

**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.

2. Fixed-Line Domestic Communications –

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

Section 2.1 – General information on areas of operation

On June 1, 2007, the Communications (Telecommunications and Broadcasts) (Payments for Telecommunications Services) Regulations, 5767-2007 and the Communications (Telecommunications and Broadcasts) (Calculation and Linkage of Payments for Telecommunications Services) (Amendment) Regulations, 5767-2007 are expected to come into force. Under the draft regulations that the Company has received, 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

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 2005.

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 are due to come into force on the same date, prescribing that the reduction of interconnect tariffs as of June 1, 2007 is expected to be 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. In addition, the draft regulations include a new arrangement for providing a discount in monthly fixed fees for subscribers entitled to a pension under the Assurance of Income Law, 5741-1980. If this arrangement is approved, it will come into force under the draft regulations on September 2, 2007 in lieu of the reduced usage fee arrangement, and therefore, it is not expected to have a substantial effect on the Company's revenues.

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

Section 2.2.3 – internet access services

The number of the Company's ADSL subscribers, as at March 31, 2007, is approximately 911,000 subscribers (compared with approximately 891,000 subscribers at the end of 2006).

Section 2.2.5 D – IP-Centrex

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

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 initial position as expressed in a document submitted 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.

On May 27, 2007, the Company presented its position to the Commission, and is expected to continue presenting its position at the next session that is set down.

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.

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 looking into submitting a new, updated application.

Section 2.6.6A – Numbering and number portability

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. The Company, Pelephone and Bezeq International are studying the implications of the notices, and each of them will respond accordingly.

Apart from that, it should be noted that the Company is preparing itself for the operational and marketing consequences of implementation of the number portability program. Note that at this stage, it is not possible to assess the extent to which the Company's revenues will be harmed.

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(i) 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 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 quarter of 2007, the Company sold an additional 6 real estate properties, of a total area of approximately 9,200 sqm of land plus approximately 3,400 sqm built-up, at a total sum of approximately 6.92 million dollars.

Likewise, as at the date of this report, 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.

Section 2.9 – Human resources

Section 2.9.2 – personnel according to employment framework

During the first quarter of 2007, the number of employees fell from 8,096 as at December 31, 2006 to 7,693 as at March 31, 2007 (a reduction of 403 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 shall report the rest of the steps that it takes with respect to allocation of the options to the two directors elected from amongst the employees.

Section 2.9.7 – Company officers and senior executives

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.

No discussion was held and no resolutions were passed regarding the grants paid to the former CEO of the Company Mr. Yacov Gelbard, for 2005 and 2006 and his obligation to return the respective grants to Pelephone and to the Company still remains.

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

On May 27, 2007, the subsidiary Bezeq Gold (Holdings) Ltd. (“Bezeq Gold”) sold 100,000,000 par value Debentures (Series 5) of the Company on the Tel Aviv Stock Exchange. The consideration, in the sum of NIS 111,900,000, was transferred to the Company as repayment of the balance of the loan granted by the Company to Bezeq Gold, for the purpose of purchasing the Debentures (Series 5).

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 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 the Company's debt turnover.

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 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 2.16 – 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.

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.

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 by June 17, 2007.

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 studying the notice and intends to exercise its right to a hearing.

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 – the Company is conducting clarification proceedings with the Ministry with respect to such disputes. The principal sum in disputes amounts, as at March 31, 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 2.18 – Legal proceedings

For updates on the subject of legal proceedings, see Note 8 to the financial statements of the Company for the period ended March 31, 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. 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. The Company is examining the application and shall respond to it in accordance with the provisions of the Companies Law.

- D. 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.
- E. 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

In May 2007, Pelephone received responses to its request for proposals (RFP) to set up a UMTS network (subject to the consent of Pelephone's competent organs), from five potential suppliers.

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.

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 is currently preparing its response to the hearing.

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 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 (see also update to section 2.13.6 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 March 31, 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

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 4.11 - 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 March 31, 2007, Bezeq International held 42.45% (33.66% under full dilution) of the share capital of Walla! Communications Ltd.

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

For updates on the subject of legal proceedings, see Note 8 to the financial statements of the Company for the period ended March 31, 2007.

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

Section 5.1 – General information on areas of operation

As at March 31, 2007, DBS had 542,248 subscribers.

Section 5.6.5 – Competition

With respect to section 5.6.5 F – VOD – on May 21, 2007, a bill for the amendment of the Communications Law was approved in first reading to the effect that, *inter alia*, the Minister of Communications was given authority, following consultation with the Council, and in the event that he finds that there is a difficulty in providing VOD services via satellite to a similar extent and in a similar

format to those provided by the general licensee for the provision of cable broadcasts, to permit DBS to provide such services not via satellite.

Section 5.12 – Finance

Section 5.12.2 – credit restrictions applicable to the corporation

As at March 31, 2007, DBS was in compliance with the financial conditions under the financing agreement, following relief received from the banks in this regard, after the balance sheet date, the banks having extended the date for DBS to reach an arrangement with the Israel Aviation Industry regarding a debt to the latter, 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 June 30, 2007.

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. The defendant has not yet filed a statement of defense (the final date for filing the statement of defense is July 1, 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 the Company's 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.

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.

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") 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. Further to the negotiations between the parties and to exchange of correspondence between them, on March 14, 2007, a letter was sent to the Company from counsel for Halal once again setting out Halal's

position, it alleging that the Company's conduct constitutes fundamental breach of the agreement, and Halal gave notice that if the debt was not paid forthwith, the Company would be sued before an arbitrator. In a letter of March 28, 2007, counsel for the Company gave notice that the Company dismissed Halal's claims. The Company further gave notice that it was prepared to have the dispute heard by an arbitrator and that in accordance with the provisions of the agreement, it would deposit the balance of the sum in dispute in trust. An initial pre-arbitration session – 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 (which increases by \$ 75,000 each month) – has been set down for May 31, 2007.

For additional updates on the subject of legal proceedings, see Note 8 to the financial statements of the Company for the period ended March 31, 2007.

28.5.2007

Date

Bezeq – The Israel Telecommunication Corp. Ltd.

Names and titles of signatories:

Dov Weisglass, Chairman of the Board
Ika Abravanel, Acting CEO