section 3.18.1.3.

This information includes forward-looking information, which is based on Pelephone's assessments. The actual outcome might be substantially different from the above assessments, if there is a change in any one of the factors which were taken into account in making these assessments.

Section 3.18.3.1 – Pelephone's license

In April 2007, the Ministry of Communications published its decision regarding amendment of the license on the matter of changing the mechanism used for identifying users of erotic services as being an adult. Under the amendment, removal of the obstruction of access to receipt of erotic services is to be by way of submission of a written application together with a photocopy of an identity card or by physically appearing before a service representative. The amendment, which was supposed to come into force on May 25, 2007, has been delayed in the meantime by virtue of a temporary injunction awarded by the Supreme Court, pending hearing of the application for injunction and petition before a panel of three judgments. This injunction was given under a private petition to the High Court of Justice against this amendment, which was filed during the month of May. The petition includes an application for an interim injunction to suspend entry of the amendment into force. Pelephone intends to join this petition.

On April 17, 2007, the Ministry of Communications published a hearing document to carriers regarding repeal of a clause in the MRT licenses permitting the marketing of plans with alternate billing segments to 12 second billing segments. According to the document, Pelephone will be allowed to market plans with 12 second billing segments only, and as of January 1, 2009, plans with 1 second billing segments only. During August 2007, the Ministry of Communications' decision was received, pursuant to which as of September 4, 2007, the cellular companies are not permitted to market plans with billing segments of greater than 12 seconds. Likewise, the Ministry of Communications referred, in its decision, to the December 2004 amendment of the license and noted that charging by segments of one second as of January 1, 2009 as set out in the Regulations (see also section 3.18.2 of the periodic report) will apply retroactively to packages marketed prior to that date as well, contrary to Pelephone's position. In discussions in the Economic Committee of the Knesset held in August 2007, a sub-committee was appointed to the Economic Committee regarding the Promotion of Competition in the Cellular Market. The sub-committee chose to focus on the issue of transparency in the cellular companies' invoices. The committee proposed a number of changes to the existing structure of the invoice. In addition, at the beginning of October 2007, a ministerial committee of the Ministry of Communications was set up with the aim of promoting changes in the invoices of the cellular companies in order to increase transparency. The committee is expected to adopt the recommendations of the sub-committee to the Economic Committee, and is also expected to recommend additional changes. Pelephone has welcomed the process and is working to improve the invoices sent to its customers.

During September 2007, the Ministry of Communications published a hearing for carriers under which it proposed an amendment to the MRT licenses which will restrict the maximum liability period for subscribers to 18 to 24 months. This hearing is based on the recommendations of a consultancy firm which checked the issue of virtual carriers for the Ministry of Communications, and in the same framework, also checked the level of competition in the cellular market in Israel. According to the recommendations, the most common liability period in the Israeli market is 36 months, which is longer than usual in similar competitive markets in Europe. Pelephone's position is that in any event, a provision requiring the shortening of the period of liability should not be imposed retroactively, and companies should be allowed to offer a range of plans with differing commitment periods along with plans requiring no commitment,

Section 3.18.3.3 – Site licensing

Certain local authorities and planning committees are trying to attack the legality of the use made by Pelephone and other cellular companies of an exemption from a building permit granted to wireless access installations used by the cellular networks under the Planning and Building Law, 5725-1965. In a number of judgments, the courts of local affairs have recognized the legality of use of such exemptions. Recently, the Court of Local Affairs handed down a ruling which contradicted previous rulings in the same court, to the effect that the above exemption does not apply to access installations that operation on cellular networks. Additional proceedings in this matter, including appeal proceedings in the District Court, have not yet been ruled upon. Recently, a High Court petition was also filed in this

regard, in an attempt to attack the legality of use of the above exemption which was dismissed due to threshold conditions. Pelephone is operating in accordance with the exemption proceedings, erects and operates such access installations as aforesaid in accordance with detailed radiation permits granted under the Non-Ionized Radiation Law, 5766-2005. For this issue, see also the update to section 3.18.1.3 above.

A number of local authorities recently contacted the Commissioner for Radiation at the Ministry of the Environment, expressing their objection to the erection of access facilities, relying on a section of the Non-Ionized Radiation Law which makes the grant of activation permits for access facilities conditional upon the consent of the relevant authority. Additional authorities are expected to join in expressing this objection. Due to these objections, the Ministry for the Environment is refusing to issue operations permits for access facilities which have been constructed lawfully in those authorities.

During the past month, discussions were held in the Interior and Environmental Protection Committee of the Knesset regarding regulations under the Non-Ionized Radiation Law. The regulations provide a series of rules for the construction of sites, such as safety distances, location of sites, etc. After termination of the hearings in the committee and approval of the regulations, the Minister of the Environment and the Minister of Communications must sign the regulations as final approval thereof. With respect to the access facilities, two further judgments were recently passed by the Court for Local Affairs which recognized the legality of erecting wireless access facilities used by cellular networks.

Section 3.19 – Legal proceedings

For updates on the subject of legal proceedings, see Note 8 to the financial statements of the Company for the period ended September 30, 2007.

4. International Communications and Internet Services – Bezeq International Ltd. (“Bezeq International”)

Section 4.1 – General

Section 4.1.1 – Structure and changes to area of operations

In addition to the services set out in this chapter of the periodic report, Bezeq International has, since its full merger with BezeqCall Communications Ltd. (“**BezeqCall**”) on February 11, 2007 (the “**date of full merger**”), been providing NEP (network end point) services (“**NEP Services**”), including data communications infrastructure services, passive infrastructure installation services and low voltage systems, sale of exchange systems including IP telephony communications systems, and provision of installation and maintenance services for these systems.

Section 4.1.2 – Legislative and statutory restrictions applicable to Bezeq International

Section 4.1.2.1 – On July 11, 2007, the Bill for an amendment to the Communications (Telecommunications and Broadcasting) Law, 5742-1982, which is parallel to the Limitation of Access to Adult Internet Sites Bill, 5766-2006, of Knesset Member Amnon Cohen, was approved by the Ministerial Committee and submitted to the Economic Committee of the Knesset. The Bills, which were discussed by the Economics Committee, propose restricting access to sites that contain pornographic content, gambling, or violence; *inter alia* by imposing an obligation on internet service providers, including Bezeq International, to activate mechanisms that oversee access to such sites. Due to the many questions raised in the Committee relating to the constitutionality of the amendment, as well as to the technical aspects involved in implementation of it, the Committee requested that the Ministry of Communications present it with data prior to its making any decision in this regard. At this stage, the basic format of the proposed law has not yet been prescribed, and it is not possible to assess the implications of this Law, if and when it is passed, on the commercial operations of Bezeq International.

Section 4.1.2.5 – Network End Point License

On December 31, 2006, the Ministry of Communications approved transfer of BezeqCall’s NEP License to Bezeq International. As of the date of the full merger, Bezeq International has been providing NEP services under this license.

Section 4.2 – Products and Services

Section 4.2.5 – NEP Services

In the NEP Services sector Bezeq International provides: Sale, installation and maintenance of exchange systems, installation and maintenance of data communications infrastructure, installation and maintenance services for passive infrastructure and low voltage systems, placing an emphasis on integrative solutions that are tailored to business and institutional customers on their premises.

Section 4.4 – New products

As of the date of full merger, all of the products and services that BezeqCall sold and supplied at that date were received by Bezeq International. In this regard, see update to section 4.2 above – Products and Services.

Section 4.6 – Competition

Section 4.6.4 – NEP Services

The traditional field of telephone exchanges is characterized by a large number of competitors and by fierce competition, which has given rise to an erosion of prices for services. The most prominent competitors are: Tadiran, Eurocom, Telrad, GlobeCall, Gil International, Tel-Yad.

The data communications and IP telephony field is characterized by the entry of new players – IT companies – into the world of voice. These are companies such as: Binat, Teldor, Netcom, IBM. These companies are substantially different from the traditional NEP companies and are of a higher technological level. There is also a trend of communications companies conglomerating and of entry of new carriers, intending to provide customers with total communications solutions – telephony, transmission, data communications, internet, information security, etc.

Section 4.9 – Intangible Assets

Section 4.9.3 – Acquisition of Actcom – Active Communications Ltd.

On July 9, 2007, the Registrar of Companies approved the merger of Actcom and Bezeq International Ltd., under the provisions of section 323 of the Companies Law, 5759-1999; such that Bezeq International received Actcom (all of its assets, rights and liabilities) and Actcom was expunged from the Register.

Section 4.10 – Human Resources

On June 18, 2007, the appointment of the Deputy CEO as Acting CEO of Bezeq International was approved (in place of CEO of Bezeq International, who had been appointed Acting CEO of the Company). The position of Deputy CEO of Bezeq International was cancelled. On November 6, 2007, the appointment of the Acting CEO as CEO was approved.

Section 4.10.2 – Organizational Structure

Management of Bezeq International has resolved, with the consent of the board of directors, to alter the organizational structure of the company, in the following way:

- A. Organization and Methods Department will be transferred to the management of the Finance Department;
- B. Human Resources will be separated from the Finance Department into an independent department, under the management of a manager reporting to the CEO of Bezeq International;
- C. Operations Department will be merged into the Service Department, under the management of the VP Services.

Section 4.11 - Suppliers

As of the date of full merger, all of the rights and obligations of BezeqCall under joint venture, marketing and sale agreements to which BezeqCall had been a party, were transferred to Bezeq International, giving it the right to market and supply installation, support and maintenance services for the equipment sold as part of the NEP services; the most significant of these are the agreements with: LG, Nortel, Cisco and Tadiran.

Section 4.13 – Credit Policy

Section 4.13.1 – Customer credit

As part of the provision of NEP services, Bezeq International effects sales to its customers by way of payments in many instalments. In this way, Bezeq International gives its customers credit, which they repay in instalments. In order to reduce the exposure which might stem from providing credit for lengthy periods to its customers, Bezeq International checks their financial resilience, sets ceilings for the maximum credit available to customers and registers a charge over the equipment sold, pending full repayment of the credit.

Section 4.14 - Investments

1. As at June 10, 2007, Bezeq International held 42.84% (33.66% under full dilution) of the share capital of Walla! Communications Ltd. During the second quarter of 2007, Bezeq International exercised the rest of the options available to it, in return for shareholders loans it provided to Walla! During the third quarter of 2007, the rest of the holders of the series 3 options of Walla! exercised their rights such that as at September 30, 2007, Bezeq International held 34.41% (33.66% under full dilution) of the share capital of Walla!.
2. B-Zone Partnership – on October 23, 2006, Bezeq International executed an agreement with 2+ (Two Plus) Wireless Solutions Ltd. (hereinafter: “**2+**”) to set up a general partnership under the name of B-Zone (hereinafter: the “**Partnership**”). Each of the parties' share in the Partnership is 50%. The purpose of the Partnership is to work to set up, support and manage wireless browsing networks in public areas, enabling connection to high-speed internet browsing and collecting payment from the end user for permission to browse the internet (hereinafter: the “**area of operations**”). Under the agreement, each of the partners transferred its activities in the partners' area of operations to the Partnership, as of the date

of commencement of the Partnership's operations. After the Partnership was set up, an agreement was signed between it and 2+ for the provision of outsourcing services to the Partnership by 2+, under which the Partnership would operate and its ongoing management would be effected by 2+. On July 1, 2007, the Partnership commenced its operations. Pursuant to the provisions of the foundation agreement of the Partnership, Bezeq International gave the Partnership a guarantee in favor of the receipt of a line of credit in the sum of US \$ 50,000. In addition, on October 15, 2007, Bezeq International granted a loan to the Partnership in the amount of \$35,000 for the purpose of developing the Partnership's operations. Under the Agreement, Bezeq International also undertook to pay 2+ the sum of US \$ 45,000 in favor of setting up the Partnership's operations, of which Bezeq International paid 2+ US \$ 30,000 on October 15, 2007.

3. On December 21, 2006, an agreement was signed between Bezeq International and Dasner Communications Ltd. for the establishment of a joint company, under which Bezcom Ltd. was set up during January 2007 (hereinafter: "**Bezcom**"). Bezcom was set up as part of the expansion of Bezeq International's global operations, together with the Dasner Group which specializes in marketing over the internet. The purpose of Bezcom is to act to provide communications services to end customers around the world, *inter alia* via a unique communications solution for the provision of telephony services. Bezcom commenced development operations in March 2007, and during August 2007 commenced its commercial launch. Pursuant to Bezcom's foundation agreement, the parties undertook to provide initial financing for Bezcom's operations in the sum of up to US \$ 1.5 million per party, by way of provision of shareholders' loans. On September 3, 2007, the parties each provided a sum of NIS 210,000 to cover Bezcom's expenses as at such date.

Section 4.15 – Finance

During the month of January 2007, Bezeq International repaid on-call loans provided to BezeqCall by a number of banks, in the total sum of approximately NIS 20.3 million.

After the balance sheet date, Bezeq International began a process of early repayment of loans received from banking corporations, subject to the approval of its organs. During October 2007, approximately NIS 15 million of the loan balance of approximately NIS 35.8 million was repaid.

Section 4.16 – Taxation

During the month of February 2007, Bezeq International paid income tax down payments for the 2006 tax year, in the sum of approximately NIS 36.3 million.

Section 4.19 – Legal proceedings

1. With respect to section 4.19.4 of the Company's periodic report for 2006 regarding the petition to the Supreme Court sitting as the High Court of Justice, filed by Bezeq International on February 5, 2006, to cancel the decision of the Minister of Communications under which Bezeq International would only be granted a license to operate domestic fixed line telephony services using VOB technology after the Company's market share in the field of domestic fixed line telephony fell below 85%, the Supreme Court accepted Bezeq International's application and on July 8, 2007, awarded an interim injunction instructing 012 Telecom to focus its requests to contracts regarding fixed line domestic telephone on their own customers only, by direct mail, rather than by applying to the public; On September 5, 2007, the Supreme Court handed down a judgment dismissing the Petition and leaving the Minister of Communications' decision in force.
2. On June 6, 2007, HOT Telecom Limited Partnership ("**HOT**") filed a claim against Bezeq International in the District Court at Tel Aviv, under which it sought declaratory relief and an interim injunction under which Bezeq International would not do any act, directly or indirectly, to obtain confidential information belonging to it, and would not make any use of such information should it be obtained; that following an investigation that it had undertaken which showed, it claimed, that Bezeq International was operating unlawfully to obtain the details of customers who had joined as subscribers to its internet access infrastructure services.

Bezeq International filed its response to the application for temporary injunction to the Court, in which it alleged that HOT's claims against Bezeq International and its managers regarding the existence of methodical and systematic operations at Bezeq International aimed at unlawfully obtaining information about HOT's customers are insubstantial and that in any event, there is no

evidentiary infrastructure for such, and that if any of Bezeq's representatives has indeed acted as alleged by HOT, such person acted of their own accord, in absolute contravention of the instructions of Bezeq International.

On July 23, 2007, the Court acceded to HOT's application and awarded an injunction prohibiting Bezeq International and/or any of its employees and/or persons acting on its behalf and/or any representative of it from contacting the employees of HOT and/or its representatives directly or indirectly in order to obtain confidential information regarding the identity of its customers, by way of grant of benefits and/or making use of such information that may have reached it. In light of Bezeq International's clear policy, which existed even prior to the filing of this claim, and which prohibits unauthorized receipt and use of such information, it would appear that the injunction granted by the Court will not have any implications on Bezeq International's operations or its financial results. As at the date of this report, Bezeq International's response to the principal claim (regarding the declaratory relief) has not yet been submitted; however, at this stage, given the causes of action and the clear policy of Bezeq International regarding the receipt of information relating to customers of infrastructure suppliers, it would appear that the claim will not substantially affect the conduct of Bezeq International's business, or require it to use substantial resources to remove such.

3. On July 29, 2007, Bezeq International filed a claim against HOT in the District Court at Tel Aviv in the sum of NIS 23.2 million for damages caused to it by HOT since the latter decided, in contravention of the provisions of its license, not to allow Bezeq International to participate in the joint parcels offered by it (joint parcels for access services and for infrastructure services which offer a total price which is attractive to customers). The claim was filed following a decision by the Ministry of Communications, in October 2006 (passed following a complaint by Bezeq International in this regard) that HOT had breached the conditions of its license and therefore was required to integrate Bezeq International into the joint parcels, together with the other internet access service providers in competition with Bezeq International. In the statement of claim, Bezeq International claims loss of profits in the sum of NIS 23.2 million over a period of approximately two years (2005-2007) in which HOT blatantly refused to cooperate with it. According to Bezeq International, during this period it lost many customers who wished to enjoy its services but wanted to have HOT's infrastructure services. Due to HOT's conduct, Bezeq International was in fact obstructed from accessing a whole swathe of customers which it could not bring into its services or retain. As at the date of this report, HOT has not yet filed a statement of defense.
4. Further to the provisions of the update to section 2.6.6A above, on May 27, 2007, Bezeq International received a letter from the Director General of the Ministry of Communications, giving notice to Bezeq International that he intended to impose a financial sanction upon it in the sum of NIS 2,031,750 for failure to implement and operate the number portability plan, commencing on September 1, 2006.

In response to the Ministry of Communications, Bezeq International claimed that as holder of a general license for the provision of international telecommunications services, it does not allocate numbers to its customers and therefore, in any event, is not part of number portability, which is effected by domestic carriers and cellular carriers. Bezeq International's part in this matter amounts only to creating the interfaces required with respect to incoming calls to cellular and/or domestic carriers, in accordance with the characterization of the form of number portability prescribed by the cellular and domestic carriers, and checks done with them. Bezeq International performed its duties under the law by preparing itself as required and it was ready, prior to the date set down for implementation of the portability program on September 1, 2006, to do all that was required to implement the program, in whatever manner the domestic carriers might decide to employ, and its acts did not prevent the effecting of portability from any number or customer whatsoever.

Therefore, there are no grounds for the Ministry of Communications' claim in this regard, since not only is it in contradiction to the facts of the matter, but also causes harm to Bezeq International, which has invested immense resources in this regard and which acted without delay to implement what was required of it on time and in the manner prescribed by the relevant persons. In light of all of the above, it is clear that Bezeq International has implemented number portability faultlessly, and that it should be deemed to be a party prepared for number portability, in accordance with the provisions of the law and on the date set out in such provisions.

5. With respect to section 4.19.3 of the Company's periodic report for 2006 regarding the application for leave to appeal filed by Bezeq International with the District Court at Tel Aviv against the ruling of the Local Court in Tel Aviv under which Bezeq International's appeal against the decision of the Director General of the Ministry of Communications to impose a monetary sanction in the sum of approximately NIS 1 million for alleged breach of the conditions of its license regarding erotic services was partially upheld and under which the Ministry of Communications was required to refund Bezeq International the sum of NIS 387,000, on October 15, 2007, the District Court handed down a judgment dismissing the appeal and affirming the ruling of the Local Court regarding the rest of the sum of the monetary sanction paid by Bezeq International.

For further updates on the subject of legal proceedings, see Note 8 to the financial statements of the Company for the period ended September 30, 2007.

5. Multi-channel television – D.B.S. Satellite Services (1998) Ltd. (“DBS”)

Section 5.1 – General information on areas of operation

As at June 30, 2007, DBS had 543,031 subscribers.

Section 5.1.3 – Market developments in the area of operations

In October 2007, the Bill for the Arrangements Law for 2008 was approved under first reading by the Knesset Plenum, which included, *inter alia*, provisions to amend the Second Authority for Radio and Television Law, 5750-1990, under which the Second Authority for Television and Radio must plan, set up and operate a digital distribution system, backed up by a satellite distribution system for the commercial television stations (Channel 2 and Channel 10) for two channels of the Broadcasting Authority (if the Broadcasting Authority should so desire) and of the Knesset Channel (Channel 99), should it so request, such that such channels will be distributed to the public freely throughout the country, by December 2008 (under the limitations set out in the Bill). Should the aforesaid Bill be legislated as a binding statute and such distribution as aforesaid be effected by the Second Authority, the broadcasts of such channels shall constitute a partial substitute for DBS's broadcasts.

Section 5.4 – New Products

High Definition TV (HDTV) – DBS is currently completing its preparations for marketing a decoder enabling the reception of high definition broadcasts. In DBS's assessment, the service is expected to be launched by the end of 2007.

The aforesaid is forward looking information and realization of it is dependent, *inter alia*, upon technical preparations and third parties, and therefore, this assessment may not come into being or may come into being in a substantially different manner.

Viewing Programs on the Internet – in August 2007, DBS launched a content website in cooperation with Walla! Communications Ltd. which presents content intended for viewing over the internet.

Section 5.6.5 – Competition

With respect to section 5.6.5F - VOD, in July 2007, the Knesset approved the Communications (Telecommunications and Broadcasts) (Amendment No. 37) Law, 5767-2007 in second and third readings. This law, *inter alia*, authorizes the Minister of Communications to provide satellite broadcast licensees to provide services upon demand (VOD) to its subscribers, in whole or in part, after consulting with the Council and taking into account the considerations set out in the Communications Law, if it finds that there is a difficulty in transmitting VOD broadcasts via satellite in the scope and format similar to those broadcast by the general licensee for cable broadcasts. However, commercial launch of VOD services by DBS requires a license from the Ministry of Communications, upgrade of telecommunications infrastructure by Bezeq, connection of the subscriber to the DSL network and receipt of the consent of Bezeq to provide the service on conditions that will enable DBS to provide it for its subscribers, conditions which to date have not yet been met.

In this regard, see also update to section 2.6.5 above.

Section 5.10 – Raw materials and suppliers

For the lawsuit between DBS and Hillel which is being heard by an arbitrator, see update to section 5.17 below.

Section 5.12 – Finance

Section 5.12.2 – Credit restrictions applicable to the corporation

In July 2007, the financing agreement was amended under which, *inter alia*, the targets of the financial conditions which DBG is required to comply with starting with the second quarter of 2007 and ending in 2013 (the date for full repayment of the bank credit) were amended. A mechanism was also prescribed as part of this amendment setting out the rate of receipts from the issue of Debentures (Series A) of the Company, including future increases of the series, if any, to be used to repay the bank credit. In this regard, see also Note 7A to the financial statements of the Company for the period ended on September 30, 2007.

As at September 30, 2007, DBS was in compliance with the financial conditions under the (amended) financing agreement, after receiving relief from the banks (received after the balance sheet date) with respect to the targets of a number of stipulations at September 30, 2007.

The banks extended the date for DBS to reach an arrangement with the Israel Aviation Industry regarding DBS' debt to it, so that such debt and the call for payment of it not be deemed to be a breach by it of the financing agreement, to December 31, 2008, and provided that as at such date, no proceedings are instituted against DBS by the IAI.

Private placement of debentures

In July 2007, DBS raised the sum of approximately NIS 620 million as part of a private issue to institutional investors of registered Debentures (Series A) listed on TACT Institutional at TASE (the "**Debentures**"). For the purpose of this issue, the Debentures were rated by Maalot the Israel Securities Rating Company Ltd. at BBB- / stable.

In October 2007, Maalot gave notice that the rating of the Debentures had been placed on the watch list due to disruptions of DBS's broadcasts (see below), due, according to Maalot, to higher than expected expenses having been incurred, to a deviation from DBS's business plan and to the filing of a number of lawsuits against it. Maalot noted that it will examine the effect of these events on the present rating, and will publish its conclusions at the end of its examination.

On October 21, 2007, DBS received a letter from the trustee for the debentures, stating that following disturbances in broadcasts and the publicity about them, including about falling subscriber numbers at DBS and about the compensation that DBS will grant its subscribers, he requests various documents and confirmations from DBS in order to ascertain whether those events and their long-term implications are liable to have an adverse effect on DBS's undertakings towards the debenture-holders. Following the trustee's letter, the Company and the trustee met to discuss the matter, at which time the Company was requested to submit additional information to that disclosed at the meeting. At the date of this report, the Company is considering the trustee's request.

For further details with respect to this issue, see Note 7A to the financial statements of the Company for the period ended on September 30, 2007.

Section 5.13 – Taxation

DBS is in the process of discussing tax deduction assessments for the years 2002-2004. DBS has made an appropriate provision on its books.

Section 5.17 – Legal proceedings

For the claim of DBS v. Pace (section 5.17.1 of the Periodic Report): On March 18, 2007, the registrar of the District Court set aside the defendant's application to cancel the permit of service. On April 10, 2007, the defendant appealed that decision to the District Court, and hearing of the appeal was set down for June 11, 2007. Pursuant to agreements reached by the parties, the appeal was struck out on May 28, 2007, without any order being made as to costs.

On July 15, 2007, a statement of defense was filed by Pace, simultaneously with a statement of counter-claim by it against DBS and Eurocom Digital Communications Ltd., in which an interested party is also an interested party in DBS ("**Eurocom Communications**"), jointly and severally, relating to a monetary claim in the sum of NIS 42,640,000. For this counter-claim, see also Note 8 to the financial statements of the Company for the period ended September 30, 2007.

With respect to the Al-Jazeera claim (section 5.17.2 of the Periodic Report): Following negotiations, the parties have reached an agreement with respect to continued broadcast of the channel, as part of DBS' transmissions. On May 9, 2007, Al-Jazeera signed a memorandum of understanding which anchored this agreement and set out that an application to strike out the claim would be filed within 7 days of execution of the memorandum of understanding. On May 17, 2007, an application was filed to strike out the claim, and on May 21, 2007, the Court upheld the application to strike.

With respect to the class action regarding the Sports Channel: On February 28, 2007, the court's ruling was published stating that the value of the benefit was \$ 10,000,000, and costs at a rate of 6% of the sum of the benefit were ruled for counsel for the plaintiffs, and a total sum of NIS 2,514,000 plus VAT, plus remuneration to the plaintiffs in the sum of NIS 400,000 (including VAT). DBS and the cable companies agreed that the division between the parties would be 70-30, and accordingly, on April 26, 2007, DBS's portion (30% of the total sum) was transferred to counsel for the representative plaintiff.

On April 16, 2007, the representative plaintiffs filed an appeal to the Supreme Court against the sum ruled as remuneration to the plaintiffs, and an application to increase it. DBS plans to file a counter-appeal regarding appraisal of the value of the benefit (and accordingly, with respect to the fees of counsel for the plaintiffs), and with respect to the remuneration to the plaintiff. On May 16, 2007, DBS, together with the Cable Company, filed a counter-appeal regarding the appraisal of the value of the benefit (and accordingly, with respect to the fees of counsel for the plaintiffs) and with respect to the remuneration to the plaintiff.

Proceedings regarding deficit demand from the Customs Department: In December 2006, a deficit demand was sent to Eurocom Digital Communications Ltd. ("Eurocom Communications") from the Customs Department, for payment of purchase tax and VAT (including linkage differentials, interest and fines) in the sum total of approximately NIS 10 million, for decoders purchased by DBS from Eurocom Communications, and imported by it for DBS, smart cards belonging to DBS having arrived with such decoders. Eurocom Communications and DBS have mounted objection proceedings against the deficit demand, the dispute dealing with the proper classification of the smart cards for the purposes of purchase tax. DBS has provided the sureties required by the Customs Department for assurance of the taxes in dispute and DBS and Eurocom Communications have agreed that DBS will bear any payments required under the deficit demand, if any. In the opinion of DBS' and Eurocom Communications' legal advisers, there is a reasonable chance of no effective debt in respect of the sum of approximately NIS 5 million out of the deficit demand, which is in respect of VAT, and there is a reasonable chance of subtraction or cancellation of the linkage differentials, interest and fines included in the deficit demand. As at the date of this report, a decision has not yet been made with respect to the objection to the deficit demand.

Arbitration with Halal Communications: A dispute has arisen between the Company and Halal Communications Ltd. ("Halal") in which an interested party is also an interested party in DBS, regarding the sum of the monthly payment to Halal for the leasing of space segments on the Amos 2 satellite under the agreement between the parties dated May 16, 2000 (the "agreement"), due to the Company's claim that it is entitled to an annual discount on the rental that it owes under the agreement, due to the number of space segments that it leases on Amos 2, whilst Halal claims that it is not entitled to such discount, since two of the segments leased from Halal are segments transferred from Amos 1. The parties negotiated in an attempt to solve the dispute, under which the DBS made an ex gratia payment of the sum of \$700,000 out of the sum in dispute. DBS deposited the sum in dispute with a trustee, at the rate of such at the time of commencement of the arbitration proceedings and from time to time deposits additional sums in dispute with the trustee. . In May 2007, an initial pre-arbitration session was held – in order to determine the procedures for hearing Halal's claim regarding the debt, amounting at present to \$ 1,575,000, including the sum of \$ 700,000 above (the alleged debt increasing by \$ 75,000 each month). On June 14, 2007, Halal filed a statement of claim and on July 8, 2007, DBS filed a statement of defense. On August 28, 2007, Halal submitted affidavits of evidence in chief and DBS is entitled to submit affidavits of evidence in chief by November 1, 2007.

Re class action regarding decoder depreciation (section 5.17.3 of the periodic report) - pursuant to a procedural arrangement reached by the parties, DBS filed its response to the application for approval on February 13, 2007. No response has yet been filed to the response, and the Attorney-General's position has not yet been submitted. A hearing date has been set down for November 12, 2007.

New class action regarding Pizza Meter campaign – on July 11, 2007, an application to approve submission of a class action against DBS and Pizza Meter Ltd. (hereinafter: "Pizza Meter") was filed with the District Court at Tel Aviv with respect to a campaign by DBS under which subscribers who joined the campaign were entitled to 52 coupons for a family-sized pizza from Pizza Meter for one year (hereinafter: the "Application for Approval"). According to the applicant, in May 2007, there was a change in the policy for exercising these vouchers, mainly in that delivery services were no longer provided, and this made it impossible to exercise the vouchers, in contravention of the conditions promised to subscribers when they joined the campaign. The class action is estimated to be in the sum of approximately NIS 7 million. DBS has not yet filed its response to this Application for Approval. On September 2, 2007, Pizza Meter gave notice to DBS of termination of exercise of the campaign vouchers by it following the transfer of ownership and all of the rights in the "Pizza Meter" brand from Pizza Meter Holdings Ltd. to Pizza Meter Israel – Management (2005) Ltd. Following termination of the campaign by Pizza Meter and the company's notice as aforesaid, on September 20, 2007, the applicant filed an application to amend the application for approval regarding the new facts as stated above, noting that this amounted to a litigant's admission on the part of the respondents as to the blatant breach of their undertakings.

For additional updates on the subject of legal proceedings, see Note 8 to the financial statements of the Company for the period ended September 30, 2007.

Section 5.19 – Discussion of Risk Factors

5.19.3 – Special Risks to DBS

Secondary allocation of frequency range – the frequency range used by DBS to transmit its broadcasts from the broadcast satellites to the satellite dishes installed at subscribers' homes, and allocated in accordance with a license by the Ministry of Communications is defined as the frequency range allocated under secondary allocation, such that there is an Israeli entity which is permitted to make primary authorized use of the frequency range. If the owner of the primary allocation uses the frequency range on an ongoing and significant basis, disruptions may occur to the quality and/or availability of DBS's broadcasts to its subscribers which might cause harm to the financial results of DBS. As at the date of this report, to the best of DBS's knowledge, the owner of the primary allocation has not made use of these frequencies in such a way as to cause significant and/or ongoing disruptions to DBS's broadcasts. Disruptions to reception of broadcasts – since DBS's broadcasts are wireless transmissions from the broadcast satellites on which DBS leases space segments, to the satellite dishes in subscribers' homes, the broadcast of wireless signals in the same frequency range might cause disruptions to the quality and/or availability of the broadcasts provided by DBS to its subscribers and harm to its financial results. For the disruption that occurred during September and October 2007, and to the Government's resolution in this regard, see below.

New Section 5.20 – Extraordinary Event in DBS's Business

On September 5, 2007, non-continuous disruptions began to occur in DBS's broadcasts, which occurred on a variety of waves, power and scope which caused disruptions, at various strengths, to the quality and availability of DBS's broadcasts, mainly in the north of the country and along the coast. The disruptions to broadcasting also gave rise to extraordinary loads on DBS's customer service center, which caused difficulties in receiving service. In order to locate the source of the disruptions, DBS set up teams to locate and pinpoint the disruptions, with the cooperation of specialists in this area, and with the assistance of various governmental bodies as well. To the best of DBS's knowledge, and as informed to it by government bodies following the location operations, the source of the disruptions was external, was not within DBS's control and was not related to it. The disruptions ceased on October 9, 2007 and have not occurred since, as at the date of publication of this report. To the best of DBS's knowledge, the disruptions were caused due to broadcasting operations in the frequency range in which DBS's broadcasts are transmitted from the satellites that it uses to the dishes in subscribers' homes. Therefore, despite the fact that the disruptions have stopped as at the date of this report, there is no certainty that a disrupting transmission of this kind may not occur again in the future.

The frequency range in which DBS operates as aforesaid was permitted for its use under a license granted to DBS by the Ministry of Communications prior to its commencing commercial operations (see section 5.8.1.4 to the periodic report of Bezeq for 2006), in respect of which DBS paid and continues to pay appropriate fees. In this regard, in October 2007, the Government resolved as follows:

- A. Further to the operations done by the Ministry of Communications, the Ministry of Defense and the Foreign Ministry to cease the disruptions to reception of the broadcasts of YES, to appoint an inter-ministerial committee headed by the Director General of the Ministry of Communications, and with the participation of a representative of the Foreign Ministry, a representative of the Ministry of Defense, a representative of the Ministry of Finance and a representative of the Ministry of Justice, to examine all of the aspects and issues arising with respect to these disruptions, and in broader contexts as well.
- B. To instruct the relevant government ministries to give the matter appropriate priority. The team to be appointed as set out in section A above shall place special emphasis on the issues arising in the field of mass communications in cases of emergency.
- C. The team shall provide the Government with an interim report by mid November 2007.”

On October 16, 2007, DBS gave notice that despite the fact that the disruptions to its broadcasts had been caused by external entities and not by its own act or omission, it would compensate all of its subscribers by opening up all of the channels marketed by it (with the exception of erotic channels and pay per view movie channels) to its subscribers for free, for a period of three months ending January

15, 2008, and subscribers who, under their contracts, pay a separate fee to purchase “premium” channels will be credited for such payment. This compensation, and the other expenses and damages caused to DBS with respect to these disruptions could cause harm to DBS’s financial results.

November 14, 2007

Date

Bezeq – The Israel Telecommunication Corp. Ltd.

Names and titles of signatories:

Shlomo Rodav, Chairman of the Board

Avi Gabbay, Acting CEO