

**UPDATE OF CHAPTER A (DESCRIPTION OF COMPANY OPERATIONS)<sup>1</sup>**  
**OF THE PERIODIC REPORT FOR 2004 ("THE PERIODIC REPORT")**  
**OF "BEZEQ" THE ISRAEL TELECOMMUNICATION CORP. LIMITED**

**1. DESCRIPTION OF GENERAL DEVELOPMENT OF GROUP OPERATIONS**

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

Section 1.1.5 of the Periodic Report in the matter of the merger of the Company and the subsidiary D.B.S. Satellite Services (1998) Ltd. ("DBS"), notes that the Company applied to the Jerusalem District Court for a declaratory decision determining that the decisions of the Ministers of Communications which limited the Company's injections into DBS were issued *ultra vires* and are therefore void. On March 20, 2005 the District Court ruled that the competent court for hearing the case is the High Court of Justice, and accordingly, it transferred the proceeding to that venue. Subsequently, on April 17, 2005, the Company filed, in the Supreme Court, an application for leave to appeal the decision of the District Court and an application to convert the claim – if the application for leave to appeal is dismissed – to a petition to the High Court of Justice.

It is noted that DBS also filed a petition in the High Court of Justice on the same matter.

On the matter of the conditional approval of the Antitrust Commissioner for the merger, on March 14, 2005 the Company and DBS filed appeals against the conditions for the merger. The cable companies filed an application to join the proceedings and the Company and DBS filed oppositions to that application. On March 15, 2005, the cable companies also filed an appeal of their own against approval of the merger, and the Company and DBS filed applications for dismissal of that appeal *in limine*.

For a detailed description of developments in this matter, see Note 4 to the financial statements of the Company for the period ended March 31, 2005.

**Section 1.3 – Investments in Equity and Stock Transactions**

Further to Sections 1.3.4 and 2.20 of the Periodic Report on the matter of the privatization of the Company, to the best of the knowledge of the Company, the groups participating in the proceeding are expected, on May 9, 2005, to submit their offers for purchase of 30% of the Company's share capital and an option to acquire another 10.66% of the share capital of the Company from the State of Israel.

It is noted that on April 6, 2005 the Company's bylaws were amended so as to clarify, beyond any doubt, that after another person receives advance written approval for control of the Company in accordance with the provisions of the Communications Law and the Communications Order, and he takes control of the Company, whether alone or together with others, including with the State under an agreement with it, certain provisions (those similar to provisions from the Government Company Law) in the Company's bylaws will be canceled, and the majority required for electing directors will be changed from 60% to 50%.

**Section 1.4 – Distribution of Dividends**

Further to Section 1.4.4 of the Periodic Report in the matter of an undertaking by the buyer of the controlling interest in the Company to act by virtue of his holdings in relation to distribution, it was clarified to the participants in the privatization proceeding by the Director General of the Government Companies Authority, in a letter dated April 19, 2005, that the position of the Government Companies Authority is that no restrictions will be imposed on the buyer of the controlling interest preventing him from initiating and implementing a distribution with the approval of a court in accordance with Section 303 of the Companies Law, 5759-1999 (reduction of capital). In addition, the Company received a copy of a letter which was sent to the Director General of the Government Companies Authority on April 17, 2005 by the Chairman of the Company Workers Organization, in which the Chairman of the

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<sup>1</sup>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 several sections from Chapter A (Description of Company Operations) in the Company's Periodic report for 2004.

organization informs the participants that the Company Workers Organization sees a distribution pursuant to Section 303 of the Companies Law as contrary to the arrangements with the Company employees and that any attempt to reduce the capital will meet the strong opposition of the employees.

2. **FIXED-LINE DOMESTIC COMMUNICATIONS –  
BEZEQ, THE ISRAEL TELECOMMUNICATION CORP. LIMITED ("THE COMPANY")**

**Section 2.2 – Products and Services**

In the matter of Section 2.2.2 of the Periodic Report – Telephony - on April 21, 2005 the Company received a letter from the Director General of the Ministry of Communications, stating that after examining the various considerations and data submitted to the Ministry, the Minister of Communications is considering refusing her approval (contrary to the approval in principle given to the Company by the former Minister) to cease the provisions of the Bezeqcard service. The Company has been requested to submit its remarks on this letter by May 10, 2005, and intends to oppose the possible change in the Ministry's position, as it has already made preparations for terminating the service based on the approval in principle it was given previously.

In the matter of Section 2.2.3 of the Periodic Report – Internet access services, as at March 31, 2005, the Company's ADSL subscribers number approximately 709,000 (compared with about 650,000 subscribers at the end of 2004).

**Section 2.6 – Competition**

a. **Ministry of Communications document – Clarification for participants in the privatization proceeding of the Company**

On April 6, 2005 a letter was sent to the Director General of the Government Companies Authority by the Director General of the Ministry of Communications, containing clarification for the participants in the privatization proceeding of the Company. The document contains explanations of the main questions raised by the participants in the privatization proceeding, based on the present policy of the Ministry of Communications for promoting competition in communications and provisions of the law and existing licenses, and notes that these explanations should not set any expectation or be relied upon by the participants.

The main points of the clarifications in the document appear in an immediate report of the Company dated April 11, 2005. As the Company noted in that report, it believes that the clarifications in the Ministry of Communications Clarification Document do not significantly reduce the regulatory uncertainty in which the Group and the Company operate. Furthermore, the document contains general explanations about future operations regarding which the Company is unable to make any assessment at this stage as to when or if they will occur, and therefore the Company is unable to assess their implications for the operations of the Company and the subsidiaries of the Group and on the results of those operations.

On this matter, see also Note 1C(1) to the financial statements of the Company for the period ended March 31, 2005.

b. **Interconnect fees**

On the matter of the arrangement whereby interconnect fees will not be paid for terminating a call between the networks of the Company and the cable companies ("HOT") described in Section 2.6.1 of the Periodic report – on April 14, 2005 the Company has withdrawn its petition to the High Court of Justice. On this matter, see also Note 1C(4) to the financial statements of the Company for the period ended March 31, 2005.

c. **VOB service policy**

Further to Section 2.6.1 of the Periodic Report, on April 20, 2005 the Ministry of Communications notified, *inter alia*, the Company and its subsidiaries that in completing preparation of the policy and following study of the remarks submitted in response to their

enquiries, it is considering amendment of the policy paper so that the Company or a subsidiary of the Company will be able to provide VOB services after the Company's market share in fixed-line domestic telephony in a particular customer segment falls below 85%. In addition, the Ministry of Communications intends to set two review dates, in November 2006 and November 2007, to look into the possibility of permitting the Company or a subsidiary of the Company to provide VOB services even if the Company has not lost 15% of that market share, noting the developments in competition in the field of telephony.

The Ministry of Communications requested remarks on the above by May 10, 2005. The Company sees the aforementioned amendment as possible deterioration for itself and from the aspect of its subsidiaries, and has notified the Ministry that the amendment it is considering as set out above is contrary to the policy paper and that it intends to submit its opposition in the future. See also the update to Section 4.5 below.

d. **Marketing trial for payment for VOIP services**

On the matter of licenses for a marketing trial for payment for VOIP services as described in Section 2.6.1 of the Periodic Report – after a joint discussion at the Ministry of Communications with the Company and the operators who wish to offer this service, the Ministry of Communications issued an administrative instruction for the operation of dialing directions and numbering ranges allocated for the use of a licensee for a marketing trial in the Company's network. In an additional letter from the Ministry of Communications, it was clarified that the Company will not bear "expenses in kind" of the trial, and that if additional payment is determined as part of the VOB policy, that payment will apply retroactively also for the trial period. As at the date of publication of these reports, the Company is in touch with the trial licensees for connecting them to the Company's network.

e. **Numbering and number portability**

Further to Section 2.6.5 of the Periodic Report, on March 29, 2005 the Economic Policy for Fiscal 2005 Law (Legislative amendments), 5765-2004 was passed by the Knesset. The law includes, among other things, an amendment of the Communications Law (Telecommunications and broadcasting), 5742-1982 ("the Communications Law"), whereby the Minister of Communications will prepare a numbering program for the matter of number portability with regard to a holder of a general license (including a special general license) for fixed-line domestic communication, and with regard to the holder of a general license for the provision of cellular services, and will instruct them concerning its implementation and operation by September 1, 2006. (If the Ministers of Communications and Finance see that there is a real need, and for special reasons, they may postpone, in an order and with the approval of the Knesset Economics Committee, the implementation and operation of the program for a period not exceeding three months.)

On April 20, 2005 the Ministry of Communications sent to the licensees a draft numbering plan which it is considering for implementation and operation, for their remarks by May 18, 2005. The draft sets out milestones at which the licensee must have installed and operated all the means required for the application of number portability in its systems no later than January 31, 2006, will commence interconnect tests no later than February 1, 2006 and complete them no later than June 1, 2006, and will provide number portability to whoever requests it no later than August 1, 2006. The Company is preparing its remarks to the Ministry of Communications on the proposed draft program.

As the Company noted in an immediate report on March 23, 2005, the implementation of number portability will necessitate considerable financial investment in replacing software and hardware versions in the Company's switching system. Similar investment will also be required in the Company's information systems, which could also lead to postponement of the Company's development plans in this area. In addition, operation of number portability involves costs relating to joint recording and management with the relevant operators, the full extent of which cannot yet be assessed. Even though the date for the implementation of number portability has been extended beyond the date originally proposed in the Bill (February 2006), and with which the Company commented that it believes it will be unable to comply, it will nevertheless be difficult for the Company to ready itself for number portability even by the date approved by the Committee (even if extended to the end of 2006). In addition to the aforementioned expected costs, the implementation of number portability, which will facilitate

customer transition from the Company's network to the networks of its competitors, is liable to adversely influence the Company's ability to compete.

f. **The Company's commitments with business customers**

Further to Section 2.6.6G of the Periodic Report – on March 28, 2005 the High Court of Justice decided to leave in place the interim order for staying cancellation of the agreements between the Company and business customers until the hearing of the petition is heard on July 4, 2005. However, the Court also determined in its decision that there is no impediment to the Ministry of Communications calling NIS 8 million of the bank guarantee out of the guarantee given to the Ministry by the Company. As at the date of publication of this report, the Ministry of Communications has not taken any action relating to foreclosure of the guarantee.

**Section 2.9 – Human Resources**

a. **Labor dispute and its subsequent clarification on the matter of the retirement of the remaining transferred employees by 2011**

As reported by the Company on April 5, 2005 and April 14, 2005 in its immediate reports, on April 5, 2005 the Company received notice of a possible strike at the Company starting on April 21, 2005 ("the Labor Dispute"). After talks between the Government Companies Authority, the Company and the workers' representatives which ended on April 13, 2005 in an exchange of letters among the parties, the Labor Dispute was brought to an end. The main points in the correspondence were these:

- "(1) It is possible that after sale of the State's holdings in the Company, the Company will request negotiations with the employees' organization in accordance with Section 4A of the Special Collective Agreement (Amendment) dated March 18, 2004, which states that 'Immediately after signing this Agreement, the parties will start intensive negotiations to arrange the retirement of the remaining transferred employees by 2011 on the one hand, and the demands of the Company's Management for organizational and other changes on the other hand.'
- (2) The Government Companies Authority clarified that, if after sale of the State's holdings in the Company an agreement as referred to above is made, no additional approvals will be required from the Government Companies Authority and the Supervisor of Wages at the Ministry of Finance, for extension of the validity of the retirement agreement. The Government Companies Authority also clarified that to the extent its approval is required for the agreement, the sale of the State's holdings will replace the approval.
- (3) The correspondence will be presented to the participants in the proceeding for the sale of the State's holdings in the Company."

In the opinion of the Company, the above will not change the existing agreements. Furthermore, the aforementioned clarification will not influence the financial statements of the Company. To the best of the Company's knowledge, the correspondence was shown to the participants in the proceeding for the sale of the State's holdings in the Company.

- b. In the matter of a one-time bonus to Company employees in the amount of half of the amount of the salary reduction in accordance with the Plan for Recovery of the Israeli Economy Law and a collective agreement for encouraging economic growth in respect of the period from August 28, 2004 to the date of transfer of the State's holdings to the buyer of the controlling interest in the Company – see Note 1D to the financials statements of the Company for the period ended March 31, 2005.

**Section 2.13 – Finance**

a. **Section 2.13.4 – Credit received after December 31, 2004**

On April 4, 2005 the Company completed an issue, by way of a private placement to institutional investors, NIS 286,967,000 par value debentures (Series 5). The proceeds from the issuance amounted to NIS 315,663,700, where the purchase price for NIS 1 par value is 110

points and reflects a yield of 4.46% (the Company received the proceeds on April 4, 2005). The debentures were listed for trading on the Tel Aviv Stock Exchange and their terms are the same as those of the debentures from the same series which are in circulation (registered debentures, repayable in six equal annual installments in each of the years 2100 to 2016, bearing interest of 5.3% p.a. and not secured by any lien).

b. **Section 2.13.6 – Credit rating**

1. Moody's rating for eurobonds – On March 7, 2005 the rating outlook was changed from A3 (Stable) to A3 (Negative). The change reflects the uncertainty arising from the expected continuation of the privatization of the Company and the possibility that the new holder of control at the Company (after the privatization is completed) will change the financial strategy of the Company. See the Company's immediate report dated March 8, 2005.
2. Midroog rating for debentures series (4) and (5) – On March 24, 2005 the rating outlook was changed from Aa1 (Watch List) to Aa1 (Negative). The negative rating outlook was given because of the process of sale of the controlling interest in the Company and in light of the possible implications of the transfer of control from the State to private hands. See the Company's immediate reports dated March 27, 2005 and March 28, 2005.
3. Maalot rating for all series of the Company's debentures – On March 28, 2005 a rating of AA was given (no change in the rating). See the Company's immediate report of March 28, 2005 for details of the main considerations for the rating.

It is noted that the above ratings of Midroog and Maalot were made ahead of the private placement described in sub-section A. above.

**Section 2.14 – Taxation**

On taxation, see Note 2B to the financial statements of the Company for the period ended March 31, 2005.

**Section 2.15 – Environmental protection**

- a. On the matter of the Non-Ionized Radiation Bill distributed by the Ministry of the Environment – the revised version of the Bill – the transitional period has been extended from nine months to one year.
- b. On the matter of permits for communications installations under the Planning and Construction law – see the update to Section 2.16 (sub-section E.) below.

**Section 2.16 – Limitation and regulation of Company activities**

- a. On the clarifications by the Ministry of Communications to the participants in the privatization proceeding of the Company, and on number portability – see the update to Section 2.6 above.
- b. Further to Section 2.16.1 of the Periodic Report concerning the regulation of Company tariffs, and Section 2.16.3 concerning royalties – on March 29, 2005 the Knesset approved the amendments to the Communications Law described in those sections, as part of the Economic Policy Bill.
- c. Further to Section 2.16.2 of the Periodic Report concerning the main points of the amended license/tariffs – Following the Company's notice of its intention to demand the participation in payment of a commission by subscribers who pay through the Postal Bank, the Ministry of Communications announced that it is considering amendment of the Company's license so that it will determine that the Company must enable a range of means of payment of its bills, including through the Postal Bank. The Ministry of Communications also stated that its position is that the Company may not collect such a commission. The Company responded that the proposed amendment of the license and the position of the Ministry of the matter are beyond its authority and unreasonable. The Company is currently in discussions with the Ministry of this matter.

- d. Further to Section 2.16.3 of the Periodic Report concerning royalties – On May 2, 2005 the Company received a copy of a letter dated April 20, 2005, sent by the Director General of the Ministry of Communications and the Deputy Supervisor of Budgets at the Ministry of Finance to the Director General of the Government Companies Authority, setting out the position of the Ministries of Communications and Finance on the matter of the obligation of the holders of international telecommunications licenses and of fixed-line domestic telecommunications licenses to pay royalties. According to the letter, following the recommendations of the committee for formulating policy and rules for opening fixed-line communications to competition, against the background of the proceeding for sale of the State's holdings in the Company and as part of the preparations for the implementation of number portability service throughout the telecommunications sector, the Telecommunications Regulations (Royalties) will be amended by the Ministries and brought for the approval of the Minister of Communications, the Minister of Finance and the Knesset Finance Committee, as required by law, so that commencing January 1, 2006, a reduction of 0.5% will be made each year in the rate of the royalties paid by those licensees until reaching a rate of 1% in 2010.
- e. Further to Section 2.16.10B of the Periodic Report concerning permits for communications installations under the Planning and Construction Law, including permits from the Supervisor of Radiation – in view of the intensive activity at the Company to obtain the permits, and in the light of interruption of the operations of certain installations, several sites and their classification change from time to time. As at the date of publication of these reports, there has been no material change in the overall volume of the installations.

### **Section 2.17 – Material agreements**

- a. Further to Section 2.17.2 (concerning a deed of trust for debentures (series 5) dated May 24, 2004 and an addendum to that deed dated December 6, 2005) – on March 30, 2005 an additional addendum to the deed of trust was signed between the Company and the Nominees Company of Mizrahi Bank Ltd. in respect of an issue of NIS 286,967,000 par value debentures from the same series. See the update to Section 2.13 above and the Company's immediate report dated March 30, 2005.
- b. Further to Section 2.17.7 –
  - (1) On April 17, 2005 a special collective agreement was signed between the Company, the Workers Committee and the Histadrut, concerning an arrangement with an alternative entity to the Makefet Fund for everything relating to early retirement arrangements for Company employees. On this matter, see also Note 5A to the financial statements of the Company for the period ended March 31, 2005.
  - (2) On May 3, 2005 a special collective agreement was signed between the Company, the workers representatives and the Histadrut in the matter of payment of a one-time bonus in the amount of part of the sum of the salary reduction pursuant to the Plan for the Economic Recovery of Israel Law and a collective agreement to encourage growth in the economy, as described in the update of Section 2.9 (sub-section b) above.

### **Section 2.18 – Legal proceedings**

For updates on the subject of legal proceedings, see Notes 6A(1) to 6A(6) to the financial statements of the Company for the period ended March 31, 2005.

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

On the proceeding for privatization of the Company, see the update to Section 1.3 above.

## **3. CELLULAR – PELEPHONE COMMUNICATIONS LTD. ("PELEPHONE")**

### **Section 3.7 – Competition**

On the matter of number portability, see the update of Section 2.6(e) above. Implementation of the number portability plan will impose implementation costs and complexities on Pelephone, the scope and implications of which cannot yet be assessed.

### **Section 3.18 – Restriction and supervision of Pelephone's actions**

- a. Further to the matter of number portability – see the update of Section 3.7 above.
- b. Further to Section 3.18.2 concerning supervised tariffs – in partial compensation for reduction of the tariffs described in that section, on March 1, 2005 Pelephone raised the outgoing call tariff from the Pelephone network and on May 3, 2005 it raised the SMS tariff for outgoing messages from the Pelephone network.

### **Section 3.19 – Legal proceedings**

For updates on legal proceedings, see Note 6A(5) and 6A(8) to the financials statements of the Company for the period ended March 31, 2005.

## **4. INTERNATIONAL COMMUNICATIONS AND INTERNET SERVICES – BEZEQ INTERNATIONAL LTD. ("BEZEQ INTERNATIONAL")**

### **Section 4.1 – General**

Further to Section 4.1.2.2 of the Periodic Report concerning royalties – see the update of Section 2.16 above concerning a letter of the Director General of the Ministry of Communications and the Deputy Director of Budgets at the Ministry of Finance dated April 20, 2005, in the matter of the expected gradual reduction in the percentage of royalties.

### **Section 4.4 – New products**

New products launched in 2005:

- a. Hosted Exchange services – A managed e-mail service. The service is based on a model of providing remote managed solutions on the broadband infrastructure, which reduces a business's costs compared with the alternative of purchasing a server and licenses.
- b. Mobile Max services – This service enables convenient use of dialing from abroad to Israel from compatible cellular handsets, using a Bezeq International phone card.
- c. Call Back service – A phone card service from abroad to Israel which reverses the direction of the call (Israel – abroad), thereby reducing costs.

### **Section 4.6 – Competition**

On April 20, 2005 the Ministry of Communications gave notice of its intention to amend the main points of the policy it published concerning the licensing of the provision of telephony services by means of broadband access (VOB – Voice Over Broadband)), in a way that will prevent Bezeq International (as a subsidiary of the Company) from providing VOB services until the market share of the Company in fixed-line domestic telephony in a particular customer segment (business or private) falls below 85% or until another decision is made after examining competition in that field in November 2006 and November 2007. This policy amendment, if adopted, is liable to oust Bezeq International from this developing market, thereby awarding its competitors in Internet access and international dialing services (most of which have received marketing trial licenses from the Ministry of Communications for providing these services) a clear competitive advantage in that they will be able to offer their customers a total communications solution combining access to the Internet, international telephony and fixed-line domestic telephony services. The inability of Bezeq International to offer a similar solution is liable to cause its existing customers to leave in favor of the competitors' services and to make it difficult for Bezeq International to recruit new customers. Bezeq International is unable to estimate, at this stage, the effects of the above on the results of its operations and its financial condition. On this matter, see also the update of Section 2.6 above.

Implementation of the numbering plan and number portability (as detailed in the update of Section 2.6 (sub-section E) above, is liable to compel Bezeq International to make additional investments in

infrastructure and equipment. Bezeq International is unable to estimate, at this stage, the total scope of such investments.

#### **Section 4.17 – Restriction and supervision of Bezeq International's operations**

Further to Section 4.17.1.3 of the Periodic Report concerning royalties – see the update of Sections 2.16 and 4.1 above.

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

- a. With regard to the claim of an equipment supplier which was filed on November 24, 1998 in the Tel Aviv District Court against Bezeq International and the Company, as described in Section 4.19.1 of the Periodic Report, the Court recommended to the parties, in a pre-trial hearing on March 2, 2005, to make a further attempt at mediation and to notify it of their decision. At this stage, Bezeq International is awaiting receipt of the position of the plaintiff on the matter. The case is scheduled for the hearing of evidence and oral summations on September 11 and 20, 2005.
- b. With regard to the claim filed on April 4, 2004 in the Jerusalem District Court by a competing international communications operator, as described in Section 4.19.2 of the Periodic Report, a pre-trial hearing of the action was held on April 10, 2005, in which the Court recommended that the parties apply for a mediation proceeding. The plaintiff and the State of Israel consented to the mediation proceeding. On April 17, 2005 Bezeq International and the Company gave notice that they do not agree to a mediation proceeding. Another pre-trial hearing is scheduled for September 2005.
- c. With regard to the claim filed on January 2, 2005 in the Tel Aviv District Court by persons alleging to be the inventors and patentees of a prepaid telephone system, as described in Section 4.19.3 of the Periodic Report, on April 20, 2005 Alcatel Telecom Israel Ltd. ("Alcatel") notified the legal advisers of Bezeq International that it intends to take over the management of the defense in the case on behalf of Bezeq International in connection with one of the systems which are the subject of the claim (which it supplied), subject to a number of qualifications; it is doing so pursuant to the provisions of the agreement between Bezeq International and Tadiran Communications Ltd. dated December 13, 1998 (Alcatel replaced Tadiran for the matter of this agreement). The matter of transfer of management of the defense has not yet been finally agreed between Bezeq International and Alcatel's lawyers. At the request of the defendants, the date for filing the statement of defense has been set at May 15, 2005. As at the date of the financial statements, no statement of defense has been filed on behalf of Bezeq International.

For additional updates on legal proceedings, see Note 6A(7) to the financial statements of the Company for the period ended March 31, 2005.

#### **Section 4.21 – Risk factors**

- a. Section 4.21(e) – Anchor countries – concerning a commitment made by Bezeq International in its official price list to the lowest prices in four countries (USA, Russia, France and Argentina) until the end of 2005, and consequently the possible adverse effect on the revenues of Bezeq International if the price lists of its competitors are revised to below Bezeq International's prices – during the first quarter of 2005 the tariff to these four countries was revised from 44 agorot per minute to 29 agorot per minute.
- b. Additional risk factor – International communication cables – The laying of a gas pipe along the shores of Israel by Israel Electric Corporation is liable to damage the underwater communications cable system which is the main artery of Israel's international communications. The matter is being handled by the Ministries of Communications and Infrastructures. Med Nautilus, the company responsible for most of Bezeq International's underwater communications cable system, announced that its network is properly backed up and secured, including the marine connection relating to the gas pipe. In view of the aforesaid, Bezeq International assesses the risk level as low.



## **5. MULTI-CHANNEL TELEVISION – D.B.S. SATELLITE SERVICES (1998) LTD. ("DBS")**

### **Section 5.6 – Competition**

Further to Section 5.6.4 concerning positive and negative factors in competition – in the opinion of DBS the feasibility (including from engineering and economic aspects) of the advanced services, including video on demand, is possible by means of using a broadband infrastructure, but DBS has not yet received approval to provide these services commercially and the Ministry of Communications has announced that it believes such service would require legislative amendment. It is noted that video on demand service was launched recently by the cable companies for their digital service subscribers.

### **Section 5.9 – Human resources**

Further to Section 5.9.1 of the Periodic Report – Organizational structure – as at the date of this report, the organizational structure of DBS has been changed so that DBS now consists of only eight divisions (rather than 10), after unification of the sales and marketing divisions and unification of the customer service and technical service divisions to form the customer service department.

### **Section 5.12 – Finance**

On the matter of the financing of DBS's activities and the need to recruit additional sources of finance for it – in view of the position of the Ministry of Communications (see the update of Section 1.1 above), and without derogating from DBS's contentions in relation to that position, DBS is actively seeking alternative sources of financing for implementing its business plan (beyond bank credit). In March 2005 and April 2005 DBS entered into agreements with institutional bodies for receipt of NIS 50 million in long-term CPI-linked loans bearing 11% interest p.a., on inferior repayment terms compared with the bank credit except for similar exception to those applicable to the shareholders' loans which the shareholders of DBS have made available and will make available after April 1, 2004. To secure repayment of the loans to the institutional bodies, the Company made a commitment (which is contingent, *inter alia*, on a positive value of DBS), and the banks which are financing the operations of DBS agreed that in the event of realization of the Company's shares in DBS by them, the institutional bodies would be entitled to a proportional part of the proceeds, at the percentage determined in the agreements. The institutional bodies were also given an option to extent loans in the same amount as already extended, provided that the amounts of the loans are required according to the business plan of DBS. Concurrently with these agreements, appropriate amendments were also signed in the financing agreement with the banks which are financing the operations of DBS, which are mainly viewing the loans received from the institutional bodies as if they were shareholders' loans as aforesaid.

On this matter, see also Note 4 to the financial statements of the Company for the period ended March 31, 2005.

### **Section 5.14 – Restrictions and supervision of the corporation**

Further to Section 5.14.1 of the Periodic Report, Specific legal restrictions on operations – according to a decision of the Council for Cable Broadcasts and Satellite Broadcasts ("the Council") in 2003, DBS had met the obligation to invest in local productions except for the sum of NIS 2,500 thousand and under-investment of NIS 6,000 thousand in original quality productions, but the Council allowed DBS to make up these shortfalls during 2004 and 2005. DBS notified the Council that it had met its local production obligations for 2004 (including the proportional part of completing past obligations), and the matter is currently being examined by the Council. For 2006 onwards, no decision has been made as yet with regard to the percentage of DBS's revenues that will be invested in local productions (according to the Communications Law, that percentage should be between 8% and 12% of the revenues), but the Communications Law states that increasing the percentage of the investment in local productions required of DBS necessitates a hearing for DBS by the Council, and DBS is unaware of any plans for such a hearing.

Further to Section 5.14.2 of the Periodic Report – subordination of operations to the broadcasting license – According to a decision of the Supreme Court on March 22, 2005, in High Court of Justice 7200/02 filed by DBS against the Council and others, beyond the authority of the Minister of Communications for amendment of the broadcasting license of DBS (in consultation with the Council),

the Council alone may also modify the terms of the broadcasting license, provided that before doing so, it gave the licensee the opportunity for a fair hearing.

### **Section 5.15 – Material agreements**

Further to Section 5.15.5 of the periodic report – Finance agreement with the banks – see the update of Section 5.12 above.

### **Section 5.17 – Legal proceedings**

Further to Section 5.17.3 of the Periodic Report – on March 20, 2005 the Jerusalem District Court determined that the authority to hear the claim filed by the Company against the decision of the Minister of Communications dated December 31, 2004 and the decision of the Minister of Communications dated February 14, 2005, is that of the High Court of Justice (see the update of section 1.1 above). Subsequently, on April 7, 2005, DBS filed a petition on the same matter in the High Court of Justice, which has not yet been heard.

\_\_\_\_\_  
Date

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"Bezeq" The Israel Telecommunication Corp. Limited

Names and titles of signatories:

Dalit Braun, Member of the Board (Chairperson of the approval meeting)  
Amnon Dick, CEO

<p>The information contained in this periodic report constitutes a translation of the periodic report published by the Company. The Hebrew version was submitted by the Company to the relevant authorities pursuant to Israeli law, and represents the binding version and the only one having legal effect. This translation was prepared for convenience purposes only.</p>
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