

# **Update of Chapter A (Description of Company Operations)<sup>1</sup> of the Periodic Report for the Year 2005 ("the Periodic Report") of "Bezeq", the Israel Telecommunication Corp. Ltd. ("the Company")**

## **1 – Description of General Development of the Group's Operations**

### **To Section 1.1 – Group Activity and Description of its Business Development**

#### **To Section 1.1.6 of the Periodic Report – Mergers and acquisitions**

With regard to reports in the media on the subject and pursuant to the Company's clarifying immediate report from April 10, 2006, the Company is examining its continued holding in Walla! Communications Ltd. by means of its subsidiary Bezeq International Ltd. This examination has not yet matured to the point of any form of negotiations.

On April 30, 2006 an agreement was signed between the Company, Malam Systems Ltd. and the Goldnet Communications Services partnership, on the one hand, and the subsidiary Bezeq International Ltd. on the other, in the matter of the acquisition of all the operations of the Goldnet Communication Services partnership by Bezeq International Ltd. in consideration of the sum of NIS 6.8 million, which would be divided between the Company (NIS 5.1 million) and Malam Systems Ltd. (NIS 1.7 million). In this regard see also the update to Section 4.9 hereunder.

#### **To Section 1.4 – Distribution of Dividends**

Further to Section 1.4.3 of the Periodic Report in the matter of the resolution of the Company's Board of Directors from March 1, 2006 to recommend to the General Meeting of the Shareholders of the Company the distribution of a cash dividend to the shareholders of the Company, in a total amount of NIS 1,200,000,193, which constitute, as at the date of the distribution, NIS 0.4606446 per share and 46.06446% of the issued and paid up capital of the Company, the General Meeting of the Shareholders of the Company approved the distribution of the dividend on March 23, 2006. The dividend was distributed on April 16, 2006.

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<sup>1</sup> The update is in accordance with Regulation 39A of the Securities Regulations (Periodic and immediate reports), 5730-1970, and includes material innovations or changes that took place in the corporation's business in any matter that must be described in the Periodic Report. The update pertains to the numbers of the sections in Chapter 1 (Description of Company Operations) in the Periodic Report of the Company for the year 2005.

## **2 – Fixed-Line Domestic Communications - "Bezeq", the Israeli Telecommunication Corp. Ltd. ("the Company")**

### **To Section 2.1 – General Information regarding the Area of Operations**

In the matter of Section 2.1.2 of the Periodic Report on the subject of updating the Company's tariffs – the next tariff update is expected to be on June 1, 2006, although as of the date of this report the Company has not yet received a draft of the relevant regulations.

In the matter of Section 2.1.9 of the Periodic Report on the subject of issuing special general licenses for the providing fixed-line domestic communication services – see Sections 2.6.1 and 2.6.4 below.

### **To Section 2.2 – Products and Services**

The Ministry of Communications has informed the Company that its position is that the Company should have informed it about the provision of IP – Centrex services, which is a virtual private network service before starting to provide the service, and that therefore the Ministry is considering approval of the provision of the service by the Company and its terms. The Company explained to the Ministry that the service is included in its license. The Company replied to all the Ministry's questions and provided the information it requested.

In the matter of Section 2.2.3 of the Periodic Report – on March 7, 2006, the Ministry of Communications published a hearing for all the communication companies in connection with its intention that a united 144 call center would be operated for all the communication companies, with callers being able to obtain the telephone numbers of all the operators' subscribers in a single telephone call. Concurrently, a united website would operate for all the communication companies. In a letter of response submitted by the Company on March 26, 2006, the Company presented its position that the directory assistance service is auxiliary to the telephony services provided by the license holder; that entities that do not hold a general license should not be permitted into the sector and that the service should be retained in its present format as an auxiliary service to the services of the general license holder. The Company's position is that the demand for directory assistance services to be provided free of charge on the internet is unreasonable and disproportionate, places an unreasonable burden on the operators and compromises their rights of ownership. The directory assistance call center provided by the Company is already a "united call center" that provides information services about most telephony subscribers in Israel and, insofar as this depends on the Company – the call center will provide all the information about those telephony subscribers in Israel who request that the information about them be published for the public.

In the matter of Section 2.2.3 of the Periodic Report – internet access service – the number of the Company's ADSL subscribers as at March 31, 2006, is approximately 824,000 (compared with approximately 800,000 subscribers at the end of 2005).

### **To Section 2.6 - Competition**

#### **To Section 2.6.1 of the Periodic Report – Telephony**

- A. As at the date of publication of this report, according to reports in the media, HOT's telephony service numbers over 100,000 customers.
- B. A license for a paid marketing trial for VoIP services has also been issued to a subsidiary of Pelephone Communications Ltd. On this matter, see Section 3.7 hereunder.
- C. In the matter of Sections 2.6.1 and 2.6.4 of the Periodic Report on the subject of the issuing of special general licenses for the provision of fixed-line domestic communication services – to the best of the Company's knowledge, such licenses have been issued to GlobeCall Communications Limited Partnership and to Cellcom Fixed-Line Communication Services Limited Partnership. The subsidiary Bezeq International Ltd. has submitted an application for such a license (see update to Section 4.1.2 below).

### **To Section 2.6.3 of the Periodic Report – Transmission and Data Communication**

On the subject of the Accountant General's tender for the provision of data communication services – on April 11, 2006 the Supreme Court decided to dismiss the appeal filed by the Company against the District Court's ruling and to order it to pay court costs. The Accountant General has not yet published the results of the tender.

### **To Section 2.6.4 of the Periodic Report – Competition from the Cellular Companies**

In the matter of moderation of the downtrend in the number of voice minutes, *inter alia* as a result of the slowdown in the growth rate of the cellular companies, it is clarified that the downtrend in the number of fixed-line voice minutes is continuing. In the Company's opinion, this is due to the development of alternatives to these calls, mainly by means of internet-based calls.

In the matter of the appeal filed by the Company in 2001 in the Antitrust Court with regard to the Antitrust Commissioner's refusal to change the declaration of the Company's status as a monopoly in basic telephony service (fixed-line domestic telephony) – in the wake of the Company's petition that the Court expedite the hearing of the appeal, the Company, acting on the Court's suggestion, agreed to withdraw the appeal, and intends to file a new and revised petition to the Antitrust Commissioner. In the Company's opinion, the cellular telephony market constitutes an alternative market to fixed-line telephony, and this fact is reinforced by new and up-to-date data that have accumulated during the period since the start of the proceeding before the Court.

### **To Section 2.6.5 of the Periodic Report – Additional Factors that could affect Competition**

- A. Numbering and number portability – during February/March 2006 there was a further exchange of letters on the matter of the operators', including the Company, inability to meet the timetables that were set. The Company reiterated that it is preparing for the implementation of number portability but for real and technical reasons, it cannot meet the timetable set for implementation of the plan, and it reserves its legal rights in this matter.

On April 23, 2006 a letter was received from the Deputy Director General for Engineering and Licensing at the Ministry of Communications, in which he suspends the use of certain ranges of the prefix 076, that was allocated for the Company's use, in the wake of information received by the Ministry indicating that the Company intends to use that allocation for the provision of a service which, ostensibly, has not yet been duly approved – the IP – Centrex service. In the matter of this service, see update to Section 2.2 above.

- B. Other potential competing infrastructures – on the subject of the allocation of frequencies (WIMAX) – the Company made it clear that its position is that there is no reason and no need to allocate these frequencies, which are a limited State resource, to operators who hold special licenses and who are not obligated to provide universal service. The Company believes that mainly due to the vital need of these frequencies for providing services in outlying areas, the top priority of the policy on the subject of frequency allocation for wireless access systems must be universal service and the creation of conditions that will make it possible to provide it.

### **To Section 2.6.7 of the Periodic Report – positive and negative factors affecting the Company's competitive status**

In the matter of a lack of tariff flexibility – the Ministry of Communications recently began to intervene in the marketing campaigns offered by the Company to the public. On April 5, 2006, the Ministry of Communications published a press release addressing the consumer public directly, whereby the legality of the Springtime Campaign that the Company launched a few days previously was being examined. In the Springtime Campaign, customers who buy a telephone and other equipment from the equipment suppliers participating in the campaign are entitled to 200 free call minutes per month for calls made from Bezeq to Bezeq, for a period of one year. The Ministry announced that it is possible that customers who purchase the telephones will not be able to realize the benefit. Previously, the Director General of the Ministry of Communications sent a letter to the Company stating that the campaign was launched without the Ministry's approval. In its reply, the Company noted its fundamental legal position, which was sent to the Ministry and had not yet elicited a

response, whereby the Company does not need the Ministry's approval for marketing campaigns. However, without prejudice to this position on the part of the Company, the Company clarified that in any case the campaign in question does not fall under the category of an existing work procedure vis-à-vis the Ministry. After publication of the Ministry's press release, the Company demanded that the Ministry publish a denial or a correction. The Ministry failed to respond and continued to demand information, documents and data. The Company gave the Ministry documents and data, despite its position that the Ministry has no authority in this matter. In addition, the Company announced that it reserves the right to act in this matter. Subsequently, the Ministry of Communications announced its intention to foreclose on a guarantee in the sum of NIS 7 million out of the bank guarantee of \$10 million that the Company deposited to guarantee fulfillment of the terms of its license.

The Company intends to exhaust all the legal recourses at its disposal in this regard and, initially, the Company is filing an appeal of the ruling to the Minister of Communications.

## **To Section 2.9 – Human Resources**

In the matter of Section 2.9.1 – on May 10, 2006 the Company's Board of Directors approved the appointment of a Vice President for Regulation, as of June 1, 2006.

In the matter of Section 2.9.5 – negotiations between the Company's management and the employees' representatives regarding the change in the Company's organizational structure, retirement/dismissal of employees, and a new collective labor agreement, are continuing but have not yet matured to the point of an agreement. Regarding a collective labor dispute declared on April 27, 2006, see note 5 to the financial statements for the period ending March 31, 2006.

## **To Section 2.13 - Financing**

### **To Section 2.13.6 of the Periodic Report – Credit Rating**

1. Maalot rating – on April 4, 2006 the Company's existing rating (AA) for the debentures in circulation (private, public and Eurobonds), which had been on the Watch List since May 10, 2005, was ratified and validated, after renewed examination of the business risk, the financial risk and the Company's strategy, and following the sale of the Company's controlling interest to Ap.Sb.Ar. Holdings Ltd. ("**Ap.Sb.Ar.**").
2. Midroog rating – on April 11, 2006 the Company's rating was removed from the Watch List and left as Aa1. However, Midrug decided to lower the Company's rating horizon from stable to negative in order to reflect the possibility that the change in the Company's ownership will affect the Company's future business and financial profile.

## **To Section 2.15 – Environmental Protection**

In the matter of Section 2.15.2 - the Non-Ionizing Radiation Law, 5766-2006 – on March 26, 2006 the Radiation Supervisor notified the Company and the cellular operators that for the purpose of readiness for the law coming into effect and with the goal of tightening and improving supervision, he intends to exercise his authority under the Pharmacists Regulations. He further notified that therefore, as of June 1, 2006, those applying for operating permits would be required to comply with the conditions for issuing a permit, including the condition relating to submission of a permit under the Planning and Construction Law. The Company is examining its continued preparations for the new law, taking notice of the said notification. See also the update to Section 3.18.1.3.2 below.

## **To Section 2.16 – Limitations and Regulation of Company Activity**

### **To Section 2.16.2 of the Periodic Report – the Company's General License**

On the subject of volume discounts – to the best of the Company's knowledge, the Ministries of Communications and Finance approved a basket of alternative payments which allow the Company to provide volume discounts at a rate of up to 10%. As of the date of the publication of this Report, the Company has not received the signed approval mentioned above.

On the subject of measuring the Company's market share – on March 15, 2006 the Company submitted a detailed position document to the Ministry of Communications clarifying that the demand for the loss of "market share" – is vague and constitutes fertile ground for disputes, delays and legal resolution; likewise, the Company's position is that the conditions are ripe for granting the Company the possibility of marketing joint packages with its subsidiaries. In any case, in the opinion of the Company, a date should be set for this matter – no later than the end of Q1 2007. The Company stressed that the restrictions should be removed and the Company permitted to market joint packages in areas in which the Company has lost 15% of market share. In the matter of the parameters for measuring market share (insofar as the demand is not rescinded), the Company believes that the worthy test is the minutes test and not the revenues test, and that the loss of the Company's market share should be measured in relation to a relevant starting point (November 2004) and that proof that the loss was in favor of certain competitors should not be required.

### **To Section 2.16.3 of the Periodic Report – Royalties**

In April 2006 the Company paid the sum that was requested by the Ministry in respect of the Company's revenues from interconnect fees on calls from cellular subscribers to Company subscribers (approximately NIS 17 million). It should be noted that the Company is involved in advanced negotiations with the Ministry in order to solve various other disputes related to royalties. In connection with the reduction in the rate of royalties from 3.5% to 3% beginning January 1, 2006, the Ministry of Communications notified the Company that amendment of the Royalty Regulations, which will arrange for the decrease, will be implemented shortly.

### **To Section 2.16.7 of the Periodic Report – Antitrust Laws**

To Subsection (C) on the subject of the Company's appeal against the failure to rescind the declaration of the Company as a monopoly in basic telephony – see updated to Section 2.6.4 above.

In connection with the antitrust authority's application in the matter of claims by certain telecommunication operators, see note 1(c)(8) to the financial statements of the Company for the period ended March 31, 2006.

In connection with the search conducted at the Company's offices on May 23, 2006 and the interrogation of a number of Company employees regarding the alleged abuse of the status of the monopoly and/or an unreasonable refusal to supply an asset or service under the monopoly, see note 1(C)(9) to the Company's financial statements for the period ended March 31, 2006.

### **To Section 2.16.10 of the Periodic Report – Class Action Suit Law**

On March 12, 2006 a new class action law was published, whereby a class action can be filed on various grounds detailed in the addendum to the law and under an explicit provision of the law in the matter of class actions (individual provisions, *inter alia*, in the Antitrust Law, the Consumer Protection Law, and the Banking Law – have been cancelled). Under the law, its provisions will apply also to petitions and actions that were pending on the date of publication of the law. The law includes definitions and expansions of the parties who are permitted to file a motion for a suit to be recognized as a class action, and determines the terms for its filing. The law grants the court discretion in various matters such as compensation, relief, replacement of a plaintiff in a class action and a reservation regarding the approval of the action against a body that provides an essential service to the public. The law makes it very hard to abandon a claim or to reach a settlement, both of which, *inter alia*, require the court's approval. Under the law, a fund for financing class action suits is being established, whose function is to assist representative plaintiffs in financing petitions whose submittal is of public and social importance.

### **To Section 2.17 – Substantial Agreements**

#### **Management Agreement**

On March 23, 2006 the General Meeting of the Shareholders of the Company approved the Company's contractual arrangement under an agreement with a company that would be under the ownership and control of the shareholders of Ap.Sb.Ar., in the framework of which the Company would

receive regular management and consulting services, including by means of directors who serve and who will serve from time to time at the Company and/or at its subsidiaries, all in consideration of \$1.2 million *per annum*. The term of the contractual arrangement is from October 11, 2005 (the date of closing the acquisition of 30% of the Company's shares by Ap.Sb.Ar.) to December 31, 2008, unless one party gives the other three months' notice of its wish to terminate the agreement. A full description of the terms of the contractual arrangement was provided in the Company's Immediate Report (Amendment) dated March 13, 2006, concerning a transaction between the Company and a controlling shareholder.

### **To Section 2.18 – Legal Proceedings**

For updates on the subject of legal proceedings, see Note 6 to the financial statements of the Company for the period ended March 31, 2006.

### **3 – Mobile Radio telephone – Pelephone Communications Ltd. (hereinafter: "Pelephone")**

#### **To Section 3.7 - Competition**

In the matter of Section 3.7.2 of the Periodic Report – during the quarter, Pelephone obtained a license for a marketing trial using VoIP technology, in accordance with an application that it submitted. The license includes a condition which, in the main, stipulates that if, at the end of the hearing, the policy document of the Ministry of Communications is amended in a way which prevents Pelephone from providing VOB services, the license for the trial shall expire. The license for the trial allows Pelephone to provide domestic telephony services using VoIP technology in the scope of 8,500 extensions and lines.

#### **To Section 3.18 – Restrictions and Supervision of Pelephone's Activities**

In the matter of Section 3.18.1.3.2 – notification was recently received from the Radiation Supervisor whereby the implementation of some of the requirements of the law, among them making the issue of authorizations contingent on obtaining a building permit, will be brought forward to June 1, 2006. Pelephone informed the Supervisor of its opposition to the date being brought forward, and that the Supervisor should adhere to the effective date determined in the law, i.e. January 1, 2007.

In the matter of Section 3.18.2 (E) – in addition to changes in the Telecommunications Regulations (Interconnect fees), 5760-2000, from December 2004, whereby as of January 1, 2009 the payment for the call completion segment to another cellular network will be according to time units of one second (unlike the present billing method that permits billing according to segments of up to 12 seconds), Pelephone's license was amended in December 2004 so that as of January 1, 2009, the fee for the airtime segment will also be calculated (in addition to the call completion segment as aforesaid) according to time units of one second (rather than the present billing method, which is according to time units of 12 seconds).

In the matter of Section 3.18.2 (G) – a typographical error was made in the Periodic Report for the year 2005, and the following sentence should be deleted from the end of this section: "During the past few months, a hearing took place, both in writing and orally, in the matter of the interconnect fees for all the cellular operators and, as at the date of publication of these statements, Pelephone is awaiting the decision that shall be made by the Finance Ministry and the Ministry of Communications."

#### **In the matter of Section 3.18.3.1:**

- A. The Ministry of Communications recently amended the licenses of the cellular operators in the matter of limiting users' access to the internet in order to obtain services that include adult content. The amendment stipulates, *inter alia*, that access to erotic services included in a cellular portal or by means of an application such as a search engine which is included in a cellular portal and which enables access to sites on the internet, will be blocked for all subscribers by default, and only an adult aged 18 and above will be able to request the removal of the block from his cellular operator, in accordance with a reliable identification procedure. The amendment to the licenses entered into effect on March 30, 2006. At this stage Pelephone does not expect material damage to its revenues as a result of the amendment.
- B. The Ministry of Communications is holding a hearing with regard to its intention to require a subscriber whose call is routed to a voicemail box be given the option of disconnecting the call with no charge, by means of a preliminary voice message notifying the subscriber that his call is being transferred to a voicemail box, and that he will be charged only from that time. Pelephone intends to express its opposition in the response to the hearing.

#### **To Section 3.19 – Legal Proceedings**

For updates on the subject of legal proceedings, see Note 6 to the financial statements of the Company for the period that ended on March 31, 2006.

#### **4 – International Communication and Internet Services – Bezeq International Ltd. ("Bezeq International")**

##### **To Section 4.1 – General**

In the matter of Section 4.1.2 – Legislative and Regulatory Restrictions Applicable to Bezeq International – on May 16, 2006 Bezeq International submitted an application for a special general license for the provision of fixed-line domestic communications services to the Ministry of Communications. The issuing of a license, as stated, by virtue of which domestic VOB services will be provided (constituting an essential part of the product mix of internet service providers), will enable Bezeq International to continue to provide its customers with comprehensive communications solutions (of the types that its competitors will offer, some of which have already received similar licenses) and to expand as an equal among equals.

##### **To Section 4.9 – Intangible Assets**

On April 30, 2006 Bezeq International signed an agreement with Malam Systems Ltd. ("Malam") and the Company, for the acquisition of all the operations of the Goldnet Communication Services ("Goldnet"), a registered partnership owned by Malam (25%) and the Company (75%), which provides solutions for the dissemination and transfer of information via secured electronic means between organizations, in consideration of the sum of NIS 6.8 million, which would be paid to Goldnet. In the framework of this acquisition all the agreements between Goldnet and its customers and its suppliers, and the franchise agreements and business cooperation agreements that it has entered into will be endorsed to Bezeq International and all the intellectual property rights, inventory and/or fixed assets of Goldnet will be transferred to the ownership of Bezeq International.

On fulfillment of all the suspending conditions stipulated in the acquisition agreement (*inter alia*, approval by the Antitrust Commissioner and the Ministry of Communications), and the payment of the consideration, Goldnet, which conducted its business under the trade name of "Bezeq Gold", shall cease to provide services and shall dismiss all its employees, the lion's share of whom will be hired by Bezeq International. Goldnet shall pay its dismissed employees all the monies to which they shall be entitled in respect of the termination of their employment. Likewise, for a period of 12 months from the date of completion of the acquisition deal, Goldnet will continue with its contractual arrangements with customers by the power of agreements that it will not be possible to endorse to the Company and shall transfer all the receipts in respect thereof to the Company.

##### **To Section 4.10 – Human Resources**

In the matter of Section 4.10.3 - Organizational Structure - on May 15, 2006, Bezeq International consolidated the Technologies Division and the Information Systems Division into a new division to be called Information Technologies, which shall be headed, as Vice President, the man who served as director of the Technologies Division up to that time. The background for the change is the need to adapt the organizational structure to Bezeq International's changing needs and technologies, which stem from the customers' needs.

##### **To Section 4.14 – Investments**

During Q1 2006, Bezeq International and others exercised option warrants of Walla (Series 3). In total, Bezeq International exercised 2,564,764 option warrants (Series 3) during Q1 2006, in consideration of a sum total of NIS 4,617 thousand, which was offset from the owners loan balance that Bezeq International extended to Walla. Following the exercise of the option warrants as stated, Bezeq International's holding in Walla grew from 42.85% on December 31, 2005 to 44.92% as at the date of the interim financial statements (fully diluted, as at March 31, 2006 – 33.66%). Following the exercise of the option warrants, goodwill in the sum of NIS 2,313 thousand was generated for the Company.

## **To Section 4.19 – Legal proceedings**

In connection with the intention of the Ministry of Communications to impose a financial sanction on Bezeq International in respect of a breach of the terms of its license, due to the provision of access by telephone to erotic services, described in Section 4.19.4 of the Periodic Report, the Director General of the Ministry of Communications informed the Company, on March 29, 2006, of his decision to impose a financial sanction on the Company in the sum of around NIS 1,064 thousand; this is in respect of a single breach of provisions of Bezeq International's license and due to an ongoing breach of 115 days. After Bezeq International's request from the Ministry of Communications to delay the payment until the appeal that it intends to file has been clarified was rejected, the said sum was paid in April 2006 and was fully credited to the profit and loss report.

On May 9, 2006, Bezeq International filed an appeal to the Tel Aviv Magistrates Court against the said ruling of the Director General of the Ministry of Communications, on the basis of the opinion of Bezeq International's legal advisors whereby there is a good chance that the sum of the sanction will be either cancelled or reduced.

## **5 – Multi-channel Television – D.B.S. Satellite Services (1998) Ltd. ("D.B.S.")**

### **To Section 5.1 – General Information on Area of Activity**

#### **To Section 5.1.3 – Developments in Markets in the Field of Operations**

With regard to the government's decision on the free dissemination of certain channels by means of a land-based system of transmitters based on digital technology, supported by a digital satellite system: DBS is conducting negotiations with representatives of the Treasury with regard to the implementation of the said government's decision and was told that the Finance Ministry intends to publish a public hearing on the matter.

With regard to the government decision on the subject of obligating the multi-channel television companies to sell the public reduced channel packages, DBS is conducting negotiations with representatives of the Finance Ministry. As at the date of this report, provisions for the implementation of this government ruling are included in the Budget Law which, to the best of DBS's knowledge, has passed its first reading in the Knesset plenum.

### **To Section 5.6 - Competition**

#### **To Section 5.6.5 – Principal Methods for Coping with Competition**

In the matter of VOD – DBS was recently informed by representatives of the Ministry of Communications that it will receive a license for conducting the technological trial within a short period, but as at the date of this report the license for the trial has not yet been received.

### **To Section 5.10 – Raw Materials and Suppliers**

#### **To Section 5.10.1 – Main Raw Materials**

In the matter of Sub-Section B – space segments – as at the date of this report, DBS is paying the regular leasehold fees in respect of space segments in the Amos 1 satellite, and performs partial payment on account of the leasehold fee debt in respect of the previous period whose date of payment to Israel Aircraft Industries has passed (in view of the endorsement of the right to receive the leasehold fees from HLL to Israel Aircraft Industries). In view of DBS's delay in payments that were stipulated in the said agreement, Israel Aircraft Industries contacted DBS in March 2006 demanding that the entire debt be settled, and the parties are conducting negotiations on the matter. In addition, there is a dispute between DBS and HLL in the matter of the annual leasehold fees that HLL is entitled to receive in respect of the leasing of space segments in the Amos 2 satellite, which has not yet been arranged, with DBS paying only those sums that are not in dispute.

### **To Section 5.11 – Working Capital**

In Q1 2006 an increase occurred in the working capital deficit of DBS, which totaled approximately NIS 510 million as at March 31, 2006.

### **To Section 5.12 - Financing**

#### **To Section 5.12.2 – Restrictions of the Corporation for the Receipt of Credit**

As at March 31, 2006 DBS met the financial criteria, as per the financing agreement (after the banks agreed to amend the targets of these criteria with regard to Q1 2006). In the estimation of the management of DBS, in view of its forecasts with regard to its business results for the years ahead, it is also necessary to adjust the criteria with regard to the period up to the end of the repayment of the bank credit. In consequence, in April 2006 DBS turned to the banks in order to update the targets of the financial criteria for the period commencing in the year 2006 and until the end of repayment of the bank credit (in accordance with the targets that shall be agreed upon between DBS and the banks). The banks' answer to this request has not yet been received.

As at the date of this report, DBS is not fully meeting its undertakings under the financing agreement to take out insurance in connection with its activities and its assets in general, including with regard to its obligation to take out satellite failure insurance with regard to the satellites leased by DBS from the space segments for the purpose of its broadcasts. DBS is conducting negotiations with the banks to obtain concessions with regard to its insurance undertakings, which will enable it to meet these undertakings.

In addition, the delay in DBS's payments to Israel Aircraft Industries (as stated in the update to Section 5.10.1 above) constitutes a *prima facie* breach of the financing agreement; however, the banks have confirmed to DBS that they will not deem the demand by Israel Aircraft Industries for the repayment of the debt to be a breach of the financing agreement on the part of DBS, provided by August 1, 2006, the parties arrive at a written settlement with Israel Aircraft Industries with regard to the repayment of the said debt and that during the period up to August 1, 2006, Israel Aircraft Industries does not employ any means whatsoever to collect the said debt.

## **To Section 5.14 – Restrictions and Supervision of the Corporation**

### **To Section 5.14.1 – The Activity's Subordinacy to Specific Laws**

On the subject of original (local) productions - DBS has met its obligation for the year 2004 (including the relative share of completing past obligations), apart from immaterial deviations in the subdivision into the various genres, which the Council ordered DBS to amend during 2005. DBS notified the Council that it has met its original productions obligation for the year 2005 (including the relative share of completing past obligations), and the issue is under examination by the Council as at this date.

On the subject of royalties - To the best of DBS's knowledge, as at the date of this report an amendment to secondary legislation is under process, whereby the rate of royalties applicable to DBS beginning in the year 2006 and thereafter will be gradually reduced to a fixed percentage of 1%. DBS is unable to estimate whether the said amendment will actually be promulgated.

### **To Section 5.14.3 – The Principal Limitations by virtue of the Law and Broadcasting License**

As at the date of this report, the Council has issued an additional broadcasting license to a designated "Israeli Heritage" channel, which is also expected to be aired via DBS's broadcasts. At present, no broadcasts of independent license holders are aired in the framework of DBS's broadcasts.

The decision with regard to the restrictions that apply to DBS as to the percentage of local channels under its ownership which aired in the framework of its broadcasts, was approved by the Council as part of the rules and entered into effect in March 2006.

In the matter of tiering – in March 2006 the cable companies informed the Director General of the Ministry of Communications that in view of DBS's alleged breaches, of the administrative orders, they are ceasing to receive the notifications that DBS sends to the cable companies in connection with the transition of cable companies subscribers to DBS. DBS contacted the Ministry of Communications and requested the enforcement of the Administrative orders by the cable companies and likewise demanded that the cable companies once again receive the notifications. As at this date DBS's notifications are not being received by the cable companies, which are continuing to bill their subscribers who asked to disconnect from their services and connect to DBS's services. The results of the hearing have not yet been published. In the estimation of DBS's management, should the Administration's provisions be cancelled, without the existence of a suitable alternative arrangement that will enable one supplier to make use of another supplier's infrastructures at the subscribers' homes, this will constitute a material barrier to the transition of subscribers between the various providers.

## **To Section 5.17 – Legal Proceedings**

In the matter of Section 5.17.3 – with regard to the arbitration proceedings between DBS and Play TV Ltd., producer of the Playboy and Adult channels ("Play TV"), in connection with the arbiter's ruling and the request for clarification thereof, the parties have arrived at a settlement agreement whereby all the proceedings that were conducted between them that are the object of the arbiter's ruling, have ended. According to the settlement agreement DBS is entitled to receive a certain sum from Play TV.

Commercial agreements were also reached between the parties on other matters that were anchored within the bounds of the settlement agreement.

In the matter of Section 5.17.4 – in the matter of the Endemol lawsuit: the parties have arrived at an agreement in principle with regard to the termination of the dispute with a settlement, but this has not yet been formulated into a binding agreement whereby the lawsuit will be annulled, while DBS will pay Endemol approximately \$180,000 (including in respect of the purchase of certain content from Endemol).

In addition, on March 15, 2006 a verdict was handed down against DBS and Mr. Shlomo Liran, its former CEO, following DBS's conviction at the Tel Aviv District Labor Court of the offense of disturbing a work supervisor on behalf of the Ministry of Labor and Social Welfare – an offense under Section 26(2) of the Hours of Work and Rest Law, 5711 – 1951 and Sections 36(A)(1) and 36(C) of the Organization of Supervision of Labor Law, 5714 – 1954, and with regard to Mr. Liran, also under Section 27(A) of the Hours of Work and Rest Law, 5711 – 1951 and Section 36(E) of the Organization of Supervision of Labor Law, 5714 – 1954. DBS's conviction was based on the failure to submit documents to a work supervisor, on demand, in contravention of the obligations stipulated by law. The District Court imposed an administrative fine in the sum of NIS 25,800 on DBS and an administrative fine in the sum of NIS 38,700 on Mr. Liran. DBS is considering the possibility of appealing the verdict.

May 23, 2006

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Date

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"Bezeq", The Israel Telecommunication Corp. Ltd.

Name and title of signatories:

Menachem Inbar, Member of the Board (Chairman of the approval meeting)

Yacov Gelbard, President & CEO