

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.

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 August 13, 2007, the board of directors of the Company resolved to recommend to the general meeting of shareholders of the Company to pay a cash dividend to the shareholders in the sum total of NIS 760 million (constituting NIS 0.2917415 per share).

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

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 section numbers used in Chapter A (Description of Company Operations) in the Company's Periodic Report for 2006.

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 Half of 2007	First Half of 2006
Revenues (NIS millions)	2,835	2,895
Operating profit (NIS millions)	612	588
Number of active subscriber lines at end of period (thousands)	2,778	2,822
Average monthly revenue per line (NIS)*	76.9	80.5
Number of outgoing usage minutes (millions)	7,666	8,524
Number of incoming usage minutes (millions)	2,111	1,758
Number of ADSL subscribers at end of period (thousands)	924	844
Average monthly revenue per ADSL subscriber (NIS)	57.9	57.2

* Not including income from data communications and transmission services, services to communications providers, contract and other work, and income from incoming traffic.

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 Grunau Commission regarding the communications industry in Israel, and on the way in which those recommendations are adopted and applied.

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 October 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. During the second half of 2007, the Company plans to continue launching additional products in accordance with market trends and customer requirements.

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.

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 June 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 "**Grunau Commission**"), the Company's position as expressed in a document submitted to the Commission and as presented to the Commission is as follows:

The Commission is to create a clear regulatory horizon for the entire communications market, and for the Company in particular, so as to enable the Company to provide better and more efficient services, including upgrading the Company's infrastructure by investing in an advanced communications network (the New Generation Network – NGN) which is a precondition for innovative communications services such as IPTV (a service for provision of digital television services for subscribers over internet infrastructure). In the absence of such a horizon, the Company cannot continue investing the sums involved.

The Company also requests that the Commission give the Company a real possibility for dealing with competition by way of: absolute tariff flexibility; absolute freedom in marketing service packages; absolute cancellation of the structural and corporate separation duties, amendment of the Company's license to permit the Company to provide IPTV services.

Likewise, as with many other countries around the world, the Company expects to be given a regulatory safety net in which it was have exclusivity of use of the NGN network and of provision of services on such network for 5 years from the date on which the network becomes available.

The Company further explains that the "normative revenue" test currently used by the Ministry of Communications as a basis for prescribing the date on which the market is to be opened to competition is an inappropriate test. The Company wishes to convert the existing formula for calculating loss of market share by the Company so as to prescribe a time barrier, based on the earlier of January 1, 2008 and a drop below 85% market share, according to the Ministry of Communication's method. Since if this is not done, then the Company's commercial rivals will in fact have the power to determine when, if at all, true competition will commence in the communications market. Likewise, with respect to competition under a model enabling unbundling (the significance of which is to force the Company to sell infrastructure components to competitors), the Company clarifies that the Grunau Commission shall be required to adopt the recommendations of the previous committee which dealt with rules of competition (the Kroll Committee), to the effect that competition in the communications market must be based on independent infrastructure.

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 is unable to estimate the trends or 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 August 13, 2007, a letter was sent by counsel for the Company to the State Attorney's Office, in which the Company rejected the claims made by the State Attorney's Office, which, in its view, contradicted the legal obligations imposed upon the State, and the notice given by the State to the High Court of Justice.

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.

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, including Walla (but not including DBS) will not be entitled to provide this service. In this regard, see also the update to section 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. 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. In the Ministry's notice, the Company, Pelephone and Bezeq International were given an opportunity to state their positions to the Director General of the Ministry of Communications by June 24, 2007. 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 (after receiving an extension), 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).

Section 2.6.7 – the Company's preparations for coping with increasing 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 Grunau 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 2007, 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.

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.

The board of directors has instructed management of the Company to re-examine the procedures regarding management and realization of the Company's real estate assets, and to make recommendations to the board of directors regarding the Company's policy in this area.

Section 2.9 – Human resources

Section 2.9.1 – Organizational structure, and employees according to 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.

On June 28, 2007, an Acting Internal Auditor was appointed to the position of Internal Auditor of the Company.

On July 16, 2007, a new Company Secretary was appointed to the Company, who reports to the Chairman of the Board of Directors (and who shall take office as of the second half of August 2007). This job has been handled, since October 2005 and up until entry of the Company Secretary into office, by the Company's General Counsel.

As of August 1, 2007, the Company's VP Regulation has also been appointed Internal Compliance Officer for Anti-Trust Practices.

Section 2.9.2 – Personnel according to employment framework

During the first half of 2007, the number of employees fell from 8,096 as at December 31, 2006 to 7,489 as at June 30, 2007 (a net reduction of 607 employees) as a result of retirement of employees from the Company.

Section 2.9.6 – Employee remuneration schemes

With respect to the allocation of options to two directors from amongst the employees under the option scheme for all of the employees of the Company, which requires the approval of the general meeting of shareholders of the Company – in light of publication of the interim report of the external examiner as set out in the update to section 2.20 below, and in light of the questions raised, prior to commencement of the discussion, by some of the persons present at the general meeting convened for April 15, 2007 in order to approve the allocation, it was decided that the meeting would not be held. The Company is acting to reauthorize the allocation of the options to the two directors elected from amongst the employees and in this regard, the board of directors of the Company, on June 18, 2007, authorized an amendment of the Collective Agreement between the Company and the Employees' Representation, enabling the allotment of the options to the two directors elected from amongst the employees, at an exercise price identical to the exercise price granted to all of the Company's employees. The issue of the options to the directors elected from amongst the employees will be brought before the Audit Committee, the Board of Directors and the General Meeting for approval.

Section 2.9.7 – Company officers and senior executives

As at the date of publication of this report, there are 14 directors acting in the Company² 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 July 17, 2007, the chairman of the board of directors gave notice that he intended to terminate his office as chairman of the board of directors, and that his office would end upon appointment of another chairman for the board of directors. On July 30, 2007, the Company gave notice of the convening of an annual general meeting of shareholders of the Company for September 4, 2007, on the agenda of which is, *inter alia*, the election of directors. Following the election of directors at the general meeting, the board of directors is expected to elect a new chairman.

With respect to grants to office-bearers – 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 grants to office-bearers 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 grants to office-bearers for 2005 in the total sum of NIS 210,000. In the opinion of the board of directors, award of these grants 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 grants to the following office-bearers as follows, which, in the opinion of the board of directors, constituted extraordinary transactions:

Ika Abravanel – Deputy CEO (and as of March 29, 2007 – acting CEO) – NIS 768,000, constituting 80% of the salary in fact paid to him for 2006.

Ron Eilon – Deputy CEO and Chief Financial Officer from October 11, 2005 until August 28, 2006 – NIS 640,000, constituting 80% of the salary in fact paid to him for 2006 for the period of his employment by the Company.

Yuval Rachlevsky – VP Human Resources as of April 1, 2006 – NIS 540,000 constituting 80% of the salary in fact paid to him in 2006.

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

Some of the office-bearers will repay the Company the difference (if any) between the grants they received in the past and the grants 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 2.13 – 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, Ma'alot, which rates all of the debenture series of the Company and Pelephone, announced that following recent discoveries and following the examination report submitted by the

² Including two external directors and two directors elected from among the employees.

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 Pelephone's undertakings or the Company's undertakings.

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 draft of the new Non-Ionized Radiation Regulations prescribes payment of commissions for the filing of an application for a permit for a radiation source. If and to the extent that the above regulations are approved, the Company is expected to be required to pay commissions in a sum estimated at approximately NIS 6 million, which is expected to be spread over a number of years.

The Company wrote to the Ministry for the Environment, via the Ministry of Communications, requesting that it amend the method of calculating the safety range limit proposed in the above draft Regulations which, in the Company's view, increases the safety range beyond the current limits, meaning a reduction in the broadcast sites operated by the Company.

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.

For the Company's position on measurement of the market share in the document that was submitted to the Grunau Commission, see the update to section 2.6 above.

To the best of the Company's knowledge, the Ministry of Finance is initiating a government resolution as part of its activities in view of the Arrangements Law for 2008, the purpose of which shall be to instruct the Minister of Communications 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.

Section 2.16.7 – Antitrust Laws

With respect to the Antitrust Commissioner's investigation of May 2006 – 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.

The notice also states that before the Commissioner makes her decision, the Company is given the opportunity to state its position to the Commissioner.

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.

The Company is preparing for exercise of the right to a hearing and it is to provide its written position to the Commissioner by September 15, 2007.

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 amounts, as at June 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.

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 under the Arrangements 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, as part of the indirect amendments under the Arrangements Law for 2008, 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 2.17.5 – 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 June 30, 2007.

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

Sub-section (b) – appointment of external examiner

- A. On April 12, 2007, the Company published an immediate report setting out the interim report of the external examiner. On the same date, the board of directors of the Company held a discussion of the interim report and appointed a committee of the board of directors which was authorized to examine the immediate steps which the findings of the interim report required be taken. Likewise, the board of directors agreed to the request of the CEO of the Company, on the date, to extend his leave of absence until discussion by the board of directors of the final report of the external examiner, and determined that up until such date, Mr. Yitshak (Ika) Abravanel would continue to act in lieu of the CEO.
- B. On April 26, 2007, the Company published an immediate report setting out the final report of the external examiner. As a result of that, on April 30, 2007, the board of directors of the Company held a special meeting on the final report, and decided, *inter alia*:
1. To authorize a joint notice, signed on April 30, 2007 by the Company and Mr. Yacov Gelbard, a copy of which was attached to the Company's immediate report of the same date, to the effect that Mr. Gelbard's office as CEO of the Company would terminate on April 30, 2007.
 2. To set up a committee to find a new chief executive officer for the Company, the committee to recommend a candidate or candidates for the position of CEO to the board of directors.
 3. Mr. Ika Abravanel will continue acting in lieu of the chief executive officer of the Company (until a resolution to some other effect is passed by the board of directors).
 4. The audit committee of the board of directors is to endeavour to find a candidate to act as permanent internal auditor of the Company.
 5. To recommend to the audit committee to appoint external director Mr. Eyal Yaniv as chairman of the audit committee.
 6. To appoint a secretary for the Company and an external legal counsel to the board of directors, in addition to the Company's General Counsel.
 7. To make immediate changes to some of the working procedures of the board of directors and its committees so that minutes of discussions are detailed, the meetings are held in Hebrew (and where necessary, with simultaneous interpretation into English), and so that the board of directors holds a meeting on the last Thursday of every calendar month, at which it shall discuss the ongoing management of the Company, and at which the managers of the Divisions of the Company and by the CEOs of the subsidiaries shall present reviews of operations to members of the board of directors.

In addition, the board of directors received a review from the committee comprised of members of the board of directors which had been set up for the purpose of examining the board's working procedures as a result of the interim report by the external examiner. This review related, *inter alia*, to prescription of a new and more detailed set of work procedures for the board of directors, committees of the board, reporting and control of the subsidiaries (from the point of view of the board of directors) subject to regulatory restrictions, internal audit and management reports to the board of directors. The committee was asked to submit a final report to the board of directors within 30 days of April 30, 2007. (Accordingly, and at the committee's request, on May 28, 2007, the board of directors of the Company authorized postponement of the filing of the final report by thirty days.)

- C. 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, the setting up of committees of the board of directors, including a committee to locate a CEO and a committee to examine and make recommendations regarding the structure of management of the Company and its control of the subsidiaries, and three permanent committees (balance sheet, business, and remuneration, organization and administration) in addition to the Audit Committee, the Security Committee and the Regulation Committee which already exist in the Company. In this regard, see also the above immediate report. Note that no external legal counsel has yet been appointed to the board of directors and this shall be discussed after a new chairman is appointed to the board of directors.
- D. 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.
- E. 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 June 30, 2007.
- F. 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.

G. For re-approval of bonuses for 2005 and 2006, see update to section 2.9.7 above.

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

Section 3.1

Section 3.1.5.3

As part of the process of choosing a supplier, Pelephone received a response to a request for proposals (RFP) and is currently in negotiations with three potential suppliers. In July 2007, the board of directors of Pelephone approved proceedings to choose a supplier for the HSDPA/UMTS network. The final set-up program for the network is subject to the approval of Pelephone’s authorized bodies.

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. As at the date of this update, the Ministry of Communications has not yet accepted the recommendations of the consultancy company hired by it to look into the issue of introduction of MVNO. In addition, to the best of Pelephone’s knowledge, the Budgets Department of the Ministry of Finance is initiating an amendment to the Communications Law as part of the indirect amendments made under the Arrangements Law for 2008, the purpose of which is to provide tools for enforcing the right of use of a cellular network on a virtual carrier.

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 (after receiving an extension), 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 3.15 – Financing

Section 3.15.6 – Credit rating

On May 1, 2007, Ma'alot, 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

Section 3.18.3.1 A

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. If the aforesaid amendment of the license comes into force, 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. Pelephone submitted its response to the hearing at the end of May 2007, and has not yet received the Ministry's response, as at the date of this update.

Section 3.18.3.3

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. 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.

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 June 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.

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 then Deputy CEO of Bezeq International 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.

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

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!

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.

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 of January 31, 2007, to amend the Ministry of Communications' policy regarding licensing of VOB services, a decision 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; this injunction resulted in the cancellation of a broad media campaign by 012 Telecom regarding VOB services offered by it by virtue of its domestic license. On August 5, 2007, 012 Telecom, in respect of whose services the above injunction was issued, filed an application to reduce and/or clarify the interim injunction and to instruct the Company to deposit a guarantee for its costs, in the sum of NIS 5 million. As at the date of this report, the Company's response to that application has not yet been filed.
- 2, On June 6, 2007, HOT Telecom Limited Partnership ("**HOT**") filed a claim against the Company 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.

For further updates on the subject of legal proceedings, see Note 8 to the financial statements of the Company for the period ended June 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 5.4 – 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 - DBS is currently completing its preparations to launch a content website in cooperation with Walla! Communications Ltd. aimed at presenting 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. 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. For further details with respect to this issue, see Note 7A to the financial statements of the Company for the period ended on June 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 September 30, 2007, and provided that as at such date, no proceedings are instituted against DBS by the IAI.

Private issue 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) intended for listing 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. For further details with respect to this issue, see Note 7A to the financial statements of the Company for the period ended on June 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 June 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. The date of hearing of the appeal and the counter-appeal has been set down for September 3, 2007.

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 Company made an ex gratia payment of the sum of \$700,000 out of the sum in dispute, and later deposited the sum in dispute with a trustee, at the rate of such at such time. 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. Pursuant to the arbitrator's ruling, Halal is required to submit affidavits of evidence by August 31, 2007 and the Company shall be entitled to submit affidavits of evidence in chief by September 30, 2007.

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 12, 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.

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

13.8.2007

Date

Bezeq – The Israel Telecommunication Corp. Ltd.

Names and titles of signatories:

Dov Weisglass, Chairman of the Board

Avi Gabbay, Acting CEO