

UPDATE OF CHAPTER A (DESCRIPTION OF COMPANY OPERATIONS)¹
OF THE PERIODIC REPORT FOR 2004 ("THE PERIODIC REPORT")
OF "BEZEQ" – THE ISRAEL TELECOMMUNICATIONS CORP. LTD.
(HEREINAFTER: "THE COMPANY")

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 period Report in the matter of the merger of 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 transfers 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 court. Accordingly, on April 17, 2005, the Company filed an application with the Supreme Court for leave to appeal the decision of the District Court and an application to turn the claim, should the application for leave to appeal be dismissed, into a High Court of Justice petition. The application for leave to appeal the decision of the District Court was dismissed, and on May 10, 2005, a petition was filed with the High Court of Justice.

It is noted that DBS also filed a petition in the High Court of Justice on the same matter. The cable companies were joined as respondents to the petitions, the hearing for which has been set for October 11, 2005.

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 their application was rejected on July 25, 2005. On March 15, 2005, the cable companies, for their part, also filed an appeal against approval of the merger. The Company's and DBS's applications to strike out this appeal *in limine* were dismissed on July 25, 2005. The appeals filed by the Company and DBS are to be heard on September 22, 2005.

For a detailed description of developments in this area, including regarding a letter from the Antitrust Commissioner to the Company dated July 25, 2005, see Note 4 to the financial statements of the Company for the period ended June 30, 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, the Company has been given notice by the Director of the Government Companies Authority to the effect that, on May 9, 2005, two groups submitted offers for purchase of 30% of the Company's share capital and options to acquire another 10.66% of the share capital of the Company from the State of Israel (the "State's Holdings") and the State has chosen Ap. Sab. Ar. Holdings Ltd. ("Ap. Sab. Ar."), which offered NIS 4,237,000,000 for the State's Holdings, as the preferred bidder. Transfer of the State's Holdings to Ap. Sab. Ar. requires the receipt of consents under all laws and in particular, the approval of the Prime Minister and of the Minister of Communications under the Communications (Telecommunications and Broadcasts) Law, 5742-1982 (the "Communications Law") and the Telecommunications (Prescription of Essential Service Provided by Bezeq, the Israel Telecommunication Corp. Limited) Order, 5757-1997 (the "Telecommunications

¹ The update is pursuant to Article 39A of the Securities Regulations (Periodic and immediate reports), 5730-1970, and includes material changes or updates 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.

Order”) and the consent of the Antitrust Commissioner under the Antitrust Law, 5748-1988. Upon receipt of all of the necessary consents, the State shall transfer the State’s Holdings to Ap. Sab. Ar. in return for payment of the offered price, plus Accountant General’s interest from the date of submission of the offer during the sale proceedings until the date of transfer of the holdings to Ap. Sab. Ar. Details of the conditions of exercise of the options have been provided to the Company by the Director of the Government Companies Authority, as set out in the Company’s Immediate Report of July 14, 2005.

It is noted that the Antitrust Commissioner’s consent to the transaction was given on May 17, 2005.

Following the “industrial espionage” incident (see in this regard section 2.20(b) below) and disputes that have arisen between the State and Ap. Sab. Ar. regarding the effect of that incident on the Bezeq Group, on July 7, 2005, the Parties reached an agreement regarding various demands made by Ap. Sab. Ar. as conditions of completion of the transaction. Based on a notice from the Government Companies Authority, this agreement has implications in respect of the exercise price of the options received by Ap. Sab. Ar., to the extent that they might relate to and result from the aforementioned incident, plus the accrual of interest on the transaction price through the completion of it. For this matter, see the Company’s Immediate Reports dated July 10, 2005 and July 14, 2005.

It is noted that on April 6, 2005, the Company’s bylaws were amended so as to clarify, beyond any doubt, that when another person receives advance written approval for control of the Company in accordance with the provisions of the Communications Law and the Telecommunications Order, and takes control of the Company, whether alone or jointly with others, including with the State under an agreement with it, certain provisions (those similar to provisions from the Government Companies 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 imposed on the buyer of the controlling interest should prevent 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’ Union, in which the Chairman of the organization gives notice that the Company Workers’ Union 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.

It is possible that after the closing of the sale transaction, agreement will be reached on this issue with the Workers Union.

Section 1.6 – General Environment and Influence of External Factors on Group Operations

The relations between the Company and its subsidiaries are strictly limited, which make it very difficult for the Group to manage the high level of competition in the field of communications. Similar limitations do not apply to entities in competition with the Company. Thus, for instance, on July 7, 2005, an unconditional merger was approved by the Antitrust Commissioner between Discount Investment Company Ltd. (“DIC”) and Cellcom Israel Ltd. (“Cellcom”), which, when implemented, will make DIC

the holder of the controlling interest in Cellcom. In the Company's opinion, approval of the merger unconditionally gives rise to an asymmetrical situation in which the Bezeq Group is under severe limitations, whilst the DIC Group, which also holds other communications companies, is not under similar limitations. The Company is considering the steps it should take in this regard.

**2. FIXED-LINE DOMESTIC COMMUNICATIONS –
“BEZEQ” – THE ISRAEL TELECOMMUNICATIONS 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 is considering refusing to give 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 objected to the change in the Ministry of Communications' position, having already prepared to terminate the service, based on the approval in principle which had been given to it previously. However, in light of the Ministry of Communications request not to terminate the service until the final decision of the Minister of Communications is obtained, the service has not been terminated. On June 7, 2005, the Minister passed a decision to the effect that the Company would not be given consent to stop providing the “Bezeqcard” service. As at the date of publication of this Report, the Company is acting to reactivate the service, in an orderly and proper manner.

On July 10, 2005, the Ministry of Communications issued a paper on telephone number information services in the era of multiple communications providers for public comment. The Ministry gave notice that it intends to examine the need to amend the current arrangement for provision of information services and that it would consider, *inter alia*, obliging each cellular operator to provide an information service to its subscribers, at no cost, for all cellular subscribers in Israel, as a substitute for the current arrangement. The position of the public has been requested, *inter alia*, with respect to activation of a uniform information call center for all telephone numbers in Israel, or a separate call center for each operator, or for each level of communications (fixed-line, mobile), and activation of the center by communications operators only or by other operators. The date for submission of positions has been set down for August 10, 2005. The Company is formulating its response to this matter.

In the matter of Section 2.2.3 of the Periodic Report – Internet access services, as at June 30, 2005, the Company's ADSL subscribers number approximately 740,000 (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 process 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 process 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 for promoting competition in communications and provisions of the law and existing licenses, and notes that they should not be cause for expectation or reliance on the part of 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 on the operations of the Company and the subsidiaries of the Group and on the financial results of those operations.

On this matter, see also Note 1C(1) to the financial statements of the Company for the period ended June 30, 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 June 30, 2005.

c. Competition with "Hot-Telecom"

Competition with HOT is increasing, and is expressed, *inter alia*, in offers by HOT which combine broadband internet, telephony and cable television.

d. VOB Service Policy²

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 making an amendment to 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 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 Company views this amendment as a possible worsening of its position and of its subsidiaries, and has given notice to the Ministry of Communications that the amendment that it is considering, as set out above, contravenes the policy principles document. On May 25, 2005, the Company once again contacted the Ministry of Communications, asking for an oral hearing before the Minister of Communications. In its letter, the Company once again clarified, *inter alia*, that it should not be denied the ability to provide VOB services, and that such denial would contradict the license and the law, would be unprecedented anywhere in the world, and would severely harm the Company and its customers;

According to its press release, Golden Lines applied to the Ministry of Communications for a special general license for the provision of telephony services on broadband infrastructure. The Company wrote to the Ministry of Communications in this regard, informing it that a special general license should not be granted to Golden Lines until the hearing proceeding has ended.

² Voice Over Broadband

The Company has been invited to a hearing at the Ministry of Communications on August 7, 2005.

See also, updates to sections 3.7 and 4.6 below.

e. 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 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 another 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, dialing directions have been opened to one licensee and the Company is in advanced negotiations with other trial licensees for connecting them to the Company's network.

On June 23, 2005 the Company applied to the Ministry of Communications in order to respond to the information that a marketing trial license for the provision of VOIP services has been given to Cellcom and requested that, if possible, it be suspended at least until the completion of the hearing proceedings and the setting of policy.

f. Numbering and number portability

Further to Section 2.6.5(A) of the Periodic Report, on March 29, 2005, the Economic Policy for Fiscal 2005 (Legislative Amendments) Law, 5765-2004 was passed by the Knesset. The law includes, among other things, an amendment of the Communications (Telecommunications and Broadcasting) Law, 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 the licensees a draft numbering plan, which it is considering for implementation and operation, for their remarks. The draft set 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. On July 31, 2005 the Company provided the Ministry of Communications with its position to the effect that it would not be possible to meet the timetable outlined by the Ministry for implementation of the number portability plan, and that the Company is in the process of examining technological changes, and that against this background, investment at this time in implementation of number portability on the existing network and systems would be a cumbersome and unnecessary example of patchwork. The Company requests that a committee be set up to re-examine the timetable and the possibilities of implementing number portability and formulating a program, including changing the law.

As the Company further 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. In addition, substantial financial investments 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. The activation of number portability also involves costs for joint registration and administration with relevant operators. These are costs that cannot yet be fully estimated. Even though the date for the implementation of number portability has been extended beyond the date originally proposed in the Bill (which was 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 as aforesaid (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.

g. The Company's commitments with business customers

Further to Section 2.6.6(G) 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 pending hearing of the case set down for 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. "Hot-Telecom" has been joined as a respondent in the petition. Hearing of the petition has been set for November 17, 2005.

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 immediate reports, on April 5, 2005, the Company received notice of a possible strike at the Company commencing 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 Economic Plan 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 update to Section 2.17(b)(2) below and note 1D to the financials statements of the Company for the period ended June 30, 2005.

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

On the matter of Section 2.10.2 to the periodic report – the framework agreement with Supplier D for the purchase and maintenance of transmission equipment has been extended by one year until the end of March 2006.

Section 2.12 – Investments

For sale of the Company's holdings in XPERT Integrated Systems Ltd. see Note 4B to the Company's financial statements for the period ended June 30, 2005.

Section 2.13 – Finance

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

On April 4, 2005, the Company issued, through a private placement to institutional investors, NIS 286,967,000 par value of 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 2011 to 2016, bearing interest of 5.3% p.a. and not secured by any charge).

In addition, on June 30, 2005, the subsidiary Bezeq Gold (Holdings) Ltd. ("Bezeq Gold") sold 100,000,000 par value debentures (series 4) of the Company on the Tel Aviv Stock Exchange. The proceeds, in the sum of NIS 105,160,000, were transferred to the Company in payment of the balance of the loan granted by the Company to Bezeq Gold for the purpose of acquisition of the debentures (series 4).

b. Section 2.13.6 – Credit rating

1. Moody's rating for eurobonds – On March 7, 2005, the rating forecast was changed from A3 (Stable) to A3 (Negative). The change reflected 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 in completed) will change the financial strategy of the Company. See the Company's immediate report dated

March 8, 2005. Following the notice of sale of the State's Holdings in the Company to Ap. Sab. Ar. Co. (see update to Section 1.3 above), Moody's gave notice, on May 10, 2005, that it had placed on review the possibility of reducing the rating of the bonds. Examination of the rating will focus on the uncertainties expected to be derived from purchase of the State's Holdings in the Company by Ap. Sab. Ar. And the fact that changes might take place in the Company's financial policy and strategy. See the Company's immediate report dated May 11, 2005.

2. Midroog rating for debentures series (4) and (5) – On March 24, 2005, the rating forecast was changed from Aa1 (Watch List) to Aa1 (Negative). The negative rating horizon was given because of the transfer of control from the State into private hands. See the Company's immediate reports dated March 27, 2005, and March 28, 2005. Following the notice of sale of the State's Holdings in the Company to Ap. Sab. Ar. Co., Midroog gave notice, on May 16, 2005, that it was transferring rating of the Company's debt to watch list, for the purpose of examining the possibility of reducing the rating. In Midroog's assessment, sale of the core of control of the Company could have a substantial influence on its business strategy and business and financial profile. See the Company's immediate report dated May 16, 2005.
3. Maalot rating for all series of the Company's debentures – On March 28, 2005, the rating AA was given (no change in the rating). See details of principal considerations for rating in the Company's immediate report dated March 28, 2005. Following the notice of sale of the State's Holdings in the Company to Ap. Sab. Ar. Co., Maalot gave notice on May 10, 2005, that the rating of the Company's undertakings was in the process of review (watch list), under which it would look into the effect of transfer of control of the Company and the business and financial strategies implemented by the purchaser of the core of control of the Company on the Company's rating, and it would publish its conclusions at the end of such review. See the Company's immediate report dated May 11, 2005.
4. Standard & Poors Rating for Eurobonds – following the notice of sale of the State's Holdings in the Company to Ap. Sab. Ar. Co., S&P gave notice on May 10, 2005, that it had placed the Company on Creditwatch, with negative implications to the debentures rated by it at A-. As a result of the expected change in ownership of the Company, S&P expects a basic change in the Company's financial policy and capital structure. See the Company's immediate report dated May 11, 2005.

Section 2.14 – Taxation

On taxation, see Notes 2B and 11 to the financial statements of the Company for the period ended June 30, 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. On June 22, 2005, the aforesaid Bill was published after passing First Reading.
- b. On the matter of permits for communications installations under the Planning and Construction law – see the update to Section 2.16 (sub-section g.) below.

Section 2.16 – Limitation and regulation of Company activities

- a. On the matter of number portability – see the update of Section 2.6(f) above.
- b. Regarding Section 2.16.1 – 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. In addition, on May 31, 2005, an order was published under which the Supervision of Commodities and Services Law is not to apply to telecommunications services for which payment of a fee has been set under section 15(c) of the Communications Law.
- c. Regarding Section 2.16.1 of the Periodic Report concerning the regulation of Company tariffs, as the Company reported on May 30, 2005, commencing on June 1, 2005, the Company reduced the tariffs supervised by the Company prescribed under section 15(a) of the Communications Law, by an average rate of approximately 2.2%, based on a tariff update formula prescribed in regulations in place at that time. The regulations also contain an amendment of the method of calculation set out below. The aforesaid reduction is based on a change of some 1.2% in the consumer price index and the average rationalization coefficient at a rate of approximately 3.4%. It should be noted that the update includes, *inter alia*, a reduction of approximately 3.2% in call tariffs and an increase of approximately 1.2% in fixed fees.

On the matter of amendment of the calculation method, as the Company reported in an immediate report dated May 5, 2005, as part of the Ministry of Communications' handling of the annual update of the Company's tariffs, it became apparent to professional staff at the Ministry that it was necessary to amend the method of calculation set out in the regulations in such a way as to enable more precise measurement of the data used for calculating the annual rationalization coefficient.

As the Company reported, according to initial estimates, the immediate affect of the aforesaid amendment would give rise to a reduction in its income in the sum of approximately NIS 30 million per annum in each year of the current tariff arrangement (up to the end of 2007). Apart from the aforementioned, the effect of this amendment, as of the amendment in June 2006, might considerably increase the reduction in the Company's revenues to the extent that the change in the calculation formula will bring about an increase in the tariff reduction coefficient in the coming tariff updates as well, from June 2006 until the end of the arrangement period.

- d. Regarding Section 2.16.2 – 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 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 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. Attempts to speak with the Ministry of Communications in this matter have been fruitless, and as at the date of publication of these reports, the Company does not require that subscribers paying via the Postal Bank participate in payment of the commission to that Bank.
- e. Further to Section 2.16.2 of the Periodic Report concerning the general license of the Company:
 - (1) On July 14, 2005, the Company's general license and the licenses of other operators were amended. The amendment to the license prescribed that the Company must act in accordance with the Israeli

Standard regarding reliability of bills and due disclosure in telephone accounts. In addition, provisions that are different from those in the aforesaid standard were prescribed regarding rounding off of sums in bills. Under the amendment, the provisions of the standard regarding due disclosure in telephone bills will come into force by October 14, 2005, whilst provisions relating to reliability of billing will come into force by January 14, 2006. The Company's license was amended in this manner, despite the fact that the Company expressed its opinion to the Ministry that there is no room or justification for the standard in its proposed format, and certainly not for changing it, by adopting it in the license, into a binding standard, bypassing the statutory mechanism set out in the Standards Law. Likewise, the Company clarified that implementation of the standard involves investment of considerable resources, technical difficulties and the effecting of broad based changes to core systems, which cannot be done at the same time as implementation of the number portability program, and that it needs a longer period of time to implement the standard. The Company is prepared to implement the standard in accordance with the amendment of its license, however, at the same time, it contacted the Ministry of Communications and gave notice to it that it would not be able to meet the dates set out for implementation of the standard under the amendment of the license, and asked that the matter be presented to the Ministry in order that the Company's request for a longer preparation period may be re-examined.

- (2) On June 8, 2005, the Ministry of Communications provided a draft appendix to the general licenses to the cellular licensees, HOT and the Company, for remarks, regarding the replacement of the "erotic services" appendix with "adult services". Under the draft appendix, a variety of services that are not appropriate for minors, due to their nature and substance, will be regulated by way of use of access code 1919, instead of what the Ministry sees as the restricted arrangement of "erotic services". The proposed amendment extends the content that may be offered via the aforesaid code to all "adult services" such as introductions, chats, matchmaking, etc., and prescribes clear rules for "reliable identification" of an adult prior to removal of the block. The Company, without going into the main body of the matter, asked that the requirement to play a voice message to all subscribers blocked from the service not apply to a licensee which does not itself produce the service, since the technology by which the Company currently provides access to the service, and which was adopted based on the previous amendment to the license, does not enable this.

f. Regarding Section 2.16.3 of the Periodic Report concerning royalties –

- (1) 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 process for sale of the State's Holdings in the Company and as part of the preparations for the implementation of the number portability service throughout the entire telecommunications sector, the Telecommunications (Royalties) Regulations are to 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.

- (2) Concerning the dispute between the Company and the Ministry of Communications regarding the payment of royalties for revenue from interconnections from cellular subscribers to subscribers of the Company during the period between April 1999 and the end of 2000, on July 25, 2005, the Company received a letter from the Director General of the Ministry of Communications demanding that the Company pay the above royalty debt in dispute in the sum of approximately NIS 17 million. The Company replied to the Ministry of Communications that it was taking the legal position and that Ministry had not given reasons for its decision and had not referred to claims and data recently presented by the Company to professional staff at the Ministry. The Company also sought to hold an urgent meeting with the Director General of the Ministry of Communications in this matter, and to postpone the demand for payment until such talks could take place. On this matter, see also Note 6A(12) to the financial statements of the Company for the period ended June 30, 2005.
- g. Concerning Section 2.16.10(b) of the Periodic Report regarding permits for communications installations under the Planning and Building Law, including permits of the Commissioner for Radiation:
- (1) Due to intensive activities being carried out by the Company regarding the obtaining of permits, and due to the termination of operation of certain installations, the number and class of sites 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.
 - (2) For the amendment to NOP 36A – see update to Section 3.18(c) below.

Section 2.17 – Material agreements

- a. Regarding Section 2.17.2 (deed of trust for debentures (series 5) dated May 24, 2004, and an addendum to that deed dated December 6, 2004) – on March 30, 2005, an additional addendum to the deed of trust was signed between the Company and the Mizrahi Bank Nominee Company Ltd. in respect of an issue of NIS 286,967,000 par value of debentures from the same series. See the update to Section 2.13 above and the Company's immediate report dated March 30, 2005.
- b. Regarding Section 2.17.7 of the Periodic Report –
 - (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 all matters relating to early retirement arrangements for Company employees.

In addition, on June 28, 2005, an agreement was entered into between Harel Insurance Company Ltd. ("Harel") and the Company. The contract regulates payment of pensions for early retirement and provisions for old-age and survivor pensions deriving from legislative amendments under the Israeli Economy (Recovery Program) Law for employees who retired from the Company from the end of 2003 / beginning of 2004 and/or who will retire from the Company in accordance with the special collective agreement for retirement of September 2000 as amended on March 18, 2004 and on April 17,

2005. Following execution of the agreement with Harel, the special collective agreement between the Company, employee representatives and the General Trade Union as aforesaid was amended on the same date (June 28, 2005).

As a result of the contract with Harel, the Company reduced its provision for early retirement, after performing adjustments that also stem from an updated estimate of the total retirement liabilities of NIS 90 million in its financial statements for the period ended June 30, 2005.

On this matter, see also Note 5A to the financial statements of the Company for the period ended June 30, 2005.

- (2) On May 3, 2005, a special collective agreement was executed between the Company, the employee representation and the General Trade Union regarding payment of a one-time grant in the sum of part of the amount of reduction of salaries under the Israeli Economy (Recovery Program) Law and under the collective agreement for encouragement of economic growth. See also update to Section 2.9 above (sub-section (b)).

Section 2.18 – Legal proceedings

For updates on the subject of legal proceedings, see Notes 6A(1), 6A(12) and 6A(18) to the financial statements of the Company for the period ended June 30, 2005, and clause 1.1 above.

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

- a. Regarding the proceeding for privatization of the Company, see the update to Section 1.3 above.

The “Industrial Espionage” Incident

b. On May 29, 2005, the media published that the Israel Police Force was conducting an enquiry regarding “industrial espionage” via computer systems in which, according to such publications, the subsidiaries of the Company – Pelephone, Bezeq International and DBS – were also involved. As a result, senior employees of those subsidiaries were called in for inquiry and/or to give evidence.

Pelephone notified, in response to the aforesaid publications, that neither it nor its employees had any connection to the obtaining of information by unlawful means, that it and its employees were surprised by the publications and that they would cooperate with the Police in order to clarify the facts in the incident.

Bezeq International gave notice, in response to the summons to investigation of its employees, that it would give the Police any assistance required, and that it would not have assisted or touched material obtained in unlawful ways. Concerning Bezeq International in this affair, see also Section 4.1 below.

DBS gave notice in response to the aforesaid publications that if offenses were committed against the law, they were committed in express contravention of its instructions and that it had not sufficed with entry into an oral contract with the investigation company, but rather, had had the investigation company sign an unequivocal undertaking to act only in accordance with the law, and the investigation company had undertaken that it and all those taking part in the agreement with it would act in accordance with the law. It should be noted that the cable companies filed a claim against DBS in which they requested an order declaring that the cable companies were the owners of all of the secret materials obtained, allegedly, by DBS unlawfully, and orders instructing DBS to avoid any use of such materials. In a hearing which took place on July 7, 2005, an order was given with the consent of the

Parties, to the effect that DBS would not make use of the documents and information relating to the cable companies allegedly transferred to from the investigation companies. Regarding DBS in this incident, see also Note 6A(19)(a) to the financial statements of the Company for the period ended June 30, 2005.

It should be noted that a number of senior employees of the Company were summoned to give evidence at the Police regarding confidential documents of the Company which were found in the possession of competitors, and to evaluate the level of damage expected to be incurred by the Company as a result of such. The Company is examining this issue and its steps regarding its confidential material that is in the possession of its competitors.

On the implications of this incident on the privatization of the Company, see the update to Section 1.3 above.

3. CELLULAR – PELEPHONE COMMUNICATIONS LTD. “PELEPHONE”

Section 3.1 – General information on areas of operation

On the matter of the “industrial espionage” incident, see Section 2.20(b) above.

On Section 3.1.5.2 – the PTT (Push To Talk) service was launched during 2005, in a reduced manner at this stage.

Section 3.2 – Products and services

Regarding section 3.2.2 – during 2005, Pelephone began supply of dual handsets which support CDMA and GSM technology. The handsets will provide an additional solution to roaming services in other countries where the network is not CDMA.

Section 3.7 – Competition

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

Regarding Section 3.7.2, the Ministry of Communications some time ago gave notice, as part of a process of final formulation of its policy regarding the field of licensing of supply of telephony services by way of a broad band access service (VOB), of its intention not to permit the companies in the Bezeq Group (including Pelephone) to take part in this field so long as the Company’s share of the fixed-line domestic telephony field in the segment of certain customers does not fall below a given threshold, or earlier taking into account the situation of competition in the field, after an examination to take place at examination stations on the timeline and on prescribed dates. Pelephone objects to this policy and is of the opinion that it should be treated as an independent body, due also to the existence of the restrictions imposed upon it regarding joint marketing with the Company. Pelephone is waiting to present its arguments in a hearing before the Ministry of Communications. On this matter, see also Section 2.6(d) and (e) above.

Section 3.15 – Finance

On June 29, 2005, Pelephone issued NIS 333 million par value debentures by way of private placement to institutional investors, in return for their par value (see Note 1E(3) of the Company’s financial statements for the period ended June 30, 2005).

Section 3.18 – Restriction and control of Pelephone's actions

- a. Regarding the matter of number portability – see the update of Section 3.7 above.
- b. Regarding Section 3.18.2 – Controlled tariffs – in partial compensation for reduction of the tariffs referred to 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.
- c. Regarding Section 3.18.3.3 – set up of communications installations – NOP 36 – on July 24, 2005, the Government of Israel decided to temporarily postpone approval of the resolution of the National Planning and Building Council regarding amendment of National Outline Plan 36A dealing with the set-up of small and minor broadcast installations. The amendment revolved around expansion of the discretion of local committees, provision of objection rights to the public and requiring companies to deposit undertakings to indemnify the planning committees for claims of devaluation of land. The cellular companies' portion of this indemnification was budgeted at 80% of the value of the devaluation and the balance is supposed to be borne by the local committees. The aforesaid postponement is intended to enable the committee of CEOs that was set up, to submit its conclusions within a month. Approval of the amendment as placed before the Government will have severe implications on the ability of the cellular companies (including Pelephone) to develop their networks, and the existence of an indemnification obligation will impose an inestimably heavy economic burden on them. On the matter of the petition filed in the High Court of Justice on this matter against the Government, Pelephone and others, see Note 6A(15) to the financial statements of the Company for the period ended June 30, 2005.

Section 3.19 – Legal proceedings

For updates on legal proceedings, see Notes 6A(5), 6A(14) and 6A(15) to the financial statements of the Company for the period ended June 30, 2005.

Section 3.21 – Expected developments in the coming year

Regarding the tender of the “Yoter” Soldiers' Welfare Association in section 3.21.3, a competing cellular company won that tender.

4. INTERNATIONAL COMMUNICATIONS AND INTERNET SERVICES – BEZEQ INTERNATIONAL LTD. (“BEZEQ INTERNATIONAL”)

Section 4.1 – General

On the matter of the “industrial espionage” affair – On May 31 2005, three employees of Bezeq International were called in for questioning as part of the police investigation into industrial espionage by computerized means (a Trojan horse program). After being questioned, the employees were released with restrictions. Up to the date of publication of the interim financial statements, no proceedings have been instituted against Bezeq International and/or its employees relating to the above investigation. On this matter, see also Section 2.20(b) above and Note 6A(19)(b) to the financial statements of the Company for the period ended June 30, 2005.

Regarding Section 4.1.2.2 to the Periodic Report regarding royalties – see the update of Section 2.16(f) 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 the 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 supporting cellular handsets, using a Bezeq International phone card.
- c. Call Back service – A phone card service from abroad to Israel which enables the direction of the call to be reversed (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 in 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 telephony services and some are already operating in accordance with it) 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 turnover among its customers and to make it difficult for Bezeq International to recruit new customers. Bezeq International is unable, at this stage, to estimate 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(d) above.

Implementation of the numbering plan and number portability (as detailed in the update to Section 2.6 above, sub-section F) is liable to compel Bezeq International to make additional investments in infrastructure and equipment. Bezeq International cannot, at this stage, estimate the total extent of such investments.

Section 4.17 – Limitation and regulation of Bezeq International activities

Regarding Section 4.17.1.3 of the Periodic Report regarding royalties – see update to 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. However, this recommendation was rejected by the suppliers. The case is scheduled for the hearing of evidence and oral summations on September 20 and November 9, 2005.
- b. With regard to the claim filed on April 4, 2004, in the District Court at Jerusalem 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 to the parties to 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 consent to a mediation proceeding. Another pre-trial hearing is scheduled for September 2005.

- c. With regard to the claim filed on January 2, 2005, 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, after Alcatel Telecom Israel Ltd. ("Alcatel") contacted Bezeq International on April 20, 2005, Alcatel took over 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), 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). On July 17, 2005, statements of defense on behalf of Bezeq International and a third party notice, against the supplier of an additional system operated by Bezeq International and used for the supply of the service under the Claim.

For updates on other legal proceedings, see also Note 6A(14) to the financial statements of the Company for the period ended June 30, 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 the 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 the estimation of Bezeq International, in view of this notice, the risk level of such damage appears to be low.

5. MULTI-CHANNEL TELEVISION – D.B.S. SATELLITE SERVICES (1998) LTD. (“DBS”)

Section 5.1 – General information on areas of operation

The number of DBS subscribers as at June 30, 2005 amounted to approximately 496,000.

For the “industrial espionage” incident see Section 2.20(b) above and Note 6A(19)A of the Company's financial statements for the period ended June 30, 2005.

Regarding Section 5.1.5 of the Periodic Report (Substitutes for Products in the Area of Operations and Changes Applying to them), an inter-ministerial committee was recently set up comprising of representatives of the Ministries of Finance and Communications, with the purpose of examining turning the terrestrial offices of the Broadcasting Authority and the Second Authority into digital offices in such a way as to enable national digital broadcast of Broadcast Authority and Second Authority transmissions. To the best of DBS's knowledge, no resolutions have yet been adopted on the matter.

Regarding Section 5.1.6 (structure of competition in the field of operations and the changes applying to it), the cable companies have recently started the sale and marketing of a basket of services, including multi-channel television services, internet and fixed-line telephony.

Section 5.6 – Competition

Further to Section 5.6.4 concerning positive and negative factors in competition – in the opinion of DBS the appropriate 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 the video on demand service has recently been launched by the cable companies to their digital service subscribers. In July 2005, DBS applied to the Ministry of Communications requesting a license for a marketing test for the provision of the said services in return for payment, to at least 10,000 subscribers, in addition to the application, not yet approved, to receive a commercial license for the provision of the above services. The Ministry of Communications' response to this has yet to be received.

Section 5.8 – Intangible assets

Further to Section 5.8.1.2 of the Periodic Report – in February 2005, DBS contacted the Civil Administration with an application to extend the term of its license for satellite broadcasts in Judea, Samaria and the Gaza Strip until 2014. In June 2005, a representative of the Civil Administration replied that in light of the special conditions in Judea, Samaria and the Gaza Strip, there is no room, at this stage, to extend the term of the license, and therefore, the term of the above license remains unchanged (until January 2009).

Further to Section 5.8.1.3 of the Periodic Report – DBS is acting in order to extend the term of the license to effect uplinks, which expires on October 31, 2005 (and not until April 2006 as set out in the Periodic Report), until the latest date possible.

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), in light of the 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 (which is described above in the update of Section 1.1), 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 that are financing DBS's operations 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 to the financing agreement with the banks which are financing the operations of DBS.

In June 2005, an institutional entity which provided DBS with a long-term loan in April 2005 as set out above, exercised the option given to it under the loan agreement, and provided DBS with an additional loan in the sum of NIS 20 million, on the conditions of the original loan agreement.

On this matter, see also Note 4B and Note 6B to the financial statements of the Company for the period ended June 30, 2005.

Further to section 5.12.3 of the Periodic Report (credit sums received in 2004), since the beginning of 2005, DBS has received loans from shareholders and others in the sum of NIS 117 million and the banks have increased their credit by some NIS 14 million.

Further to Section 5.12.4 (credit of corporation) – DBS's credit allowance is approximately NIS 1,375 million. As at June 30, 2005, DBS has utilized NIS 1,362 million of its credit allowance.

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 Cable and Satellite Broadcast Council (the "Council"), in 2002 DBS was in compliance with its obligation to invest in local productions, except for approximately NIS 3,900 thousand and under-investment of approximately NIS 7,800 in original quality productions, and in 2003, DBS had met the obligation to invest in local productions except for the sum of approximately NIS 370 thousand and under-investment of approximately NIS 5,200 thousand in original quality productions, however the Council allowed DBS to make up these shortfalls during 2004 and 2005 (with original quality productions). 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 is 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 – subordination of operations to the broadcasting license – according to a decision of the Supreme Court on March 22, 2005, in HCJ 7200/02 filed by DBS against the Council & Ors., apart from the Minister of Communications' authority to amend 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 gives the licensee the opportunity of a fair hearing.

Further to Section 5.14.3 of the Periodic Report – on June 30, 2005, the Satellite and Cable Broadcasting Council (hereinafter: the "Council") passed a resolution regarding an "invitation to present positions regarding rules of ownership of channels produced in Israel", as part of which, the Council invited the public to present it with its positions in this regard, including on the question of whether DBS should be under the channel production restrictions which apply at present only to cable companies, and in the event that it should be, which amendments and adjustments ought to be made to them in comparison with the rules currently applying to cable companies. In July 2005, DBS submitted its remarks in this regard to the Council, and in doing so, expressed the position that there was no room for applying limitations in the matter beyond those already set out in the Law at present.

Section 5.15 – Material agreements

Further to Section 5.15.2 of the Periodic Report – pursuant to the Second Space Agreement (as defined in section 5.15.2 of the Periodic Report), in May 2005, DBS began to lease two additional space segments on the Amos 2 satellite, so that as at the date of this report, DBS leases a total of 6 space segments on the Amos 2 satellite. As at the date of this Report, DBS leases 7 space segments on the Amos 1 satellite. Due to a technical limitation that is preventing the continued lease of the eighth space segment, until solution of that limitation, rental is not being paid for the aforesaid eighth segment.

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

Regarding Section 5.17.3 of the Periodic Report –

- (a) On March 20, 2005, the District Court in Jerusalem held that jurisdiction to hear the claim filed by the Company in the matter of the decision of the Minister of Communications dated December 31, 2004, and the decision of the Minister of Communications dated February 14, 2005, obtained to the High Court of Justice (see update to clause 1.1 above). DBS subsequently filed a petition to in the same court on April 7, 2005, which has not yet been heard.
- (b) In May 2005, arbitration proceedings commenced between DBS and Play TV Ltd., the producer of the “Playboy” and “Adult” channels (hereinafter: “Play TV” and the “Channels”) regarding an argument by DBS regarding its right to rescind the agreement, and regarding other claims by Play TV as to performance of the Agreement. Following an application for interim relief submitted by Play TV, the arbitrator decided, on June 9, 2005, that DBS would not be able to offer an erotic channel produced by another supplier at a cheaper rate than the “Adult” Channel, and that DBS would not display that channel as a preferable channel the Play TV Channels. On June 22, 2005, the parties submitted their pleadings to the arbitrator. In the claim filed by DBS, DBS petitioned for declaratory relief under which the agreement between the parties had been legally voided due to the broadcast of a film on the Channel, on three separate occasions, the content of which contravened the provisions of the Communications Law, and the Council’s resolutions (hereinafter: the “Film”). In a suit filed by Play TV, it claims the sum of NIS 6,159,800, based on Play TV’s claims regarding campaigns run by DBS, under which the Channels and films produced by Play TV were offered at a reduced price, without this being coordinated with it, and regarding various errors in DBS reports, on the basis of which, the consideration paid to Play TV is prescribed. Play TV also applied for declaratory relief under which the notice of rescission of the agreement was given unlawfully, that the monetary sanction imposed by the Council for broadcast of the Film be paid by the parties in equal shares, award of a mandamus order regarding broadcast of an “Adult” channel in a pay-per-night (PPN) viewing format, and comparison of its price as against the price of another erotic channel broadcast as part of DBS’s broadcasts, and other auxiliary relief. The parties’ responses to the mutual claims have yet to be filed. DBS gave notice to Play TV that notwithstanding its claims, *ex gratia* until the arbitrator’s ruling on the matter, DBS would suspend the operative results of rescission of the agreement between the parties and would continue to act in accordance with the provisions of it. At this stage, DBS’s legal counsel are unable to assess how this dispute might end.

- (c) For further updates on legal proceedings, see Notes 6A(16), 6A(17), and 6A(19)(a) to the financial statements of the Company for the period ended June 30, 2005, and Section 1.1 above.

August 2, 2005

Date

Bezeq – The Israel Telecommunication Corp. Ltd.

Names and titles of signatories:

Hava Shechter, Member of the Board (Chairperson of the approval meeting)

Amnon Dick, CEO

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.