

INTERNET GOLD GOLDEN LINES LTD  
Form 20-F  
April 19, 2016

**SECURITIES AND EXCHANGE COMMISSION**

**Washington D.C. 20549**

**FORM 20-F**

**REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

**OR**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2015**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Date of event requiring this shell company report \_\_\_\_\_

**Commission file number: 0-30198**

**INTERNET GOLD – GOLDEN LINES LTD.**

(Exact name of Registrant as specified in its charter and translation of Registrant's name into English)

**Israel**

(Jurisdiction of incorporation or organization)

**2 Dov Friedman Street, Ramat Gan 5250301, Israel**

(Address of principal executive offices)

**Doron Turgeman, CEO, +972-3-9240000 (phone), +972-3-9399832 (fax)**

**2 Dov Friedman Street, Ramat Gan 5250301, Israel**

(Name, Telephone, E-mail and/or Facsimile Number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
<b>Ordinary Shares, NIS 0.01 Par Value</b>	<b>NASDAQ Global Select Market</b>

Securities registered or to be registered pursuant to Section 12(g) of the Act: **None**

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: **None**

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report:

**Ordinary Shares, par value NIS 0.01 per share** 19,203,186

(as of December 31, 2015)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP  International Financial Reporting Standards as issued by the International Accounting Standards Board  Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow:

Item 17       Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes       No

## **INTRODUCTION**

We are a leading communications group in Israel. Our shares are listed on the NASDAQ Global Select Market and on the Tel Aviv Stock Exchange, or TASE. B Communications Ltd. (formerly known as 012 Smile.Communications Ltd.) is our subsidiary.

On April 14, 2010, our principal subsidiary, B Communications, completed the acquisition of the controlling 30.44% interest in Bezeq (TASE:BZEQ), Israel's largest telecommunications provider, from Ap.Sb.Ar. Holdings Ltd. (a consortium of Apax Partners, Saban Capital Group and Arkin Communications) for an aggregate cash purchase price of approximately NIS 6.5 billion. In accordance with the terms of the transaction, effective as of the closing of the acquisition, B Communications designated seven directors to replace the Apax-Saban-Arkin Group's representatives on Bezeq's Board of Directors, which numbers 11 directors. We began consolidating Bezeq's financial results into our financial statements effective as of the closing of the acquisition. B Communications currently owns 26.34% of Bezeq's outstanding shares. B Communications' ordinary shares are listed on the NASDAQ Global Select Market (symbol: BCOM) and on the TASE. We currently own 64.78% of the ordinary shares of B Communications.

The Bezeq Group operates the most comprehensive telecommunications infrastructure in Israel, with a broad range of telecommunications services across all of its markets. Through its wholly-owned subsidiaries, the Bezeq Group is a leading provider in Israel of fixed-line telephony services and fixed-line broadband Internet infrastructure access services, cellular telephony services, Internet service provider, or ISP, services, international telephony, or ILD, services, international and domestic data transfer and network services and information and communication technology, or ICT, services, pay television services and other communications infrastructures and services. In each of these markets, the Bezeq Group holds a significant market share, as indicated in the chart below.

As used in this annual report, the terms "we," "us" and "our" mean Internet Gold - Golden Lines Ltd. and its subsidiaries, "B Communications" means B Communications Ltd., "SP1" means B Communications (SP1) Ltd., "SP2" means B Communications (SP2) Ltd., "Eurocom Communications" means Eurocom Communications Ltd., "Bezeq" means Bezeq - The Israel Telecommunications Corp., Ltd.; "Pelephone" means Pelephone Communications Ltd., "Bezeq International" means Bezeq International Ltd. and "YES" (the trade name for DBS) and DBS mean DBS Satellite Services (1998) Ltd. Bezeq, Pelephone, Bezeq International and DBS are sometimes referred to as the Bezeq Group in this annual report.

Our consolidated financial statements appearing in this annual report are prepared in New Israeli Shekels and are translated into U.S. dollars at the representative rate of exchange at December 31, 2015 (NIS 3.902= \$1.00). The dollar amounts so presented should not be construed as representing amounts receivable, payable or incurred in dollars or convertible into dollars. All references in this annual report to "dollars" or "\$" are to U.S. dollars and all references in this annual report to "NIS" are to New Israeli Shekels.

Statements made in this annual report concerning the contents of any contract, agreement or other document are summaries of such contracts, agreements or documents and are not complete descriptions of all of their terms. If we filed any of these documents as an exhibit to this annual report or to any registration statement or annual report that we previously filed, you may read the document itself for a complete description of its terms.

## Forward Looking Statements

Except for the historical information contained in this annual report, the statements contained in this annual report are “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995, as amended, with respect to our business, financial condition and results of operations. Such forward-looking statements reflect our current view with respect to future events and financial results. We urge you to consider that statements which use the terms “anticipate,” “believe,” “do not believe,” “expect,” “plan,” “intend,” “estimate,” “anticipate” and similar expressions are intended to identify forward-looking statements. We remind readers that forward-looking statements are merely predictions and therefore inherently subject to uncertainties and other factors and involve known and unknown risks that could cause the actual results, performance, levels of activity, or our achievements, or industry results, to be materially different from any future results, performance, levels of activity, or our achievements expressed or implied by such forward-looking statements. Such forward-looking statements are also included in Item 4 – “Information on the Company” and Item 5 – “Operating and Financial Review and Prospects.” Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Except as required by applicable law, including the securities laws of the United States, we undertake no obligation to publicly release any update or revision to any forward-looking statements to reflect new information, future events or circumstances, or otherwise after the date hereof. We have attempted to identify significant uncertainties and other factors affecting forward-looking statements in the Risk Factors section that appears in Item 3.D. “Key Information - Risk Factors.”



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**PART I****ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS**

Not applicable.

**ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE**

Not applicable.

**ITEM 3. KEY INFORMATION****A. Selected Financial Data**

The tables below as of and for the five years ended December 31, 2015 set forth selected consolidated financial data, which is derived from our audited consolidated financial statements. The audited consolidated financial statements as of December 31, 2014 and 2015 and for the years ended December 31, 2013, 2014 and 2015 appear in this annual report.

**Consolidated Statement of Income Data:**

	Year Ended December 31,					2015
	2011	2012	2013	2014	2015	2015
						(\$ in millions, except share and per share data)
	(NIS in millions, except share and per share data)					share and per share data)
Revenues	11,376	10,278	9,563	9,055	9,985	2,559
Depreciation and amortization	2,984	2,367	2,014	1,873	2,131	546
Salaries	2,109	1,980	1,874	1,771	1,960	502
General and operating expenses	4,468	3,997	3,586	3,371	3,878	994

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Other operating expenses (income)	323	(1 )	57	(535 )	3	1
	9,884	8,343	7,531	6,480	7,972	2,043
Operating income	1,492	1,935	2,032	2,575	2,013	516
Finance expense	1,079	997	931	1,329	759	195
Finance income	(497 )	(582 )	(535 )	(635 )	(164 )	(42 )
Finance expense, net	582	415	396	694	595	152
Income after financing expenses, net	910	1,520	1,636	1,881	1,418	364
Share of losses (profit) in equity-accounted investee	216	245	252	170	(12 )	(3 )
Income before income tax	694	1,275	1,384	1,711	1,430	367
Income tax	656	556	524	667	347	89
Net income for the year	38	719	860	1,044	1,083	278
Income (loss) attributable to owners of the Company	(264 )	(37 )	26	(103 )	87	22
Income attributable to non-controlling interest	302	756	834	1,147	996	256
Net income for the year	38	719	860	1,044	1,083	278
Basic earnings (loss) per share	(13.46 )	(1.94 )	1.33	(5.38 )	4.54	1.16
Diluted earnings (loss) per share	(13.50 )	(1.97 )	1.26	(5.50 )	4.47	1.15

**Statements of Financial Position:**

	December 31,					
	2011	2012	2013	2014	2015	2015
	(NIS in millions)					(\$ in millions)
Cash and cash equivalents	1,447	764	867	732	619	158
Restricted cash	-	-	-	65	155	40
Total assets	25,262	22,806	21,410	21,558	22,410	5,743
Total current liabilities	4,780	4,899	4,104	3,974	5,352	1,371
Non-current liabilities	16,249	14,427	14,153	14,818	14,457	3,705

**Exchange Rate Information**

The following table sets forth, for the periods and dates indicated, certain information regarding the Bank of Israel representative rate of exchange for dollars, expressed in NIS per one dollar. The representative rate is the average between the buying rate and the selling rate of exchange. We do not use such rates in the preparation of our consolidated financial statements included elsewhere herein. See Note 2 to the consolidated financial statements included elsewhere in this Form 20-F.

Period	Average
Year ended December 31, 2011	3.578
Year ended December 31, 2012	3.856
Year ended December 31, 2013	3.611
Year ended December 31, 2014	3.578
Year ended December 31, 2015	3.887

Period	High	Low
November 2015	3.921	3.868
December 2015	3.905	3.855
January 2016	3.983	3.913
February 2016	3.964	3.871
March 2016	3.912	3.766
April 2016 (through April 18)	3.819	3.765

On April 18, 2016, the representative rate of exchange was NIS 3.785 = \$1.00 as published by the Bank of Israel.

**B. Capitalization and Indebtedness**

Not applicable.

**C. Reasons for the Offer and Use of Proceeds**

Not applicable.

## **D. Risk Factors**

*Investing in our ordinary shares involves a high degree of risk and uncertainty. You should carefully consider the risks and uncertainties described below before investing in our ordinary shares. If any of the following risks actually occurs, our business, prospects, financial condition and results of operations could be harmed. In that case, the value of our ordinary shares could decline and you could lose all or part of your investment.*

### **Risks Relating to the Bezeq Group's Business**

**Competition from other telecommunications providers and recent and potential changes in the competitive environment and communications technologies could adversely affect the Bezeq Group's business, results of operations and financial condition.**

The Bezeq Group faces significant competition from established and new competitors who provide cellular telephony, fixed-line telephony, fixed-line broadband Internet infrastructure access, ISP and pay television services. In addition to the entrance of new competitors, competition among the existing communications groups in Israel is intensifying. Four main groups, each consisting of companies under common or joint control, hold a significant share of the communications market in Israel today: the Bezeq Group, the Cellcom Group, the Partner Group and the HOT Group. The Bezeq Group's three principal competitors may in some cases be required to comply with fewer regulations because, among other reasons, they use different technologies to provide their services or do not own their own fixed-line network.

Competition in the cellular telephony industry has intensified since 2012. This has led to lower prices and higher customer churn rates, which in turn has affected the results of Pelephone and the Bezeq Group. Bezeq expects competition to continue to increase amid the changing legislation in Israel and consolidation in the telecommunications industry that permits certain service providers to market a combination of fixed-line telephony, fixed-line broadband Internet infrastructure access, ISP and pay television services, or a "bundle", for an aggregate price which is lower than the price of the individual products and services in the bundle. The Bezeq Group is currently subject to restrictions on marketing bundles, which are stricter than the restrictions applicable to its competitors. In addition, Bezeq expects additional competitive pressure will arise from the convergence of broadcasting and communication technologies, which may lead participants in the Israeli media and telecommunications industries to offer bundles of fixed-line telephony and cellular telephony, Internet and/or video broadcast services in competition with it. These competitive forces may create further downward pressure on prices, which may result in a decrease in the Bezeq Group's average revenue per user, or ARPU, and increase the Bezeq Group companies' churn rates. In addition, the Bezeq Group companies may bear higher costs if they introduce new products or services to maintain or improve their competitive positioning and reduce subscriber churn. Furthermore, technological developments and falling equipment prices could enable other operators to provide services similar to those provided by the Bezeq Group at much lower costs. In combination with difficult economic environments, these competitive pressures could adversely impact the Bezeq Group's ability to increase, or in certain cases maintain, its ARPUs, operating cash flows and liquidity.





In November 2014, the Minister of Communications, or the Minister, amended the licenses of Bezeq and Hot Telecommunications, the two infrastructure owners in Israel, to define the basket of services under the licenses (managed broadband access and wholesale telephony services). The applicable new regulations include the obligation to provide the services, including accompanying services, and the regulation of maximum rates (which require the Finance Minister's approval) for the provision of the wholesale services.

The ongoing implementation of the wholesale market regulation may have a significant negative impact on the Bezeq Group which cannot be quantified at this time. However, the Bezeq Group may in the future be granted a permit to provide non-divisible bundles of services and the structural separation may be cancelled.

*Domestic fixed-line telephony* is regulated and controlled by the Ministry of Communications, which regulation is based among other things, the issuance of licenses to entities operating in the segment.

*Fixed-line telephony* is characterized by an intense competitive dynamic. Bezeq's competitors are HOT Telecom (which, pursuant to a decision by the Minister in 2014, obtained an extension for its mandatory implementation of universal services in full deployment), VoB service providers that have operated for several years under licenses with no obligation to provide universal service, and without their own independent access infrastructure, and entities related to Internet ISPs and international communication services providers. Some of the competitors are part of the three other telecommunications groups, and Bezeq believes that cellular companies are also competitors in the telephony segment. Following the decision and implementation of the wholesale telephony service in a resale format, service providers with a unified license that were permitted to provide domestic carrier services without any infrastructure at all will compete with Bezeq by offering basic telephony services that are identical to Bezeq's services, to Bit Stream Access, or BSA, service subscribers.

Upon application of the wholesale market, ISPs and holders of a general special license will compete with Bezeq, among others, in the provision of service packages that include broadband services, using Bezeq's infrastructure at wholesale prices. Communication operators that compete with Bezeq may buy services from Bezeq at supervised prices, including infrastructure segments, and thus compete with Bezeq by selling complete service packages to their customers.

*Fixed-Line Broadband Internet Infrastructure Access.* Bezeq's principal competitor in the fixed-line broadband Internet infrastructure access service market is HOT, which is currently the only other fixed-line broadband Internet infrastructure access provider in Israel. Bezeq's fixed-line broadband Internet infrastructure access services business also faces competition from cellular telephony operators who are increasingly able to utilize a combination of technologically advanced and high bandwidth technologies, such as universal mobile telecommunications system, or UMTS, and long term evolution, or LTE, technologies. Under the Ministry of Communications' policy for the establishment of a wholesale market for fixed-line telephony and broadband Internet infrastructure access, Bezeq will be required to provide access to its fixed-line broadband Internet network infrastructure to other service providers on a

wholesale basis, which may increase competition in the fixed-line broadband Internet infrastructure access market.

HOT has not provided wholesale services as yet because of the absence of the approval of a pricing structure by the Ministry of Communications. On January 14, 2016, the Ministry of Communications published guidelines to determine the maximum tariffs for wholesale services on HOT's network.

The Internet segment is characterized by high rates of penetration, as a result of the deployment of a national access infrastructure. Bezeq's main competitor in this area is HOT and Bezeq is also exposed to competition from the cellular companies. Upon implementation of a wholesale market, ISPs and unified general license holders will be able to compete with Bezeq, by providing packages of services, including broadband services, using Bezeq's infrastructures, at wholesale tariffs. In addition, following the decision regarding wholesale telephony services for resale, unified license holders authorized to provide domestic carrier services will also be able to include telephony services in their packages.

In the transmission and data-communications sector, Bezeq competes mainly with HOT Telecom, Cellcom and Partner, who operate as communication groups and provide full communications solutions to their customers.

Competition in the industry depends on a number of factors, such as regulatory decisions, possible changes in the terms of the licenses of Bezeq and its subsidiaries, and in the terms of the licenses of their competitors, mergers and joint ventures between companies that compete with the Bezeq Group, possible repercussions of the Concentration Law, further development of the wholesale market, the lack of symmetry between the Bezeq Group and its competitors' ability to provide a comprehensive service, the new services that Bezeq will be permitted to provide, the tariff policy, the extent of flexibility allowed to the Bezeq Group when offering service bundles and technological developments.

In addition to HOT's cable and optical fiber network and the optical fiber infrastructures of Cellcom and Partner, there are a number of infrastructures in Israel today that have the potential to serve as communications infrastructures based on optical fibers. These infrastructures are mostly owned by government companies and bodies, including the infrastructures of the Israel Electric Corporation, or IEC, Israel Railways, Mekorot Israel National Water Company, or Mekorot, Petroleum & Energy Infrastructure Ltd. and Cross Israel Highway Ltd. Some municipalities are also trying to create an alternative to communications license holders by deploying their own infrastructures.

In August 2013, IBC Israel Broadband Company (2013) Ltd., or IBC, (60% of which is owned by a group of investors headed by the ViaEurope Group and 40% is owned by IEC) was granted a general license for the provision of communication infrastructure services (i.e., data communications, digital transmission and VPN) over fiber optics. In accordance with the license, IBC will enter into an agreement with IEC to obtain the right to use its fiber-optics network and will become the network's operator. In addition, IBC is entitled to use the communication facilities of another operator. Pursuant to the provisions of the license, IBC was obligated to make a gradual universal deployment over a period of 20 years.

At the same time, IBC received a special license for the provision of domestic fixed data-communication services, according to which it is entitled to provide IP/VPN services and broadband data-communication lines for a period of five years (with the option to request an extension). This special license does not necessitate the provision of universal services to all the residents in Israel.

Bezeq estimates that the significant relief granted to IBC in respect of the obligation to provide universal service (the option to make a gradual universal deployment over a long period of time), the granting of a special license for the provision of data-communication services without providing universal service, and the possibility that IBC will be allowed to receive wholesale infrastructure services from Bezeq may adversely affect Bezeq's operations and its financial results.

*Cellular Telephony.* There are five operators with cellular licenses operating in the cellular communications market in Israel today (Pelephone, Cellcom, Partner, Golan Telecom and HOT Mobile) and a few MVNO operators with cellular licenses for hosting on another network, the principal MVNO is Rami Levy. The entry of new operators into the market since 2012 has led to fierce competition resulting in higher subscriber churn rates, significant price erosion and eroded margins.

In 2012, subsequent to the Ministry of Communications gaining the right to allocate new frequencies and operating licenses, Golan Telecom began operating as a new operator and HOT Mobile began operating a UMTS network. As a condition to the issuance of their licenses, the new operators undertook to establish independent nationwide networks (with temporary hosting on existing networks on a domestic roaming basis).

In January 2015, under the 4G frequency tender, Marathon 018 Ltd. was awarded a 5MHz bandwidth frequency, subject to compliance with the requirements under the tender. If Marathon 018 receives a cellular operator license, it will become the sixth non-MVNO operator.

In November 2015, Cellcom entered into an agreement with Golan Telecom to acquire 100% of Golan Telecom's subscribers. If approved, this agreement will reduce the number of infrastructure operators to four (or five if Marathon 018 is added). Golan Telecom has not yet complied with its commitment to establish a nationwide independent network. If this agreement is not approved, Golan Telecom will be required to operate on an infrastructure sharing basis.

In April 2015, the Minister approved a network sharing agreement between Partner and HOT Mobile to operate active radio segment infrastructures. Subsequent to gaining the approval, Partner and HOT Mobile established a joint company that received a special license to provide cellular radio infrastructure services to a MVNO operator. This license is valid for 10 years. In September 2014, Pelephone entered into a collaboration agreement with Cellcom for the maintenance of passive components at the cellular sites owned by the two companies, which is expected to reduce maintenance costs at these sites. The agreement provides for maintenance of the shared sites through a supplier that will be selected by Pelephone and Cellcom.

*International Telephony.* The ILD market in Israel is characterized by a high degree of competition. At the end of 2015, there were eight companies offering ILD services to private and business customers in Israel. Changes in licensing policies and the expanded use of VoIP technology have significantly reduced the barriers of entry into this market. In addition, cellular telephony operators now offer ILD services as part of the unlimited packages they offered. Further, a recent hearing published by the Ministry of Communications proposes the adoption of a new regulatory regime allowing domestic fixed-line operators and cellular telephony operators to provide ILD services as part of the service packages they offer to their subscribers. We expect competition in this market, including price competition, to increase in the future.

*Internet Service Providers.* Access to broadband Internet in Israel requires households to purchase Internet access services from a licensed ISP and broadband Internet infrastructure access services from a separate provider. While there are only two fixed-line broadband Internet infrastructure access service providers in Israel (Bezeq and HOT), many telecommunication companies hold ISP licenses in Israel, including Bezeq International, 013 Netvision (which merged with Cellcom), 012 Smile (which merged with Partner), HOT Net and numerous minor niche players. The Israeli ISP market is a saturated market and as competitors are typically unable to differentiate themselves based on price, they attempt to differentiate themselves primarily by strengthening customer loyalty; however, competition has led to increased churn rates and reduced income per customer.

*Pay Television.* The Israeli television market is characterized by a very high penetration rate and an increasing emphasis on new television technology, in particular digital, HD and interactive television services, such as Video on Demand, or VOD, requiring high-bandwidth and bi-directional distribution platforms. In the multi-channel pay television market, DBS and HOT are the only two companies in Israel licensed to provide multi-channel pay television broadcasts. Other factors impacting competition in the market include the availability of free-to-air digital terrestrial television, or DTT, channels and the increasing availability and quality of video content offered over the Internet and cellular networks, which is not currently regulated and does not require designated infrastructure. We believe that the implementation of certain regulatory changes, including the expansion in the number and variety of free-to-air DTT channels and the possible appointment of a private entity to operate the DTT system instead of the Second Authority, which is the public authority that supervises commercial broadcasting in Israel, may increase competition in the television market.

There can be no assurance that the measures taken by the Bezeq Group companies to streamline their operations and improve the services they provide to differentiate themselves from their competitors will be successful. If the Bezeq Group companies are unsuccessful in their efforts, the Bezeq Group's business, financial condition and results of operations could be adversely affected.

**The Bezeq Group operates in a highly regulated telecommunications market, which limits its flexibility in managing its business and may materially and adversely affect our results of operations.**

The Bezeq Group operates in a highly regulated industry in Israel, which limits its flexibility in managing its business efficiently, and may increase its administrative and operational expenses and limit its revenue. The Bezeq Group is subject to government supervision and regulation relating to, among other things:

regulations requiring structural separation between the members of the Bezeq Group;

regulations restricting the Bezeq Group's ability to market bundles;

price regulation for certain services that the Bezeq Group provides;

rules and regulations imposed on telecommunications service providers with significant market share;

rules governing the interconnection between different telephone networks and the interconnection rates that the Bezeq Group can charge and pay;

regulations governing the prohibition of exit-fees or cancellation charges;

regulations requiring the Bezeq Group to grant other telecommunications operators access to its infrastructure;

regulations governing roaming charges and other billing and customer service matters;

rules for authorizations, licensing, acquisitions, renewals, pledging and transfers of licenses;

requirements covering a variety of operational areas such as land use, health and safety and environmental protection, technical standards and subscriber service requirements rules and regulations relating to subscriber privacy;

rules and regulations relating to universal service provision and requirements to extend the Bezeq Group's services to areas of Israel even where it is not economically profitable to do so; and

regulations restricting the number of television channels DBS can own and specifying the minimum investment DBS is required to make in local content productions.

**Bezeq's tariffs for its fixed-line services are subject to government control, which harms its ability to compete and places downward pressure on its tariffs, which adversely affects its business.**

Bezeq's tariffs for its main services (including interconnect fees) are subject to government control and intervention. The Minister is authorized to intervene in existing tariffs and marketing offerings and impose directives on Bezeq. On average, Bezeq's controlled tariffs erode in real terms. Significant changes in controlled tariffs, if implemented, could have a materially adverse effect on Bezeq's business and financial results. Furthermore, the limitations applicable to Bezeq in marketing alternative tariff packages could create difficulties for Bezeq in offering an appropriate competitive response to changes in the market. In the context of the application of a wholesale market, the Ministry of Communications has the power to set the price for which Bezeq will sell its services to license holders. The low prices determined may adversely affect Bezeq's level of revenues and profits.

**The Bezeq Group is subject to restrictions on intercompany relations with its principal subsidiaries, which harms its ability to compete and adversely affects its business.**

Bezeq's general license for domestic fixed-line communication services obligates it to ensure that its relationships with its principal subsidiaries do not result in favoring them over their competitors. Bezeq is also subject to various limitations as a result of the State of Israel declaring it a monopoly in the fixed-line services business. In addition, Bezeq is subject to limitations set forth in merger approvals granted by the Israeli Antitrust Authority. As a result of such limitations, separation of Bezeq and its principal subsidiaries' management, financial and marketing systems, assets and employees is required, which results in high administrative overheads. Bezeq is also subject to limitations with respect to the offering of bundles with its principal subsidiaries, which adversely impacts its business, particularly in light of the entry into the market of communications companies competing directly with Bezeq in most of its areas of operation based on the provision of bundled services to the customer.

**Potential health risks related to cellular network sites and cellular telecommunication devices could have a material adverse effect on Pelephone's business, results of operations and financial condition.**

Several lawsuits have been filed against cellular telephony operators and other participants in the cellular industry alleging adverse health effects and other claims relating to radio frequency transmissions to and from sites, handsets and other cellular telecommunications devices, including lawsuits against Pelephone. Although these lawsuits were settled during 2013 with no material expenses incurred, there can be no guarantee that potential future lawsuits will have favorable outcomes. Any exposure to such liabilities could have a material adverse impact on our business, results of operations and financial condition.

Pelephone takes steps to ensure that the levels of radiation emitted by its transmission facilities, equipment and devices do not exceed the levels of radiation permitted in the directives of the Israeli Ministry of Environmental Protection which align with international standards. However, health risks may be found to exist and transmission sites or devices and equipment may emit more radiation than that allowed in radiation standards, causing a risk to health, which may have an adverse effect on Pelephone's business and could result in a reduction in the use of cellular telephony services, difficulty in renting sites, claims for physical and property damages in substantial amounts and attempts to exercise the deeds of indemnity that Pelephone deposited with the planning authorities pursuant to the Planning and Construction Law. Pelephone's third-party liability insurance policy does not currently cover electromagnetic radiation.

Under the Planning and Construction Law, local planning committees may be held liable for the depreciation of the value of nearby properties as a result of approving a building plan or permit. Under the Israeli Radiation Law, the National Council for Planning and Construction requires indemnification undertakings from cellular companies as a precondition to obtaining a building permit for new or existing cellular network sites. The National Council has decided that until the national building plan is amended to reflect a different indemnification amount, Pelephone, as well as other cellular telephony operators, will be required to indemnify it in full against all losses resulting from claims for reductions in property values as a result of granting a permit for a cellular site.

**The Bezeq Group may face difficulties in obtaining some of the building and environmental permits required for the establishment and operation of its network sites, which could have an adverse effect on the coverage, quality and capacity of its network.**

The Bezeq Group, mainly with respect to its Pelephone cellular telephony operations, is subject to the Israeli Radiation Law, which regulates the emission of electromagnetic radiation from broadcast facilities. The Israeli Radiation Law prohibits, among other things, the construction or operation of a source of radiation in contravention of any applicable permit and the construction or operation of a source of radiation without a permit. After receiving a written warning from the authorities, failure to remedy a violation will subject the permit holder, officers and directors to civil liability or criminal prosecution on a strict liability basis. While the Bezeq Group is constantly working to obtain or renew permits to set up and operate its various broadcasting installations, the policies maintained by the various regulators and amendments to applicable statutes and standards could adversely impact the infrastructure of such installations. Any such adverse impact could affect the services offered over Pelephone's infrastructure, the result of which could have a material adverse effect on the revenues of the Bezeq Group from such services. The establishment of a broadcasting site without obtaining a building permit constitutes, among other things, a breach of the Planning and Construction Law, and in some instances, this has resulted in demolition orders against sites, indictments or the initiation of civil proceedings against Pelephone and some of its officers. Pelephone has succeeded in most of these instances to avoid demolition or to delay the execution of demolition orders pursuant to arrangements it reached with the planning and building authorities to resolve the lack of licensing. These arrangements have not required any admission of guilt by officers of Pelephone or their conviction. However, it is not certain that this will continue in the future, or that there will be no further instances in which demolition orders are issued and indictments are filed in respect of building permits, including against officers.



The establishment and operation of communications facilities in Israel are also subject to building permits from various planning and building committees, a process that involves a number of approvals from Israeli state entities and regulatory bodies. Bezeq's and Pelephone's inability to obtain such approvals and permits in the future may impair the quality and capacity of their existing networks and the deployment of new networks.

The deployment and manner of set-up of communications facilities in Israel are regulated by the National Outline Plan for Communications 36, or NOP 36, and National Outline Plan for Communications 56 in the Palestinian Administered Territories, or NOP 56. These plans were designed to ensure coverage for transmitting and receiving radio, television and wireless communications, while avoiding radiation hazards, minimizing damage to the environment and simplifying and increasing the efficiency of the processes involved in setting up new facilities.

Difficulties in obtaining approvals for the construction and operation of cellular network sites and other cellular network infrastructure could have an adverse effect on the extent, coverage and capacity of our cellular network, thus impacting the quality of the Bezeq Group's voice and data services and ability to continue to market its products and services effectively.

Pelephone, like the other cellular telephony operators in Israel, provides repeaters, also known as bi-directional amplifiers, to subscribers seeking an interim solution to weak signal reception within specific indoor locations. Due to the lack of a clear policy of the local planning and building authorities, and in light of the practice of the other cellular telephone operators, Pelephone has not requested permits under the Planning and Construction Law for the repeaters. If the local planning and building authorities determine that permits under the Planning and Construction Law are also necessary for the installation of these devices, or any other receptors that Pelephone believes do not require a building permit, it could have a negative impact on its ability to obtain permits for its repeaters.

The construction and operation of a "Source of Radiation" and the provision of a radiation measurement service requires a permit. Bezeq obtained operating permits for the communication facilities and broadcasting sites it operates. Bezeq also took steps to obtain radiation permits for its high-voltage facilities, and permits were received for 27 such high-voltage facilities. Permits for two other facilities are pending. The law includes a punitive chapter under which the construction or operation of a source of radiation in violation of the provisions of the permit and the construction or operation of a source of radiation without a permit, after having been warned in writing, are strict liability offenses.

Approximately 20% of the Bezeq Group's cell sites are wireless access devices that operate in reliance on an exemption from the requirement to obtain a building permit. Bezeq Group's reliance on the exemption for wireless access devices have been challenged and is currently awaiting ruling by the Israeli Supreme Court. Under an interim order issued by the Supreme Court in September 2010, the Bezeq Group is unable to further construct wireless access devices in cellular networks in reliance on the exemption. Under a decision of the Supreme Court of February 2011, the order will not apply to the replacement of existing wireless access devices under certain conditions. In September 2011, the interim order was relaxed to allow two new UMTS operators, Hot Mobile and Golan Telecom, to construct

wireless access devices in reliance on the exemption until July 31, 2012 and was thereafter extended several times.

Should the Israeli Supreme Court determine that all wireless access devices without building permits must be removed, it could have a negative impact on Pelephone and the Bezeq Group.

**The Bezeq Group's systems and operations are vulnerable to damage or interruption, which could expose it to material risk of loss or litigation.**

The Bezeq Group provides services using various infrastructure systems that include exchanges, transmission, data communication and access systems, cables and computerized systems. Any failure to manage the growth and complexity of the Bezeq Group's networks could lead to a degradation of service and network disruptions that could harm its reputation and result in a loss of subscribers.

Under its cellular license and the Wireless Telegraph Ordinance, Pelephone has rights of use of frequencies in the 850 MHz spectrum for operating its CDMA network, and in the 850 MHz and 2100 MHz spectrums to operate its UMTS/HSPA network, and in the 1800 MHz spectrum for operating its LTE technology network. The frequencies assigned to Pelephone are exposed to interruptions that could impair the service quality of the networks that it operates.

Although some of the Bezeq Group's systems have backup, damage to some or all of these systems, whether due to a technical fault or natural disaster, could cause extreme difficulties in providing services. If any part of the Bezeq Group's infrastructure, including its IT systems, cellular information systems, communications lines, antenna sites, equipment or technology becomes subject to a flood, fire, other natural disaster, terrorism, acts of war, a computer virus, a power loss, material bugs in software or other catastrophe or unauthorized access, its operations and customer relations could be materially adversely affected. In addition, disaster recovery, security and service continuity protection measures that the Bezeq Group companies have, or may in the future undertake, and their monitoring of network performance, may be insufficient to prevent losses.

Although no incidents have occurred in numbers that are statistically significant, the Bezeq Group's networks and other technical equipment have been, and may continue to be, subject to occasional malfunctions due to material bugs in software or technical shortcomings or imperfect interfaces with equipment in private homes, the networks of other operators or its own networks or with other surrounding equipment. The Bezeq Group might incur liabilities or reputational damages as a result of such malfunctions.

In addition, the Bezeq Group accumulates, stores and uses data in the ordinary course of its operations that is protected by data protection laws. Although the Bezeq Group takes precautions to protect subscriber and employee data in accordance with the applicable Israeli privacy requirements, it may fail to do so, and certain subscriber and employee data may be leaked or otherwise used inappropriately. Violation of data protection laws may result in fines, loss of reputation and subscriber churn and could have an adverse effect on the Bezeq Group's business, financial condition and results of operations.

**Bezeq Group companies are parties to legal proceedings, which could result in them being ordered to pay significant sums.**

The Bezeq Group companies are parties to legal proceedings, including class actions, which could result in them being ordered to pay significant sums, the amount of which cannot be estimated. Class action claims can relate to a small loss for a single customer and yet can become a material claim for the Bezeq Group, if certified as a class action applicable to all customers or a significant portion of them. In addition, since Bezeq provides communications infrastructure as well as billing services to other licensees, parties suing those licensees in other class actions may also try to involve Bezeq as a party to such proceedings.

**The markets in which the Bezeq Group operates are characterized by material capital investments in infrastructure, subscriber equipment and changing technology, which imposes a heavy financial burden on the Bezeq Group and consequently, its capital expenditures may not generate a positive return.**

The markets in which the Bezeq Group operates are characterized by material capital investments in infrastructure and subscriber equipment as a result of changing technology. The frequent technological changes in infrastructure and terminal equipment and the intense competition in various market segments impose a heavy financial burden on the companies operating in the telecommunications market, requiring them to update their infrastructure technology from time to time or to introduce new devices into the market at heavy cost. The development of new technologies can render existing technologies obsolete, resulting in the need for large monetary investments in order to retain a competitive position. The Bezeq Group's future success will depend on its ability to develop and introduce, on a timely and cost-effective basis, new infrastructure and subscriber equipment that keep pace with technological developments. If the Bezeq Group is unable to respond promptly and effectively to changing technology, it will be unable to compete effectively in the future and its business could be adversely affected. No assurance can be given that the Bezeq Group's recent or future capital expenditures will generate a positive return or that it will have adequate capital available to finance such future upgrades. If the Bezeq Group is unable to, or elects not to, pay for costs associated with expanding or upgrading its networks, or making other capital expenditures, its growth and competitive position could be materially adversely affected.

**The Bezeq Group requires licenses from the Ministry of Communications to operate its business and is subject to monitoring and enforcement by the regulator.**

The Bezeq Group conducts its operations pursuant to licenses granted by the Ministry of Communications for specified periods, which may be extended for additional periods upon request. There is no certainty that such licenses will be renewed or extended in the future and any cancellation or change in the terms of the Bezeq Group's licenses may materially affect its business and results of operations, including the immediate acceleration of some of its debt.

Although we believe that the Bezeq Group is currently in compliance with all material requirements of its licenses, the interpretation and application of the technical standards used to measure these requirements, including the minimum quality standards and other license provisions, disagreements may arise in the future between the Ministry of Communications and the Bezeq Group. In addition, following recent amendments to the Communications Law introducing administrative enforcement, the Bezeq Group may be subjected to administrative enforcement proceedings and monetary sanctions. The Bezeq Group has provided significant bank guarantees to the Ministry of Communications to guarantee its performance under its licenses. If the Bezeq Group is found to be in material breach of its licenses, the guarantees may be forfeited and the licenses may be revoked. In addition, the Ministry of Communications is authorized to levy significant fines for breaches of the Bezeq Group's licenses, which could have a material adverse effect on the Bezeq Group's financial condition or results of operations.

Under the Concentration Law, Bezeq and each corporation owned by Bezeq and by the Eurocom Group (a private telecommunications group in Israel that has investments in telecommunications, satellite services, media, consumer electronic products, real estate, financial services and additional fields) is deemed a “Concentrating Entity,” within the meaning of the Concentration Law. In addition, DBS is deemed to be an influential entity in the broadcasting field and, as a result, it too is deemed a “Concentrating Entity.” Accordingly, each award of rights (including the award of a license) by a governmental authority in an “Essential Infrastructure Field,” within the meaning of the Concentration Law, and the extension of existing licenses held by any of the Bezeq Group companies, are subject to the procedures set out in the Concentration Law, including the consideration of control concentration factors and factors relating to the promotion of an industry’s competitiveness, as well as consulting with the Committee for Reducing Concentration. The governmental authority and the Committee are obliged to consider, among other things, factors concerning the prevention of the expansion of the operations of the “Concentrating Entity.” If, as a result of the implementation of the procedures under the Concentration Law, a license is not granted to a Bezeq Group company or an existing license is not extended, the Bezeq Group’s business could be adversely impacted. Furthermore, some of the competitors of the Bezeq Group companies are not, and future competitors may not, be deemed a Concentrating Entity and therefore, are not subject to the foregoing restricting procedures which could give them a competitive advantage over the Bezeq Group companies.

**The Bezeq Group’s brands are subject to reputational risks.**

The Bezeq Group’s brands are well recognized in Israel. The Bezeq Group companies, including Bezeq, Pelephone, Bezeq International and DBS, have developed their brands through extensive marketing campaigns, website promotions, customer referrals, and the use of sales forces and dealer networks. The Bezeq Group’s brands represent a material and valuable asset. Although the Bezeq Group companies try to manage their brands, we cannot guarantee that such brands will not be damaged by any inability to remain technologically competitive, by circumstances that are external their control or by third parties with a resulting negative impact on the Bezeq Group’s activities.

**The Bezeq Group’s results of operations are subject to market risks such as currency fluctuations, inflation in Israel and the general economic environment and financial condition of the capital markets in Israel and worldwide.**

The Bezeq Group’s results of operations are subject to market risks such as currency fluctuations, the general economic conditions, inflation in Israel and the financial condition of the capital market in Israel and worldwide. The Bezeq Group measures exposure to changes in exchange rates and inflation by the surplus or deficit of assets against liabilities. In addition, Bezeq is exposed to inflationary changes in Israel as well as to market risks associated with changes to the interest rates relating to its borrowings. In addition, Bezeq’s tariff updating mechanism, which is subject to government regulation, is reviewed once a year and is influenced by the Israeli Consumer Price Index, or CPI. As a result, the annual rate of inflation and its distribution during the year can have a material influence on the erosion of Bezeq’s tariffs and its revenues and expenses during the year, which in turn could have a material adverse impact on its operating results.

From time to time, the Bezeq Group engages in currency hedging transactions to reduce the impact on its cash flows and results of operations of currency fluctuations. The Bezeq Group recognizes freestanding derivative financial instruments as either assets or liabilities in the statements of financial position and it measures those instruments at fair value. However, accounting for changes in the fair value of a derivative instrument, such as a currency hedging instrument, depends on the intended use of the derivative instrument and the resulting designation. For derivative instruments that are not designated as cash flow hedges, changes in fair value are recognized in our income statement without any reference to the change in value of the related budgeted expenditures. These differences could result in fluctuations in our quarterly results of operations.

Negative developments in, or the general weakness of, Israel's economy, in particular increasing levels of unemployment, may have a direct negative impact on the spending patterns of retail consumers, both in terms of the products they subscribe for and usage levels. Because a substantial portion of the Bezeq Group's revenue is derived from residential subscribers who may be impacted by these conditions, such conditions may make it more difficult for the Bezeq Group to attract new subscribers, more likely that certain of its subscribers will downgrade or disconnect their services and make it more difficult to maintain ARPUs at existing levels. In addition, there can be no assurance that deterioration in the Israeli economy would not lead to a higher number of customers defaulting on their contracts or increased levels of service disconnections. Therefore, a weak economy and negative economic developments may jeopardize the Bezeq Group's growth targets and may have a material adverse effect on the Bezeq Group's business, financial condition and results of operations.

**The Bezeq Group could be subject to labor disruptions that interfere with its operations and adversely affect the Bezeq Group's business, financial condition and results of operations.**

The Bezeq Group could be subject to labor disputes and adverse employee relations which could disrupt its operations and adversely affect its business, financial condition and results of operations. A significant portion of its employees is represented by labor unions, and it is possible that such employees, and our other employees, could attempt to take collective action against companies in the Bezeq Group if they are unhappy with their employment conditions. Existing employment agreements with the employees and labor union agreements may not prevent a strike or work stoppage in the future. There can be no assurance that the Bezeq Group will not experience labor disputes and/or adverse employee relations in the future.

**The Bezeq Group depends on hardware, software and other providers of outsourced services, who may discontinue their services or products, seek to charge prices that are not competitive or choose not to renew their contracts.**

The Bezeq Group has important relationships with several suppliers of hardware, software and related services that are used to operate its businesses. In certain cases, substantial investments have been made in the equipment or software of a particular supplier, making it difficult to quickly change supply and maintenance relationships in the event that the initial supplier refuses to offer favorable prices or ceases to produce equipment or provide the support that the Bezeq Group requires. Further, in the event that hardware or software products or related services are defective, it may be difficult or impossible to enforce recourse claims against suppliers, especially if warranties included in contracts with suppliers have expired or are exceeded by those in the Bezeq Group companies' contracts with their subscribers, in individual cases, or if the suppliers are insolvent, in whole or in part. In addition, there can be no assurances that the Bezeq Group will be able to obtain the hardware, software and services it needs for the operation of its business, in a timely manner, at competitive terms and in adequate amounts. The Bezeq Group's ability to renew its existing contracts with suppliers of products or services, or enter into new contractual relationships upon the expiration of such contracts, either on commercially attractive terms, or at all, depends on a range of commercial and operational factors and events, which may be beyond its control. The occurrence of any of these risks could create technical problems, damage the Bezeq Group's reputation, result in the loss of customer relationships and have a material adverse effect on its business, financial condition and results of operations.

**The Bezeq Group may be subject to claims of intellectual property infringement, which could have an adverse impact on its businesses or operating results.**

The Bezeq Group is subject to the risk of intellectual property rights claims against it. The Bezeq Group has in the past and may in the future be subject to claims of infringement or misappropriation of other parties' proprietary rights. In addition to claims relating to broadcasts on channels DBS owns, it may be subject to intellectual property infringement claims with respect to programs broadcast on foreign channels that it carries. Successful challenges to

DBS's rights to intellectual property could require DBS to enter into royalty or licensing agreements on unfavorable terms, incur substantial monetary liability or be enjoined preliminarily or permanently from further use of the intellectual property in question. This could require a change in business practices and limit the ability to provide customers with the content that they expect. If DBS is required to take any of these actions, it could have an adverse impact on its businesses or operating results.

Even if the claims of intellectual property infringement are without merit, defending against the claims can be time-consuming and costly and divert management's attention and resources away from its businesses. Israeli law relating to intellectual property contains provisions allowing the owner of an intellectual property right to apply to Israeli courts to grant various enforcement measures and other remedies, such as temporary and permanent injunctive relief and a right to confiscate infringing goods and damages. If any of these claims succeed, the Bezeq Group may be forced to pay damages or may be required to obtain licenses for the infringing product or service and may incur liabilities or reputational damages as a result. If the Bezeq Group cannot obtain all necessary licenses on commercially reasonable terms, it may be forced to stop using or selling the products and services, which could adversely affect its ability to provide certain services and products.

**Barriers to entry in the Israeli domestic fixed-line communications segment have lessened considerably in recent years.**

Operating in the Israeli domestic fixed-line communications segment requires receipt of the appropriate domestic fixed-line licenses. Traditionally, the main barrier to entry in this segment arose from the need for heavy investment in technological infrastructure and in surrounding systems, which were necessary to achieve economies of scale, and from high costs involving the establishment of marketing, sales, collection and customer support systems and the building of a brand. In recent years, these traditional barriers to entry into the Bezeq Group's segments of operation have lessened considerably as a result of the following factors: technological improvements, lower infrastructure and equipment prices, easing of regulations applying to new competitors and the mandatory obligation to allow Bezeq's competitors to use the fixed-line infrastructures and services of Bezeq and HOT.



In August 2013, IBC, a telecommunications joint venture between the government-owned IEC and a consortium of non-government companies that was selected by the IEC in a tender procedure, was granted a general license for the provision of telecommunications infrastructure services (including data services, digital transmissions and VPN) via fiber optic networks to telecommunication services providers. According to the license, IBC will enter into an agreement with the IEC to use the IEC's fiber optic network in Israel to provide such wholesale products to telecommunication services providers. If IBC is successful, it would compete with Bezeq and HOT in the wholesale market, as well as providing such services directly to large business customers. IBC has begun operating in several cities. Unlike the other communications groups, Bezeq Group is at present, subject to the stricter limitations.

The regulation of competition in VoB-based telephony, which enables telephony services to be provided based on a broadband Internet infrastructure of another operator without need for an independent fixed-line infrastructure (and competition based on dividing the network into sections and wholesale sale of services), significantly reduces the size of investment required from those competing with Bezeq, thereby lowering the barriers to entry in the fixed-line segment.

**If DBS is unable to obtain attractive programming on satisfactory terms for its pay television services, the demand for these services could be reduced, which could adversely affect its revenue and profitability.**

The success of DBS's services depends on access to an attractive selection of television programming from content providers. The ability to provide movie, sports, popular series and other programming, including VOD content, is a major factor that attracts subscribers to pay television services, especially premium services. If DBS was unable to obtain high-quality content, it could limit DBS's ability to incentivize customers to migrate from lower priced packages to higher tier programming, which would inhibit its ability to execute its business strategy. Furthermore, there can be no assurance that DBS will continue to be able to obtain an attractive selection of television programming, obtain exclusive rights to certain programming, or that the local content that DBS provides will continue to be successful. Any or all of these factors could result in reduced demand for, and lower revenue and profitability from, DBS's satellite broadcast services.

**Adverse decisions of tax authorities or changes in tax treaties, laws, rules or interpretations could have a material adverse effect on the Bezeq Group's results of operations and cash flow.**

The tax laws and regulations in Israel may be subject to change and there may be changes in interpretation and enforcement of tax law. As a result, we and the Bezeq Group may face increases in taxes payable if tax rates increase, or if tax laws and regulations are modified by the competent authorities in an adverse manner. We regularly assess the likelihood of such outcomes and have established tax provisions which represent management's best estimate of the potential assessments. The Israeli Tax Authority may challenge certain positions that we and the Bezeq Group have adopted in the past or that we and the Bezeq Group may adopt in the future. The resolution of any of these tax matters could differ from the amount we or Bezeq have reserved, which could have a material adverse effect on our cash

flows, business, financial condition and results of operations.

**Our success depends on the continued service of certain key executives and personnel.**

The Bezeq Group's key executives and employees possess substantial knowledge of its business and operations. We cannot assure you that the Bezeq Group will be successful in retaining their services or that the Bezeq Group would be successful in hiring and training suitable replacements without undue costs or delays. As a result, the loss of any of these key executives and employees could cause significant disruptions in the Bezeq Group's business operations, which could materially adversely affect our results of operations.

**Risks Related to Our Company**

**We and B Communications have a substantial amount of existing debt, which could restrict our financing and operating flexibility and have other adverse consequences; our ability to repay our debt may be affected by Bezeq's dividend distribution policy and the amount of dividends paid by Bezeq.**

We and B Communications have a substantial amount of indebtedness. As of April 18, 2016, we and B Communications had approximately NIS 4.5 billion (approximately \$1.1 billion) of debt. This significant level of debt could have important consequences, including, but not limited to, the following:

making it more difficult for us to service our debt obligations and liabilities;

making us vulnerable to, and reducing our flexibility to respond to, general adverse economic and industry conditions;

requiring that a substantial portion of our cash flows from operations be dedicated to servicing debt, thereby reducing the funds available to us to fund working capital, or other general corporate purposes;

impeding our ability to obtain additional debt or equity financing and increasing the cost of any such borrowing, particularly due to the financial and other restrictive covenants contained in the agreements governing our debt; and

adversely affecting public perception of us.

**The agreements and instruments governing our and B Communications' debt contain restrictions and limitations that could adversely affect our ability to operate our business.**

The terms of the indentures governing our and B Communications' debt contain, a number of significant covenants or other provisions that could adversely affect our and B Communications' ability to operate our businesses. These covenants restrict our and B Communications' ability to, among other things:

incur or guarantee additional indebtedness and issue certain preferred stock;

use the proceeds of any dividends received from the Bezeq Group and make certain restricted payments and investments;

create or incur certain liens;

impose restrictions on the ability of our subsidiaries to pay dividends or other payments to us; transfer or sell ownership interests in the Bezeq Group;

merge or consolidate with other entities;

impair the security interest for the benefit of holders of the Notes; and

enter into transactions with affiliates.

All of these limitations will be subject to significant exceptions and qualifications, including the ability to pay dividends, make investments or to make significant prepayments of shareholder debt. However, these covenants could limit our ability to finance our future operations and our ability to pursue business opportunities and activities that may be in our interest. In addition, our ability to comply with these restrictions may be affected by events beyond our control. In addition to limiting our flexibility in operating our business, the breach of any covenants or obligations under the agreements and instruments governing our debt will result in a default under the applicable debt agreement

or instrument and could trigger acceleration of the related debt, which in turn could trigger defaults under other agreements governing our debt. If we or B Communications are unable to repay those amounts, our creditors could proceed against any collateral granted to them to secure repayment of those amounts. As a result, a default under any of the agreements governing our and B Communications' debt could materially adversely affect our growth, financial condition and results of operations.

**Our operating results may be adversely affected by significant fluctuations in the exchange rate between the U.S. dollar and the NIS, fluctuations in the Israeli consumer price index and in interest rates.**

We report our financial results in NIS. Bezeq receives payments in NIS for most of its sales. As a result, fluctuations in rates of exchange between NIS and the U.S. dollar may affect our operating results and financial condition. As a result of B Communications' issuance of 7 % Senior Secured Notes in February 2014, it incurred \$800 million of U.S. denominated debt that is subject to exchange rate fluctuations. Although we have entered into certain hedging arrangements to protect against certain foreign currency exchange rate risks associated with the Notes, such hedging activities may be ineffective or may not offset more than a portion of the adverse financial impact resulting from foreign currency variations. Gains or losses associated with hedging activities also may negatively impact operating results. In addition, if one (or more) of our counterparties falls into bankruptcy, claims we have under any such hedging arrangements may become worthless. In addition, in the event that we refinance our debt or otherwise terminate hedging agreements, we may be required to make termination payments, which would result in a loss.

**We, B Communications, and other members of the Eurocom Group are subject to the Control Permit for holding the controlling interest in Bezeq. Failure to comply with this permit or other regulatory provisions relating to the control of Bezeq may result in the revocation of the Control Permit and our rights with respect to our Bezeq interest would be adversely impacted, which would materially and adversely affect our business and financial position.**

Pursuant to the Communications Order, we were required to obtain the prior written consent of the Ministers in order to obtain a permit to acquire the controlling interest in Bezeq. Under the Communications Order, no person may hold, directly or indirectly, "significant influence" over Bezeq or 5% or more of any particular class of Means of Control in Bezeq, nor may any person, together with any other person, appoint, elect or dismiss the general manager of Bezeq or cause the election, appointment or dismissal of any director of Bezeq, without the prior written consent of the Ministers. Subject to certain exceptions, prior written approval of the Ministers is also required to increase the holdings or other rights in excess of those determined in the initial approval, including by means of an agreement (including a voting agreement). No person may transfer control, "significant influence" or Means of Control in Bezeq to another, if, as a result of the transfer, the holdings of the transferee would require approval pursuant to the Israeli Communications Law or Communications Order and the transferor is aware that the transferee is not in possession of the requisite approval. For the foregoing purposes, "significant influence" means the ability to significantly influence the activity of a corporation, whether alone or together with or through others, directly or indirectly, other than as a result of holding Means of Control in that corporation or in another corporation, and including the ability derived from the corporation's articles of association, a written, oral or other kind of agreement, or from any other source. In this context, the right to appoint an officer or holding 25% of our Means of Control is presumed to confer significant influence. "Means of Control" means the right to vote at a general meeting of the company, appoint a director or general manager of the company, or to participate in the profits of the company or a share of the remaining assets of the

company after payment of its debts upon liquidation.

The Control Permit includes several conditions, including, among others, the requirement that SP2 be controlled exclusively by the other parties to the Control Permit and that the parties to the Control Permit hold not less than 30% of any type of Means of Control of Bezeq and SP2. In February 2011, the Ministers permitted such percentage to decrease to 29% for a period of six months commencing from the date such holdings fall below 30%, in the event of dilution resulting from the exercise of options by Bezeq employees.

Despite the 30% rule, according to Article 3(a3) of the Communications Order, which is included as part of the Control Permit, the parties may hold less than 30% under certain circumstances, including the requirement that the parties control Bezeq and maintain at least a 25% ownership interest in Bezeq.

In addition, the Control Permit requires that 19% of SP2 be held at all times by an “Israeli Party,” as defined in the Communications Order. The Control Permit also includes certain notice requirements regarding changes in the composition of the board of directors and certain holdings in us and B Communications. If we, B Communications or any other member of the Eurocom Group subject to the Control Permit fails to comply with the terms of the Control Permit or with other regulatory provisions relating to the control of Bezeq, such permit could be revoked and our rights with respect to our Bezeq interest would be adversely impacted, which would have a material adverse effect on our business and financial position.

Any event in which a receiver is appointed with respect to B Communications’ holdings in SP2 or SP2’s holdings in Bezeq will constitute grounds for the cancellation of the Control Permit. In addition, in the event that the Ministers determine that a material change in the details included in the application for the Control Permit has occurred or the members to the Control Permit failed to provide requisite notifications in accordance with the Control Permit, and there is a real concern that the essential service provided by Bezeq will be harmed, the Ministers may cancel the Control Permit or set conditions for its continuation pursuant to the provisions of the Israeli Communications Law. In the event that the Control Permit is cancelled and an application to reissue another control permit is denied, our holdings in Bezeq must be liquidated within 15 to 60 days (depending on the cause for such cancellation) pursuant to the Communications Order.

**In accordance with the recently enacted Concentration Law, if either we or B Communications are unable to delist our ordinary shares from the TASE and redeem any publicly held debt or go private prior to December 10, 2019, B Communications will not be permitted to control Bezeq after such date.**

Under the recently enacted Concentration Law, a second-tier company (i.e., a company with publicly held debt or equity securities that is subject to reporting obligations under the Israeli Securities Law and controlled by a first-tier company), is prohibited from controlling another tier company. In the case of existing companies, a second-tier company is entitled to continue to control another tier company that it controlled on the publication date of the Concentration Law for a period of six years from the date of publication of the Concentration Law, i.e., until December 10, 2019. In the event that a second-tier company controls another tier company contrary to the provisions

of the Concentration Law, a district court may appoint a trustee, who will be awarded the Means of Control in such tier company for the purpose of selling such Means of Control. The trustee shall act pursuant to the orders of such court with respect to the Means of Control. Such court may, instead of appointing a trustee and under certain circumstances, order that the Means of Control held by the controlling shareholder shall not provide any rights whatsoever. Until the appointment of a trustee by a district court, the Means of Control held by a tier company that illegally controls another tier company shall not grant any voting rights at the illegally held tier company's shareholder meetings. The Concentration Law sets forth certain mechanisms intended to enable a tier company to make various arrangements for the repurchase of its publicly-held shares and the early redemption of publicly-held debt in order to comply with the provisions of the law.

Under the Concentration Law, we are deemed to be a first-tier company, B Communications is deemed to be a second-tier company and Bezeq is deemed to be a third-tier company. Accordingly, if either B Communications or we are unable to redeem any publicly held debt and delist our ordinary shares from the TASE (which would require 90-days' prior notice to the TASE) or go private prior to December 10, 2019, B Communications will not be permitted to control Bezeq after such date and its holdings in Bezeq may be transferred to a trustee for the purpose of selling such holdings. Furthermore, if a trustee is appointed, he may motion a district court to order the cancellation of distributions made by Bezeq prior to his appointment if they are deemed to not be in Bezeq's interest.

**If we do not maintain control of Bezeq we may be deemed to be an “investment company” under the Investment Company Act of 1940, which could materially and adversely affect our business.**

Section 3(a)(1)(A) of the Investment Company Act of 1940, or the Investment Company Act, defines an investment company as any issuer that is, holds itself out as being, or proposes to be, primarily engaged in the business of investing, reinvesting or trading in securities and Section 3(a)(1)(C) of the Investment Company Act defines an investment company as any issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities and owns or proposes to acquire “investment securities” (within the meaning of the Investment Company Act) having a value exceeding 40% of the value of the issuer’s total assets (exclusive of U.S. government securities and cash items) on an unconsolidated basis. However, an issuer will be deemed not to be an investment company if no more than 45% of the value of such issuer’s total assets (exclusive of government securities and cash items) consists of, and no more than 45% of such issuer’s net income after taxes (for the last four fiscal quarters combined) is derived from, securities other than, among other things, securities issued by companies which are controlled primarily by such issuer. Primary control is presumed if the issuer owns over 25% of the controlled company’s voting securities and the issuer has control greater than that of any other person. Accordingly, so long as we maintain control of Bezeq, we will not be deemed an investment company.

If we were to no longer maintain the control of Bezeq, we could, among other things, be required either (i) to change substantially the manner in which we conduct our operations to avoid being subject to the Investment Company Act or (ii) to register as an investment company. An investment company that is organized under the laws of a foreign country may not register as an investment company, or publicly offer its securities through interstate commerce in the United States, unless the company applies to the Securities and Exchange Commission (the “SEC”), for an order permitting the company to register under the Investment Company Act, and to make a public offering in the United States. The SEC may issue an order granting the application if it finds that, by reason of special circumstances or arrangements, it is both legally and practically feasible effectively to enforce the provisions of the Investment Company Act against the issuer, and further finds that granting the application is otherwise consistent with the public interest and the protection of investors.

If we were required to register as an investment company under the Investment Company Act, we would become subject to substantial regulation with respect to our capital structure (including our ability to use leverage), management, operations, transactions with certain affiliates, reporting, record keeping, voting, proxy and disclosure requirements, and meeting these requirements would be costly, if at all possible.

**We may fail to maintain effective internal control over our financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002, which could have an adverse effect on our financial results and the market price of our ordinary shares.**



Section 404 of the Sarbanes-Oxley Act requires any company subject to the reporting requirements of the U.S. securities laws to do a comprehensive evaluation of its and its combined subsidiaries' internal control over financial reporting. To comply with this statute, we are required to document and test our internal control over financial reporting and our management is required to assess and issue a report concerning our internal control over financial reporting. The rules governing the standards that must be met for management to assess our internal control over financial reporting are relatively complex and require significant documentation, testing and possible remediation to meet the detailed standards under the rules.

Failure to maintain effective internal control over financial reporting could result in investigation or sanctions by regulatory authorities and could have a material adverse effect on our operating results, investor confidence in our reported financial information and the market price of our ordinary shares.

### **Risks Related to Our Relationship with Eurocom Communications Ltd.**

**Because Eurocom Communications controls substantially all the voting power of our ordinary shares, investors will not be able to affect the outcome of all shareholder votes.**

Messrs. Shaul and Yossef Elovitch, directly and through their control of Eurocom Communications, beneficially owned 63.80% of our outstanding ordinary shares, as of April 18, 2016. For as long as Eurocom Communications has a controlling interest in our company, it, Mr. Shaul Elovitch, the chairman of our board of directors and the chairman of the board of directors of Eurocom Communications, and the controlling shareholder of Eurocom Communications will have the power to determine or significantly influence the outcome of matters submitted to a vote of our shareholders that require a simple majority, including the power to elect all of the members of our board of directors (except external directors, within the meaning of Israeli law) and will have the ability to exercise a controlling influence over our business and affairs, including any determinations with respect to potential mergers or other business combinations involving us, our acquisition or disposition of assets, our incurrence of indebtedness, our issuance of any additional ordinary shares or other equity securities, our repurchase or redemption of ordinary shares and our payment of dividends. Because the interests of Eurocom Communications and Mr. Elovitch may differ from the interests of our other shareholders, actions taken by Eurocom Communications with respect to us may not be favorable to our other shareholders.

**Conflicts of interest may arise between Eurocom Communications, B Communications, other companies within the Eurocom Group and us that could be resolved in a manner unfavorable to us and result in reduced revenues and income.**

Conflicts of interest may arise between Eurocom Communications, B Communications and us in a number of areas relating to our past and ongoing relationships. Areas in which conflicts of interest between Eurocom Communications, B Communications, and us could arise include, but are not limited to, the following:

*Cross officerships, directorships and share ownership.* A few of our directors and officers also serve or are employed by Eurocom Communications and/or B Communications. The cross officerships and directorships as well as the ownership interests of our directors and officers in our ordinary shares could create, or appear to create, conflicts of interest when directors and executive officers are faced with decisions that could have different implications for the different companies; and

*Intercompany transactions.* From time to time, Eurocom Communications, B Communications or other companies within the Eurocom Group may enter into transactions with us or our subsidiaries or other affiliates. Although the terms of any such transactions will be established based upon negotiations between employees of such companies and us and, when appropriate, subject to the approval of our independent directors or a committee of disinterested directors and in some instances a vote of shareholders, the terms of any such transactions may not be as favorable to us or our subsidiaries or affiliates as may otherwise be obtained in arm's-length negotiations with unaffiliated third parties.

## **Risks Related to Our Ordinary Shares**

**Our share price has been volatile and may decrease in the future.**

The market price of our ordinary shares has been subject to significant price movements and could be subject to wide fluctuations in the future in response to factors such as the following, some of which are beyond our control:

Quarterly variations in our operating results;

Global economic conditions;

Price movements in the market price of Bezeq's ordinary shares;

Operating results that vary from the expectations of securities analysts and investors;

Changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors;

Regulatory changes that impact pricing of services and competition in Bezeq's markets;

Changes in market valuations of other communications companies;

Announcements of technological innovations or new services by Bezeq or its competitors;

Announcements by Bezeq or its competitors of significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments;

Changes in the status of Bezeq's intellectual property rights;

Announcements by third parties of significant claims or proceedings against us or Bezeq;

Additions or departures of key personnel;

Future sales of our ordinary shares; and

Stock market price and volume fluctuations.

Domestic and international stock markets often experience extreme price and volume fluctuations. Market fluctuations, as well as general political and economic conditions, such as a recession or interest rate or currency rate fluctuations or political events or hostilities in or surrounding Israel, could adversely affect the market price of our ordinary shares.

**We have never paid cash dividends to our shareholders and have not adopted a dividend distribution policy.**

We have never declared or paid cash dividends on our ordinary shares and have not adopted a dividend distribution policy. B Communications' indirect wholly-owned subsidiary, SP2, which directly holds Bezeq's shares and our principal source of revenues and income, is subject to limitations on the payment of dividends under the terms of the financing agreements entered into in connection with its acquisition of the controlling interest in Bezeq. You should not rely on an investment in our company if you require dividend income from your investments.

**There is a significant risk that we are a passive foreign investment company, which would subject our U.S. investors to adverse tax rules.**

For U.S. federal income tax purposes, we would be classified as a passive foreign investment company, or PFIC, for any taxable year in which either: (i) 75% or more of our gross income is passive income or (ii) at least 50% of the average quarterly value of our assets for the taxable year produce or are held for the production of passive income. Based on our current and projected income, assets and activities, there is a significant risk that we are currently a PFIC.

If we were classified as a PFIC for U.S. federal income tax purposes, complex rules would apply to U.S. investors owning our ordinary shares. Such investors could suffer adverse U.S. tax consequences. If eligible, a U.S. investor may avoid many of the negative consequences of the PFIC rules by making a "mark-to-market" election (as explained below) for each taxable year in which our company is a PFIC. For more information please see "Item 10. Additional Information – E. Taxation – United States Federal Income Taxation – Passive Foreign Investment Companies." You are urged to consult your tax advisors regarding the application of the PFIC rules to you.

**Risks Related to the Operations of Bezeq and Our Company in Israel**

**Political, economic and military instability in Israel may disrupt our operations and negatively affect our business condition, harm our results of operations and adversely affect our share price.**

We, B Communications and the Bezeq Group companies are organized and based in the State of Israel and Bezeq derives substantially all of its revenues from markets within the State of Israel. As a result, political, economic and military conditions affecting Israel directly influence us. Since its establishment in 1948, Israel has been involved in a number of armed conflicts with its Arab neighbors and a state of hostility, varying from time to time in intensity and degree, has continued into 2015. In recent years, there was an escalation in violence among Israel, Hamas, the

Palestinian Authority and other groups. Also, since 2011, riots and uprisings in several countries in the Middle East and neighboring regions have led to severe political instability in several neighboring states and to a decrease in the regional security situation. Such instability may affect the local and global economy, could negatively affect business conditions and, therefore, could adversely affect our operations. In addition, Iran has threatened to attack Israel and is widely believed to be developing nuclear weapons. Iran is also believed to have a strong influence among extremist groups in areas that neighbor Israel, such as Hamas in Gaza and Hezbollah in Lebanon. Although these matters have not had any material effect on our business and results of operations to date, the regional security situation and worldwide perceptions of it are outside our control and there can be no assurance that these matters will not negatively affect us in the future. Any major hostilities involving Israel, a full or partial mobilization of the reserve forces of the Israeli army, the interruption or curtailment of trade between Israel and its present trading partners, or a significant downturn in the economic or financial condition of Israel could have a material adverse effect on our business, financial condition and results of operations.

**Our results of operations may be negatively affected by the obligation of our personnel to perform military service.**

Many of the Bezeq Group's and our executive officers and employees in Israel are obligated to perform annual reserve duty in the Israeli Defense Forces and may be called for active duty under emergency circumstances at any time. If a military conflict or war arises, these individuals could be required to serve in the military for extended periods of time. Bezeq's operations could be disrupted by the absence for a significant period of one or more of its executive officers or key employees or a significant number of other employees due to military service. Any disruption in Bezeq's operations could adversely affect its business.

**Bezeq may be restricted in the conduct of its operations during periods of national emergency, which could negatively affect its business operations.**

During periods of national emergency, the Minister of Communications and other governmental authorities may issue various instructions regarding the use of Bezeq's network, including the use of the network by the Israeli security forces. In addition, the Israeli Equipment Registration and IDF Mobilization Law, 1987 permits the registration, taking and use of engineering equipment and facilities by Israel's Defense Forces. These actions could adversely affect Bezeq's business operations.

**As a foreign private issuer whose shares are listed on the NASDAQ Global Select Market, we may follow certain home country corporate governance practices instead of certain NASDAQ requirements.**

As a foreign private issuer whose shares are listed on the NASDAQ Global Select Market, we are permitted to follow certain home country corporate governance practices instead of certain requirements of the NASDAQ Stock Market Rules. As a foreign private issuer listed on the NASDAQ Global Select Market, we may follow home country practice with regard to, among other things, the composition of the board of directors, compensation of officers, director nomination process and quorum at shareholders' meetings. In addition, we may follow home country practice instead of the NASDAQ requirement to obtain shareholder approval for certain dilutive events (such as for the establishment or amendment of certain equity-based compensation plans, an issuance that will result in a change of control of the company, certain transactions other than a public offering involving issuances of a 20% or more interest in the company and certain acquisitions of the stock or assets of another company). A foreign private issuer that elects to follow a home country practice instead of NASDAQ requirements must submit to NASDAQ in advance a written statement from an independent counsel in such issuer's home country certifying that the issuer's practices are not prohibited by the home country's laws. In addition, a foreign private issuer must disclose in its annual reports filed with the SEC each such requirement that it does not follow and describe the home country practice followed by the issuer instead of any such requirement. Accordingly, our shareholders may not be afforded the same protection as provided under NASDAQ's corporate governance rules.

**Our shareholders may have difficulties enforcing a U.S. judgment against us, our executive officers and directors and some of the experts named in this annual report, or asserting U.S. securities law claims in Israel.**

We are incorporated in Israel and all of our executive officers and directors named in this annual report reside outside the United States. Service of process upon them may be difficult to effect within the United States. Furthermore, all of our assets and most of the assets of our executive officers and directors and some of the experts named in this annual report are located outside the United States. Therefore, a judgment obtained against us or any of them in the United States, including one based on the civil liability provisions of the U.S. federal securities laws, may not be collectible in the United States and may not be enforced by an Israeli court. It also may be difficult for you to assert U.S. securities law claims in original actions instituted in Israel.

**Provisions of Israeli law, the licenses of Bezeq and our articles of association may delay, prevent or make difficult an acquisition of our company, which could prevent a change of control and, therefore, depress the price of our shares.**

Following our acquisition of the controlling interest in Bezeq, we and our shareholders are required to comply with the Communications Law, the Communications Order and regulations promulgated by the Ministry of Communications.

Pursuant to the Communications Order, we were required to obtain the prior written consent of the Ministers in order to acquire the controlling interest in Bezeq. Under the Communications Order, no person may hold, directly or indirectly, “significant influence” over Bezeq or 5% or more of any particular class of means of control in Bezeq, nor may any person, together with any other person, appoint, elect or dismiss the general manager of Bezeq or cause the election, appointment or dismissal of any director of Bezeq, without the prior written consent of the Ministers. Subject to certain exceptions, prior written approval of the Ministers is also required to increase the holdings or other rights in excess of those determined in the initial approval, including by means of an agreement (including a voting agreement). Furthermore, under the Communications Order, no person may transfer control, “significant influence” or means of control in Bezeq to another, if, as a result of the transfer, the holdings of the transferee would require approval pursuant to the Communications Law or Communications Order and the transferee is not in possession of the requisite approval. For the foregoing purposes, “significant influence” means the ability to significantly influence the activity of a corporation, whether alone or together with or through others, directly or indirectly, other than as a result of holding “means of control” in that corporation or in another corporation, and including ability derived from the corporation’s articles of association, a written, oral or other kind of agreement, or from any other source. In this context, the right to appoint an officer and holding 25% of our means of control is presumed to confer significant influence. “Means of control” means the right to vote at a general meeting of the company, to appoint a director or general manager of the company, to participate in the profits of the company or a share of the remaining assets of the company after payment of its debts upon liquidation.

Israeli corporate law regulates mergers, requires tender offers for acquisitions of shares above specified thresholds, requires special approvals for transactions involving directors, officers or significant shareholders and regulates other matters that may be relevant to these types of transactions. Furthermore, Israeli tax considerations may make potential transactions unappealing to us or to some of our shareholders, including Israeli shareholders and shareholders whose country of residence does not have a tax treaty with Israel exempting such shareholders from Israeli tax. For example, Israeli tax law does not recognize tax-free share exchanges to the same extent as U.S. tax law. With respect to mergers, Israeli tax law allows for tax deferral in certain circumstances but makes the deferral contingent on the fulfillment of numerous conditions, including a holding period of two years from the date of the transaction during which sales and dispositions of shares of the participating companies are limited. Moreover, with respect to certain listed share swap transactions, the tax deferral is limited in time, and when the time expires, tax then becomes payable even if no actual disposition of the shares has occurred. These provisions of Israeli law may delay, prevent or make difficult an acquisition of our company, which could prevent a change of control and therefore depress the price of our shares. For additional discussion about some anti-takeover effects of Israeli law, see Item 10B. “Additional Information - Memorandum and Articles of Association” and Item 10E. “Taxation -Israeli Tax Considerations.”

**The rights and responsibilities of our shareholders are governed by Israeli law and differ in some respects from those under Delaware law.**

Because we are an Israeli company, the rights and responsibilities of our shareholders are governed by our articles of association and by Israeli law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in a Delaware corporation. In particular, a shareholder of an Israeli company has a duty to act in good faith towards the company and other shareholders and to refrain from abusing his, her or its power in the company, including, among other things, in voting at the general meeting of shareholders on certain matters. Israeli law provides that these duties are applicable to shareholder votes on, among other things, amendments to a company's articles of association, increases in a company's authorized share capital, mergers and interested party transactions requiring shareholder approval. In addition, a shareholder who knows that it possesses the power to determine the outcome of a shareholders' vote or to appoint or prevent the appointment of a director or executive officer of the company has a duty of fairness towards the company. However, Israeli law does not define the substance of this duty of fairness. There is little case law available to assist in understanding the implications of these provisions that govern shareholder behavior.

#### **ITEM 4. INFORMATION ON THE COMPANY**

##### **A. History and Development of the Company**

We were organized under the laws of the State of Israel in April 1992 under the name Euronet Golden Lines (1992) Ltd. In June 1999 we changed our name to Internet Gold - Golden Lines Ltd. We are a public limited liability company under the Israeli Companies Law 1999 and our shares are traded on the NASDAQ Global Select Market and TASE. Our registered offices and principal place of business are located at 2 Dov Friedman Street, Ramat Gan 5250301, Israel, and our telephone number is +972-72-924-0000. Our website address is [www.igld.com](http://www.igld.com). The information on our website is not incorporated by reference into this annual report on Form 20-F.

We are a leading communications group in Israel. Our principal subsidiary, B Communications, is the controlling shareholder of Bezeq (TASE: BZEQ), Israel's largest telecommunications provider. Since B Communications' initial public offering in October 2007, its ordinary shares have been listed on the NASDAQ Stock Market (symbol: BCOM) and the TASE, and since January 1, 2011 its ordinary shares are listed on the NASDAQ Global Select Market. We currently own 64.78% of the ordinary shares of B Communications. B Communications maintains a website at [www.bcommunications.co.il](http://www.bcommunications.co.il). The information on B Communications' website is not incorporated by reference into this annual report on Form 20-F.

We began providing Internet access services in 1996, and began offering broadband services in 2001 and traditional voice services in 2004. As part of our internal restructuring in 2006, we transferred our broadband and traditional



voice services businesses, which we refer to in this annual report as the legacy communications business, to B Communications (formerly named 012 Smile. Communications), and our media operations to Goldmind Media Ltd. (formerly named 012 Smile.Media). During 2010 and 2011 we sold all of our media assets.

### **Acquisition of the Controlling Interest in Bezeq**

On April 14, 2010, B Communications completed the acquisition of 30.44% of Bezeq's outstanding shares from Ap.Sb.Ar. Holdings Ltd. for a purchase price of approximately NIS 6.5 billion in cash and became the controlling shareholder of Bezeq. The Bezeq interest was directly acquired by an indirect wholly-owned subsidiary of B Communications. In accordance with the terms of the transaction, effective as of the closing of the acquisition, B Communications designated seven directors to replace the Apax-Saban-Arkin Group's representatives on Bezeq's Board of Directors. We began consolidating Bezeq's financial results into our financial statements effective as of the closing of the acquisition and began reporting the consolidated results in our 2010 second quarter earnings release.

In addition to our ownership of Bezeq shares through B Communications, a total of 1,000,000 ordinary shares of Bezeq are jointly held by Mr. Shaul Elovitch, our controlling shareholder, and his brother, Mr. Yossef Elovitch. Further, 72,360 ordinary shares of Bezeq are held by Ms. Iris Elovitch, the wife of Mr. Elovitch, and 11,556 ordinary shares of Bezeq are held by Ms. Orna Elovitch, the daughter-in-law of Mr. Elovitch.

### **Permit to Control Bezeq Granted to Members of the Eurocom Group**

As part of B Communications' acquisition of the controlling interest in Bezeq, we, SP2, SP1 and other members of the Eurocom Group applied for authorization to control Bezeq, pursuant to the Communications Law and Communications Order. On April 13, 2010, the control permit was granted subject to the condition that SP2 continues to be controlled exclusively by the other parties to the control permit, referred to as the Companies' Control Permit. Concurrently, a separate control permit was also granted to Messrs. Shaul Elovitch and Yossef Elovitch, our controlling shareholders, referred to as the Individuals' Control Permit.

According to the Companies' Control Permit, the parties (through SP2) must hold not less than 30% of any type of means of control of Bezeq. Such percentage is permitted to decrease to 29% for a period of six months commencing from the date such holdings fall below 30%, in the event of dilution resulting from the exercise of stock options by Bezeq employees. Despite the 30% rule, according to Article 3(a3) of the Communications Order, which is included as part of the Control Permit, the parties to the Control Permit may hold less than 30% under certain circumstances, including the requirement that the parties control Bezeq and maintain at least a 25% ownership interest in Bezeq.

In connection with B Communications' issuance of the 7 % Senior Secured Notes, the Security Agent for such notes was granted a pledge permit which enabled B Communications to pledge the pledged Bezeq Shares and pledged SP2 Shares as collateral for the notes and certain hedging obligations. However, pursuant to the Communications Order and the Pledge Permit, no person (individually and acting in concert with other persons) may directly or indirectly hold, acquire or control, at any given time, more than 10% of the outstanding principal amount of 7 % Senior Secured Notes without first obtaining a permit.

For additional discussion about the Control Permit, see Item 4B. "Information On The Company-Regulatory- *Permit to Control Bezeq Granted to Members of the Eurocom Group.*"

### **B. Business Overview**

Since April 14, 2010, we have been, through B Communications, the controlling shareholder of Bezeq (TASE: BZEQ), Israel's largest telecommunications provider. Bezeq is the principal provider of communications services in Israel, providing a broad range of telecommunications operations and services, including domestic fixed-line, cellular and international communication services, Internet services, multi-channel television, television and radio broadcasts, satellite broadcasts, customer call centers, maintenance and development of communications infrastructures, provision of communications services to other communications providers and the supply and maintenance of equipment on customer premises, which is referred to as network end point, or NEP services. Bezeq was founded as a government company in 1980 and became a public company in 1990 with its shares traded on the TASE and included in the TA-25 Index.

**Bezeq's Operations**

Our principal asset is our controlling interest through B Communications in Bezeq, Israel's largest telecommunications provider based on revenue and subscribers. The Bezeq Group operates the most comprehensive telecommunications infrastructure in Israel, with a broad range of telecommunications services across all of its markets. Through its wholly-owned subsidiaries, the Bezeq Group is a leading provider in Israel of fixed-line telephony services and fixed-line broadband Internet infrastructure access services, cellular telephony services, ISP services, ILD services, international and domestic data transfer and network services and ICT, pay television services and other communications infrastructures and services. In each of these markets, the Bezeq Group holds a significant market share, as indicated in the chart below.

Bezeq Group Segments	Service	As of December 31, 2015	
		Estimated Market Share	Market Position
Bezeq	Fixed-Line Telephony (private sector)	56.0%	1 of 4
	Fixed-Line Telephony (business sector)	74.0%	1 of 2
	Fixed-Line Broadband Internet Infrastructure Access	68.0%	1 of 2
Pelephone	Cellular Telephony	25.6%	3 of 5
Bezeq International	ISP	44.0%	1 of 4
	ILD	21.0%	—
DBS	Pay Television	44.0%	2 of 2

The Bezeq Group had approximately 2.18 million active fixed telephone lines in its fixed-line telephony business, 1.48 million fixed-line broadband Internet infrastructure access services subscribers (retail and wholesale), 2.65 million cellular telephony services subscribers and 635,000 pay television services subscribers as of December 31, 2015. For the year ended December 31, 2015, the Bezeq Group had revenues of NIS 9.99 billion (approximately \$2.56 billion).

The Bezeq Group's diversified telecommunications services are based on highly advanced nationwide infrastructures and are provided by the following segments of the Bezeq Group:

*Domestic Fixed-Line Communications (Bezeq)*

Bezeq is the incumbent and largest provider of fixed-line telephony and fixed-line broadband Internet infrastructure access services in Israel. Its products and services include basic telephony services on domestic telephone lines and associated services and fixed-line broadband Internet infrastructure access services through its nationally deployed, high quality infrastructure network. Bezeq also offers, among other services, transmission and data communication services, services to other communications operators and broadcasting services. Bezeq's new high-speed next generation network, or NGN, is the most advanced fixed-line communications network in Israel. The NGN, which covers 100% of Israeli households, uses VDSL2 technology and enables Bezeq to provide bandwidth of up to 100 Mbps (download) speed, as well as innovative value-added services.

	As at and for the year ended	
	December 31, 2015 (in millions, except percentages)	
	NIS 4,407	
Revenues		
Fixed-line telephony		
Estimated market share <sup>(1)</sup>	65	%
Active lines	2.181	
Churn rate	10.1	%
Fixed-line broadband Internet infrastructure access		
Estimated market share	68	%
Subscribers	1.479	

- (1) As of December 31, 2015, Bezeq's market share in the business and private sectors of the fixed-line telephony market is estimated to be 74% and 56%, respectively.

*Cellular Telephony (Pelephone)*

Pelephone is among the leading cellular telephony services providers in Israel. Pelephone provides cellular telephony services, sells handsets and other end-user equipment, and provides repair services for handsets sold by Pelephone. Pelephone's nationwide 3.5G UMTS/HSPA+ network supports download speeds of up to 42 Mbps and upload speeds of up to 5.7 Mbps, making it one of the fastest, highest quality and most advanced networks in Israel. We believe these network features provide Pelephone with a strong platform to continue to offer a variety of advanced services and products to its customers and to capitalize on the continued increasing demand for smartphones and advanced data services.

The intensified competition in the cellular market has led to subscriber churn and a price war where the operators continuously lower prices to undercut the competition. This has led to substantial erosion of the average revenue per subscriber. This trend continued and even increased in 2015, as average revenue per subscriber decreased by 19% as compared with 2014.

The opening of the market to parallel imports and multiple stores selling terminal equipment has led to a decline in the sales of cellular handsets and terminal equipment by the cellular operators. To minimize its exposure to decreased revenues, Pelephone increased the range of equipment it sells and also sells non-cellular handset terminal equipment such as tablets, laptops and accessories. Pelephone's revenue from terminal equipment in 2015 amounted to NIS 891 million, accounting for 31% of its total revenues compared with terminal equipment revenues of NIS 966 million in 2014, accounting for 28% of its total revenues. Most terminal equipment is sold through monthly installments. The decrease in terminal equipment sales over the years has led to a decrease in trade receivables as well as to a decline in trade payables to terminal equipment suppliers.

The cellular market growth rate is lower due to penetration rate saturation. The penetration rate in Israel at December 31, 2015 was 124%.

	As at and for the year ended December 31, 2015 (in millions, except percentages)	
Telephone		
Revenues	NIS 2,890	
Estimated market share	25.6	%
Active lines	2.65	
Churn rate	25.8	%

*ISP, ILD, Data Services and ICT (Bezeq International)*

Bezeq International is the leading provider of ISP services in Israel and one of Israel's leading providers of ILD and international and domestic data transfer and network services. Bezeq International provides comprehensive communications solutions that include ISP and related value-added services, international and domestic telephony, PBX supply and support, ICT, cloud computing services, data communications and information security, website server hosting and related managed services. Bezeq International also owns the JONAH high-speed submarine optical fiber communications cable system connecting Israel and Europe, which provides increased bandwidth (capacity and speed) and has positioned Bezeq International as the sole ISP in Israel to own and operate an advanced international network.

	As at and for the year ended December 31, 2015 (in millions, except percentages)	
Bezeq International		
Revenues	NIS 1,578	
ISP		
Estimated market share	44.0	%

Churn rate	17.3	%
ILD		
Estimated market share	21.0	%

*Multi-Channel Pay Television (DBS)*

DBS offers nationwide coverage through its DTH technology and is the only company in Israel licensed to provide multi-channel pay television broadcasts via satellite and is one of only two companies in Israel licensed to provide multi-channel television services, with nation-wide coverage and innovative and advanced technologies, including PVR, VOD and HD television. DBS focuses on creating clear differentiation from its main competitor, HOT, with respect to brand, content and service quality. In addition, DBS has a strong track record of innovative technology development and is a leading provider of value-added services; including hybrid IP and DTH based set-top boxes (including PVR and VOD).

Apart from DBS, the only other broadcasting licensee in the multi-channel television broadcasting sector is HOT which provides cable television services to subscribers, and has a pronounced monopoly under the Antitrust Law in the multi-channel television broadcasting sector. Cellcom Group's Cellcom also operates in the multi-channel television sector, providing television services via the Internet that customers access to view VOD content and a few linear channels (including the DTT content) by either using a special streamer or application.

	As at and for the	
DBS	year ended December 31, 2015 (in millions, except percentages)	
Revenues	NIS 1,774	
Estimated market share	44.0	%
Subscribers (in thousands)	635	
Churn rate	13.9	%

### Competitive Strengths

We believe that the following competitive strengths will enable us to retain our customer base, capitalize on growth opportunities and maintain and expand our current market share positions, which we expect to contribute to positive cash flow generation.

***The Bezeq Group is a leading provider of telecommunications services and owner of telecommunications infrastructure in Israel and provides diversified telecommunications offerings across all Israeli telecom markets.***

The Bezeq Group is the largest and the incumbent telecommunications provider in Israel, offering a broad range of services through its advanced, comprehensive and nationwide telecommunications infrastructure. The Bezeq Group holds a leading position in each of the markets in which it operates, with estimated market shares as of December 31, 2015 of 65% in fixed-line telephony, 68% in fixed-line broadband Internet infrastructure access, 25.6% in cellular telephony, 44% in ISP, 21% in ILD and 44% in pay television, based on the numbers of active lines, subscribers or outgoing minutes, as applicable. As a leading provider in each of these markets, the Bezeq Group has been able to maintain its strong performance and benefit from economies of scale. In addition, such leading positions across a diverse range of telecommunications offerings reduce the Bezeq Group's exposure to market and regulatory conditions. For example, the Bezeq Group is able to partially mitigate the negative effects of certain market trends, such as fixed-to-mobile substitution, as a result of its presence in the cellular telephony services market and its ability



to capture a share of the growing mobile subscriber base. In addition, the Bezeq Group was able to partially offset a decline in revenues in its cellular telephony segment resulting from regulatory changes instituted in January 2011, which led to a significant reduction in interconnect fee tariffs, as a result of the reduction of the Bezeq Group's expenses for interconnect fees in the fixed-line communications segment.

We believe that the Bezeq Group's ability to maintain a leading position in the Israeli telecommunications market in the face of competitive and regulatory pressures reflects, among other things, the underlying strength of its advanced nationwide network infrastructures, the strength of its brands and its extensive offering of high quality content.

***The Bezeq Group operates in an attractive macroeconomic environment with a developed telecommunications market.***

Israel is a developed, industrialized market characterized by strong macroeconomic fundamentals. Israel is a member of the Organisation for Economic Co-operation and Development, or OECD, and had GDP per capita of \$33,718 in 2014.

The Israeli telecommunications market is highly developed and benefits from favorable dynamics, including high penetration rates across all telecommunications services, high penetration of postpaid contracts in the cellular telephony market, rapid adoption rates of new technologies and significant expenditures on telecommunications services by consumers and businesses. In addition, Israel is expected to experience steady population, which should provide a natural expansion of the addressable market. In particular, Bezeq expects such population trends will lead to a steady demand for fixed-line telephony services in Israel, especially among certain sectors of the growing population in Israel where fixed-line telephony is in widespread use. Furthermore, a relatively young population contributes to the attractiveness of the market, as such consumers typically spend more on telecommunications products and services while also driving increased demand for new technologies. We believe that the potential future growth in the Israeli telecommunications market will be driven by continued strong demand for higher bandwidth, both on the broadband Internet and mobile platforms, and advanced value-added services and technologies across all telecommunications services.

*The Bezeq Group owns advanced nationwide network infrastructures and is positioned at the forefront of technological innovation across all of the telecom markets in Israel.*

The Bezeq Group has historically made substantial investments in its fully owned infrastructure, which is one of the most technologically advanced in Israel and enables the Bezeq Group to reach customers nationwide.

Bezeq has a Next-Generation Network (NGN) based on a core IP network and deployment of an optical fiber network to street cabinets (a network topology known as Fiber to the Curb, or FTTC) and also based on an access network (a system that connects NEPs on the subscriber's premises to the network and engineering systems). Bezeq completed the deployment of the network at the end of 2015. The connection from the home, or the terminal equipment (equipment which is installed on the subscriber's premises, e.g., the actual telephone, private exchanges, fax machines, modems, routers, etc.) through which the subscriber receives the service, to the access network is based on copper cables and optical cables that connect the access systems to the backbone over optic cables (through special pipes or an above ground network) and to a limited degree through wireless systems.

Today, using VDSL2 technology, it is possible to provide a bandwidth of up to 100 Mbps downstream, as well as innovative added-value services. Other advantages of the new technology are simplification of the network structure and better management ability.

The following graph illustrates changes in the surfing speeds of Bezeq's Internet subscribers 2011-2015 (in Mbps at the end of each year):

Pelephone currently operates communications networks using three main technologies:

The 4G LTE technology is based on GSM standards. The advantages of this technology are larger data communication capacity and faster download rates than with the 3G technologies. All the terminal devices that support this technology also support the 3G technologies and the transition between the technologies is seamless.

UMTS/HSPA, a digital technology based on the GSM standard. This technology is globally widespread and enables subscriber identification and services to be provided through a SIM card, which can be moved from one handset to another. The advantage of this technology, inter alia, is that it supports download speeds of up to 42 Mbps and upload

speeds of up to 5.7 Mbps. This communication network is Pelephone's primary network.

CDMA digital technology. This technology is less prevalent worldwide than UMTS/HSPA and subscriber identification is via identification details burned onto the subscriber's terminal equipment rather than by means of a SIM card. To date, this network serves a limited number of subscribers who seldom use the network. Since the UMTS/HSPA network was launched, Pelephone is working to transfer existing subscribers from CDMA to UMTS/HSPA, offering to upgrade their handsets to the new network. Pelephone is not expanding its investment in this network beyond the needs of current maintenance.

In the ISP, ILD, data transfer, networks and ICT services segment, Bezeq International is currently the sole ISP in Israel to own and operate its own high-speed submarine optical fiber communications cable system. The JONAH cable, which was launched in January 2012, has a capacity of over 7.0 Tbps and provides Bezeq International with greater capacity for utilization than any other ISP in Israel. In addition, Bezeq International is able to obtain such capacity at an incremental cost, while other ISPs in Israel are required to purchase capacity and rely on one of the two other cable operators in Israel (MedNautilus and Tamares). The JONAH cable is fully redundant (i.e., utilizes two equipped fiber pairs), and in addition, Bezeq International has available capacity on two alternate submarine routes to Europe.

In the multi-channel pay television segment, DBS is the only licensed provider of multi-channel television broadcasts via satellite in Israel. While DBS relies on third party providers for the provision of satellite capacity, it owns the satellite dishes that carry the signals from such satellites to subscriber residences and set-top boxes. DBS differentiates itself from its main competitor, HOT, by offering a wide range of high quality content and by utilizing technology to be the first pay television services provider to offer new and innovative value-added services to subscribers. For instance, DBS was the first provider in Israel to offer a set-top box that combined PVR, VOD and HD capabilities in one device (branded as “yes MaxTotal”). DBS’s PVR offering enables subscribers to download a movie or series to their yes MaxTotal set-top box over the Internet and watch recorded content immediately or at a later time. DBS is also the only provider in Israel that offers a multiroom service allowing subscribers to watch recorded content on multiple capable set-top boxes (“yes MultiRoom”) and in 2014 DBS introduced its TV Everywhere service, branded as yesGo, which allows subscribers to watch content from mobile devices. In 2015, DBS began to offer a HDPVR converter known as yesQuattro that allows the recording of up to 4 channels simultaneously, in addition to the channel being viewed, has increased the number shows that may be recorded and allows the automatic recording of prime time content (6:00 PM to midnight) on two channels that the subscriber can select, for seven days (known as PrimeTime service).

DBS also operates its yesGo service, allowing subscribers to view the channels included under the service that they have purchased for home television viewing and VOD content, over a variety of terminal devices (smartphones, tablets and PCs).

At present, there are additional providers (other than Cellcom) that enable VOD viewing through the Internet, such as AppleTV and Netflix (which currently offer content that does not have Hebrew translations). Other entities are considering launching similar services.

***The Bezeq Group’s brands are among the strongest and most widely recognized brands in Israel and are supported by its substantial investments in marketing, strong product and service offerings, extensive distribution network and leading customer service offerings.***

The Bezeq Group’s brands are among the strongest and most widely recognized brands in Israel, including Bezeq, Pelephone, Bezeq International and DBS. The Bezeq Group’s brands have been supported by its sustained and substantial investments in strong product and service offerings, marketing, extensive distribution network and leading customer service offerings. We believe the Bezeq Group’s product and service offerings combined with its advanced technology and infrastructure are the key factors driving the association of the Bezeq, Pelephone, Bezeq International and YES brands with reliability, speed, excellent service and innovation throughout Israel. The Bezeq Group’s marketing campaigns focus on and highlight various elements regarding each of its brands. For example, Bezeq focuses on the value-added services offered with its fixed-line broadband Internet infrastructure access service, Pelephone highlights the speed of its network, Bezeq International focuses on providing faster Internet speed than its competitors and its strong customer service, and DBS emphasizes its large selection of high quality international content and the subscriber viewing experience associated with it. Furthermore, the Bezeq Group also provides its customers with award winning customer service offerings in order to enhance customer loyalty.

***The Bezeq Group has an extensive offering of high quality content.***

Through its wholly-owned subsidiary, DBS, the Bezeq Group is able to complement its extensive telecommunications infrastructure with a wide array of high quality content. For instance, DBS, which benefits from strong content differentiation in the pay television market, provides a leading selection of television series and movies. With respect to television series, DBS broadcasts new television series at a minimal delay, in some cases within hours from the time the content is originally aired in the United States or worldwide. DBS also has an agreement with HBO pursuant to which DBS aired all of HBO's new English language television series and movies, the majority of which were only aired in Israel on DBS. The Bezeq Group's extensive offering of high quality content distinguishes it from competitors, and we believe that such distinction will likely enhance the Bezeq Group's competitive position if and when the Israeli wholesale market develops and the Bezeq Group's competitors that do not currently offer bundled packages with pay television begin doing so.

***The Bezeq Group's strong cash flow generation supports substantial and consistent dividends while providing for investment in the business and maintenance of a conservative level of leverage.***

The Bezeq Group is a highly cash generative business and has a proven track record of consistent operating cash flow generation. The Bezeq Group's stable, and in some segments, growing customer base and attractive offerings and services, together with its focus on profitability, provide it with strong revenues, Adjusted EBITDA margin and operating cash flow. While generating strong cash flow, the Bezeq Group has continued to invest in its business, technologies and infrastructure through major capital expenditure programs, several of which were completed in the last four years (including, the deployment of Bezeq's NGN, Pelephone's advanced 3.5G UMTS/HSPA+4G cellular network and the launch of Bezeq International's JONAH cable).

The following table sets forth the Bezeq Group's operating cash flow and ratio of capital expenditures to revenues for the years ended December 31, 2013, 2014 and 2015. The operations of DBS have been included for the last nine months in 2015.

	Year ended December 31,		
	2013	2014	2015
	(NIS in millions except percentages)		
Operating cash flow	4,152	3,796	3,740
Capital expenditure, net	916	1,045	1,484
Capital expenditure, net as a % of revenue	9.6 %	11.5 %	14.9 %

We believe the Bezeq Group has a conservative capital structure and that such conservative capital structure and strong cash flow generation have historically enabled Bezeq to make consistent dividend payments to its shareholders. Since 2006, Bezeq has distributed dividends in an amount equal to 100% of its net income after minority share in each year (and in addition, in each of 2007 and 2011, a special dividend was approved for distribution).

***The Bezeq Group has an experienced management team with a proven track record in the Israeli telecommunications industry.***

The Bezeq Group's management team has significant experience in the telecommunications industry, including with respect to the transformation of telecommunications companies and generating growth. The Bezeq Group's executive management has a proven track record in leading international and domestic technology and telecommunications companies and has successfully delivered efficient operating performance and strong returns for its shareholders despite increasing regulatory hurdles and competition in recent years. In recent years, the Bezeq Group's management has overseen significant investments in infrastructure to position the members of the Bezeq Group at the forefront of technology for the coming years.

***We control B Communications which is the sole controlling shareholder of Bezeq and have a management team with significant experience in developing and operating telecommunications companies.***

B Communications has sole control of Bezeq and, together with us and members of the Eurocom Group, are the only entities or persons that hold a permit to control and direct the activities of Bezeq. Since the acquisition of the controlling interest in Bezeq, B Communications has nominated all of the members of Bezeq's board of directors who were elected by shareholders, excluding employee representatives on the board whose nominations require the prior approval of our ultimate controlling shareholder, Mr. Shaul Elovitch, as chairman of Bezeq's board of directors, pursuant to Bezeq's collective bargaining agreement.

Our management team has long-standing experience in the communications sector. Our founder and Chairman, Mr. Shaul Elovitch, was also one of the founders of other Israeli leading telecommunications businesses (including, among others, DBS and Partner) and other major investment businesses, and has over 40 years of experience in the telecommunications market. Our Chief Executive Officer, Doron Turgeman, has over 19 years of experience in the telecommunications sector.

Our controlling shareholder, Eurocom Communications, is one of Israel's largest holding groups, with extensive experience in the telecommunications market and controlling stakes in other telecommunications companies, including Spacecom, Satcom, all of which operate in the field of satellite communications, Eurocom Cellular, a leading supplier in Israel of cellular devices, and Eurocom Digital, a leading supplier in Israel of communications products.

### **Our Strategy**

We view our holding in Bezeq, through B Communications, as a strategic asset and currently expect to maintain a long-term controlling interest in Bezeq. The telecommunications market has historically served as a growth engine for the Eurocom Group and we intend to continue to focus our business on the telecommunications field. We intend to leverage our long-term experience and expertise in the telecommunications field to continue to contribute to Bezeq's management and operations, through ongoing involvement in its business and provision of extensive consulting and strategic services. Over the coming years we intend to gradually reduce our leverage level through the repayment of debt.

### **Products and Services**

The Bezeq Group provides a wide range of telecommunications services for its business and private customers, including domestic fixed-line telephony and fixed-line broadband Internet infrastructure access services, cellular telephony services, ISP, ILD, data services, ICT solutions, multi-channel television broadcasts via satellite, customer call centers, maintenance and development of communications infrastructures, provision of communications services to other communications providers and the supply and maintenance of equipment on customer premises, also known as network end point (NEP) services.

Since May 2010, Bezeq has been permitted to offer joint service packages with its subsidiaries to private subscribers, and since July 2012, Bezeq has been permitted to offer joint service packages with its subsidiaries to business subscribers, in each case, subject to the approval of the joint service package by the Ministry of Communications and other conditions contained in Bezeq's license. The joint service packages must be capable of being "unbundled" such that each service included in a package must be offered separately and on the same terms, which effectively prevents the Bezeq Group from enhancing the attractiveness of the offer by offering a discount on the joint service packages. Joint service packages marketed by Bezeq's subsidiaries that include the services of Bezeq are also subject to similar limitations, including "unbundling" (except for a bundle offered by a subsidiary that only contains Bezeq's fixed-line broadband Internet infrastructure access service).

Bezeq currently offers packages that combine a subscription to Bezeq's fixed-line broadband Internet infrastructure access and to the accompanying ISP service, with the ability to choose from any ISP provider in Israel, including Bezeq International. The packages are "unbundled" and offered at the same price that the standalone services would cost if subscribed to separately. In addition, Bezeq offers packages to business customers that combine Bezeq's business data lines and the accompanying ISP service from Bezeq International. The packages are also "unbundled" and offered at the same price that the standalone services would cost if subscribed to separately. Business customers are also not required to use Bezeq International as their ISP provider and have the ability to choose any ISP provider in Israel.

These restrictions, and in particular the unbundling obligation, which severely limits the Group's ability to offer discounts on the components of the bundle, puts the Group in a competitively inferior position as compared to the competing communication groups which are not subject to similar restrictions in marketing joint bundles (other than a restriction on marketing a joint bundle of HOT-Net and other companies in the HOT Group). Bezeq's restriction is more significantly manifested with implementation of the wholesale BSA services and the option for ISPs to provide end-to-end services to customers at reduced prices compared with the bundles that Bezeq can market, which can be unbundled.

There is a dispute between Bezeq, Cellcom and Partner regarding the terms of the agreement for packages marketed by Bezeq, Bezeq's Internet infrastructure services together with ISP services. In this matter, Cellcom and Partner lodged complaints with the Ministry of Communications and the Antitrust Authority. Bezeq has sent its response.

### ***Domestic Fixed-Line Communications (Bezeq)***

#### *Fixed-Line Telephony Services*

Bezeq's fixed-line telephony services include basic telephony service on domestic telephone lines and associated value-added services, such as voice mail, caller ID, call waiting, call forwarding and conference calls. Bezeq also



offers its business customers national toll free numbers which provide for full or partial payment for customer calls by the business customer.

As of December 31, 2015, Bezeq had 2.18 million active fixed telephone lines in Israel. Bezeq offers a variety of payment plans, ranging from a monthly subscription fee per fixed telephone line and charge per second of use, to various fixed-line telephony packages comprised of monthly amounts of minutes for a fixed monthly fee.

Most of Bezeq's fixed-line telephony services are subject to regulatory tariff control and the prices for such services are governed by such regulations. With respect to services that are not subject to tariff control, Bezeq is required under the Israeli Communications Law to set reasonable tariffs for such services. In addition, Bezeq is allowed to offer "alternative payment packages" for services that are subject to tariff control, with different pricing than the regulated tariff, subject to certain conditions.

#### *Fixed-Line Broadband Internet Infrastructure Access Services*

Internet service in Israel is segregated into two separate elements comprised of infrastructure or network access services and ISP services. As such, a customer wishing to subscribe to fixed-line Internet services in Israel effectively needs to purchase infrastructure access services, which are provided exclusively by Bezeq and HOT, the only telecommunication operators in Israel that own national fixed-line network infrastructures, and ISP services, which can be provided by any licensed provider. The customer retains the choice with regards to providers for both services, i.e., it may choose to subscribe to the fixed-line broadband Internet infrastructure access facilities of Bezeq or HOT while using a separate ISP provider.

Bezeq provides fixed-line broadband Internet infrastructure access services to approximately 65% of the Israeli market based on the number of subscribers. There has been a growing demand for higher bandwidth speed from Bezeq's fixed-line broadband Internet infrastructure access services subscribers in recent years.

Bezeq offers its fixed-line broadband Internet infrastructure access services in a variety of packages, with prices varying according to bandwidth, and currently offers its subscribers packages with bandwidth speeds ranging from 5 Mbps up to 100 Mbps, depending, among other things, on the distance of the subscriber's premises from the street cabinet and the technology available at the subscriber's premises. Since April 2012, Bezeq has not been permitted to offer its fixed-line broadband Internet infrastructure access services at a reduced price when sold together with its fixed-line telephony services.

Bezeq offers add-on and value-added services to its fixed-line broadband Internet infrastructure access services subscribers, including Bezeq's recent offering of a shared national free WiFi network (a service allowing Bezeq's broadband subscribers to share a portion of their wireless bandwidth with other subscribers in return for the ability to browse outside of their homes using other subscribers' wireless bandwidth), free cloud services, anti-virus and parental controls. Bezeq charges its subscribers a monthly fee for certain of these add-on services. In addition, Bezeq offers the "Bhome" service - A "smart home" service that allows Bezeq's Internet subscribers to be updated on events at home in real time via their smartphones, cameras and sensors installed at home.

#### *Transmission and Data Communication Services*

Bezeq provides a wide variety of data and transmission services, both to its business customers and to other telecommunication operators. Bezeq's data service offerings include point to point, or point to multi point, network topology for business to business and multi-branch business customers, as well as connectivity, Internet access and remote access services. Bezeq provides these services on multiple platforms, from its legacy infrastructures to its newer and more advanced infrastructures, such as IPVPN and metro Ethernet.

Bezeq offers high-speed transmission services to a substantial number of the communications operators in Israel. Among other services, Bezeq provides backhaul services to cellular telephony operators and transmission connectivity services to wireline operators, ILD providers, ISPs and to the Palestinian Authority operators. Bezeq offers similar services to business customers, with a wide variety of bandwidths and interfaces.

#### *Other Services*

*Miscellaneous services to communications operators.* Bezeq provides various services to other communications operators, including rental of space and provision of services in its rented properties, hosting of cellular sites, billing and collection for ILD operators and special services for ISPs.

*Infrastructure services for HOT.* Bezeq installs and provides maintenance for the portion of HOT's cable network that runs through Bezeq's ducts and poles, which accounts for a substantial portion of HOT's cable network.

*Broadcast services.* Bezeq operates and maintains radio transmitters that are operated by radio stations and operators, including the Israel Broadcasting Corporation and the Israeli Defense Force Radio (Galei Zahal). Bezeq also operates DTT transmitters for the Second Authority. While Bezeq is responsible for the operation and maintenance of the transmitters, it is not responsible for the content of the broadcasts.

*Contract work.* Bezeq performs setup and operational work on networks and sub-networks for various customers such as the Israel Ministry of Defense, radio and television broadcasting companies, cellular and international communication operators, local authorities, municipalities and government agencies.

The following table shows the distribution of Bezeq's revenues by main products and services in its segments of operation from 2013 to 2015 (in NIS millions):

	2015	2014	2013
Revenues from fixed-line telephony	1,586	1,668	1,971
Percentage out of total Bezeq revenues in the segment	35.99%	38.64%	44.02%
Revenues from Internet infrastructure services	1,542	1,394	1,287
Percentage out of total Bezeq revenues in the segment	34.99%	32.30%	28.74%
Revenues from transmission and data communication services	1,058	1,022	990
Percentage out of total Bezeq revenues in the segment	24.01%	23.67%	22.10%
Revenues from other services	221	233	230
Percentage out of total Bezeq revenues in the segment	5.01%	5.39%	5.14%
Total revenues from the domestic fixed-line communication services segment	4,407	4,317	4,478

Bezeq's revenues are distributed into two main customer types – private (57%), and business (43%). The distribution is by revenues, as shown in the following table:

	2015	2014	2013
Revenue from private customers	2,507	2,498	2,605
Revenue from business customers	1,900	1,819	1,873
Total revenue	4,407	4,317	4,478

### *Cellular Telephony (Pelephone)*

Pelephone offers its subscribers comprehensive voice, data and text messaging services and advanced multimedia services through its nationwide 3.5G UMTS/HSPA+4G network. Pelephone's basic cellular telephony (voice) services include basic call services, call completion services and auxiliary services such as call waiting, call forwarding, voice mail, voice conference call and caller ID. Pelephone's customers can also access Internet services by using their handsets or through a cellular modem, or netstick, with download speeds of up to 42 Mbps. Pelephone's value-added services include short text messages, or SMS, multimedia messages, or MMS, and content services. Pelephone also offers its customers handset repair services for a monthly payment.

Pelephone offers a variety of packages that combine the several services it makes available to subscribers. Such packages are primarily "unlimited" packages (where the subscriber pays a fixed usage fee and is entitled to make unlimited use of the services according to the terms of the purchased plan), however Pelephone also offers usage fee packages (where the subscriber pays a monthly fee for up to a limited usage and are charged according to their excess use beyond the limit). Since February 2011, Pelephone's contracts with private customers have not included any commitment period. Pelephone's arrangements with large business customers with over 100 subscribers include commitment periods of up to 36 months.

Pelephone also provides international roaming services, based on agreements it has with cellular telephony operators abroad. In addition, Pelephone provides inbound roaming services to the customers of foreign operators while they are in Israel.

Pelephone offers various types of mobile phones, on-board telephones, hands-free devices and accessories that support its range of services. Pelephone also offers its customers other terminal equipment such as tablets, laptops, modems, television sets and game consoles.

In February 2016, Pelephone launched a private label terminal equipment brand (GINI), which initially included several 4G device models that will subsequently be augmented with additional models of phablets and tablets.

*Revenue from products and services*

The following table provides a breakdown of Pelephone's revenues from products and services (in NIS millions) in the last three years:

Products and Services	2015	2014	2013
Revenue from services	1,999	2,453	2,808
Percentage of Pelephone's total revenue	69.2 %	71.7 %	73.7 %
Revenue from products (terminal equipment)	891	966	1,001
Percentage of Pelephone's total revenue	30.8 %	28.3 %	26.3 %
Total revenue	2,890	3,419	3,809

The following table provides a breakdown of revenue from customers (in NIS million) in the last three years:

Products and Services	2015	2014	2013
Revenue from private customers	1,750	1,930	2,114
Revenue from business customers*	1,140	1,490	1,695
Total revenue	2,890	3,419	3,809

\*The revenue from business track customers includes revenue from hosting agreements which amounted to NIS 46 million in 2015 (NIS 244 million in 2014).

As of December 31, 2015, Pelephone had 2.65 million subscribers. Pelephone also has 925,000 pre-paid subscribers (customers who pay for communications services in advance), but the revenues from these customers are not a significant portion of its total revenues. In addition to Pelephone's subscribers, who are end-customers that actually use Pelephone's network, Pelephone provides services under hosting agreements to other cellular operators that use Pelephone's network to provide services to their customers. Most of the hosting income in 2015 came from Rami Levy and Alon Cellular. Most of the income in 2014 came from HOT Mobile, whose hosting agreement with Pelephone ended in December 2014.

### ***ISP, ILD, Data Services and ICT (Bezeq International)***

#### *ISP services*

Bezeq International provides a large variety of ISP services to private and business customers, including terminal equipment and support, with an emphasis on broadband Internet access services ranging from 5 Mbps to 200 Mbps based on Bezeq's ADSL infrastructure and local cable company infrastructure (HOT's UFI). Such access services are offered in various bandwidths and qualities of service based on available transmissions. Bezeq International also offers its customers a wide range of value-added services, including automatic online backup for personal computer files, antivirus, anti-spyware, anti-phishing, anti-spam, parental control over Internet use and premium technical support. Such value-added services are often provided as an integrated service package together with ISP services. In addition, Bezeq International offers packages of ISP services and fixed-line broadband Internet infrastructure access services of either Bezeq or HOT.

#### *ILD services*

In the ILD services market, Bezeq International offers international direct dialing services to business and private customers, toll-free number services for business customers overseas, international call routing and termination services (i.e., hubbing, the transfer of international calls between foreign communication providers worldwide), telephone card services enabling prepaid and postpaid dialing from Israel, and domestic telephony services by means of VoB access (a service that allows users to make and receive telephone calls over the Internet through an Internet connection) through its wholly owned subsidiary B.I.P. Communications Solutions Limited Partnership.

#### *Business Sector-Data Services and ICT*

Bezeq International specializes in providing IT and communications solutions for large local and international enterprises, offering a wide range of services and comprehensive solutions that combine its communications network and the customer's organizational computer infrastructures. Bezeq International offers a range of ICT services, including IT systems, computerized infrastructures, information security, networking and wireless and data back-up solutions, as well as maintenance for organizational computer networks, help desks and IT expert outsourcing services. Bezeq International also provides its business customers with international data networks, virtual private routed networks, or VPRN, and multiprotocol label switching, or MPLS, networks, and high-speed ISP services through a variety of broadband technologies, such as transmission, metro, ADSL, cables and WiFi.

Bezeq International offers its business customers services which allow for the upgrade and adjustment of such services to meet its customers' ever-changing requirements, which is referred to by Bezeq International as "IT as a Service" (such as IT Infrastructure as a Service, cloud computing and data backup, virtual servers and cloud call centers).

Bezeq International's customers also benefit from its advanced data centers, which supply website server hosting and co-location services as well as advanced disaster recovery solutions. Bezeq International operates large data centers and utilizes its international points-of-presence and global data network for the benefit of its international enterprise customers.

Bezeq International specializes in installing, maintaining and supporting internal organizational telephony exchanges, IP exchanges and call centers for some of the world's leading manufacturers. In traditional international communications, Bezeq International utilizes a "Soft Switch" switching system that provides Intelligent Network services for international calls enabling cost-effective advanced monitoring and customer use restrictions.

Bezeq International also provides data services to ISPs and international communications providers through its submarine optical fiber communications cable system.

***Multi-Channel Pay Television (DBS)***

*Broadcasts*

DBS currently offers a wide range of high quality content on 150 different channels, including 20 HD channels. Such channels include MTV, National Geographic, Discovery and Eurosport. DBS attempts to secure the best available programming across feature films, television series, documentary programming and original productions, while emphasizing both quality and ratings. DBS broadcasts new television series at a minimal delay in some cases, within hours from the time the content is originally aired in the United States or worldwide. DBS also has an agreement with HBO pursuant to which DBS broadcasts all of HBO's new English language television series, the majority of which were only broadcast in Israel by DBS. DBS also offers a variety of local content as well as VOD services, pay-per-view channels, radio channels, music channels and interactive services.

DBS's package offerings include a basic package, which each subscriber is required to purchase, as well as additional channels chosen by the subscriber, whether as a package or as single and PPV channels. For example, DBS currently offers, among others, a sports channels package, an entertainment and series package, a movies channels package, a business and news channels package, a science and nature channels package, a youth and music channels package, a Russian language channels package and an Arabic language channels package.

The following table provides a breakdown of DBS revenues (in NIS millions) during the last three years:

	2015	2014	2013
Revenue from broadcasts and multi-channel television services to subscribers	1,774	1,708	1,617

*Advanced services*

DBS offers its subscribers a variety of value-added services, which are among the most advanced in the world, including:

PVR set-top boxes which interface with DBS's electronic program guide and enable special services, including ordering recordings in advance, recording series and pausing live broadcasts;



HD broadcasts through DBS's set-top boxes;

VOD services via the Internet (accessed through the set-top boxes);

smartphone and tablet applications that offer viewing content as well as the option to remotely record content on the subscriber's set-top box. At the beginning of 2010, DBS launched the option of viewing a variety of its content on iPhones and expanded the service to support iPads in March 2011. The iPad application incorporates viewing content at HD quality and connection to Facebook and both the iPad and iPhone applications offer the option to remotely record on the PVR;

"yes streamer," a service that facilitates the viewing of video, pictures and music in diverse formats from the home computer on television (using DBS set-top boxes) in addition to access to certain Internet content, such as YouTube, Picasa, Flix and Flickr; and

"yes MultiRoom," a service launched in June 2013 that allows subscribers to watch content that was recorded on one capable set-top box from other capable set-top boxes they have in other rooms using the home network.

These advanced services are available to subscribers through DBS's set-top boxes, depending on the type of advanced service, which include "yes Max" (PVR capabilities and, in some of them, VOD capabilities), "HDvod" (HD and VOD capabilities) and "yes MaxTotal" (PVR, HD, VOD, streaming capabilities and yes MultiRoom in the same set-top box). DBS also provides yesGo, a TV Everywhere feature that enables subscribers to watch a significant part of its content (both linear channels and VOD) via personal computers and mobile devices such as smartphones and tablets (available on iOS and Android).

## **Marketing, Sales and Customer Service**

Under the structural separation limitations, each of the Bezeq Group companies maintains independent marketing and sales operations.

### *Domestic Fixed-Line Communications (Bezeq)*

Bezeq has marketing, sales and service systems for its business and private customers, which include customer managers for the business sector, combined sales and service call centers around the country, technical support centers for private and business customers, Bezeq stores throughout Israel offering sales and services, as well as a virtual online shop.

Bezeq markets its services mainly through advertising in the mass media, telephone sales centers, customer managers and an array of independent dealers which are mainly ISPs, outsourced sales centers, and ISPs which, upon establishment of the wholesale market, mainly market end-to-end service packages based on the Bezeq's wholesale BSA services. Bezeq also has independent service and sales channels on its website (adapted to surfing from mobile phones), a dedicated application (Bezeq Sheli, My Bezeq), and also offers an Interactive Voice Response (IVR).

*Cellular Telephony (Pelephone)*

Pelephone's distribution system includes service and sales centers dispersed throughout Israel that provide customer service, sales, repair and customer retention services. This distribution network is reinforced with stores and point of sale stands (some of which are operated by Pelephone employees, and others by authorized dealers). In addition, Pelephone operates through an external sales' network.

Pelephone's subscriber service network includes its website and special purpose call centers which provide information and service regarding various matters in three languages, technical support, information regarding customer billing, value added services, sales and general information.

*ISP, ILD, Data Services and ICT (Bezeq International)*

Bezeq International's quality of service and the professional support provided to its customers are key drivers of its success. Bezeq International's customer services for its residential and business customers include designated call centers, its website, different social network interfaces (such as Facebook) and an advanced set of online web tools (such as chat, remote takeover software and advanced monitoring systems). Bezeq International's ICT and VoB customers are also provided with field technical support and installation services by trained technicians.

Bezeq International's marketing and advertising strategy highlights the importance of a smooth and fast Internet experience and emphasizes its unique value proposition as the best broadband Internet performance provider in Israel. For the private customer market, Bezeq International uses a broad range of distribution channels to sell its products throughout Israel, including call centers for ISP and ILD services and sales agents who make door-to-door sales. In addition, Bezeq International offers joint services packages. For the business customer market, Bezeq International's marketing channels include call centers, business service and solution centers, and customer managers according to customer type (SMB, SME customers designated for outsourcing transactions, etc.).

*Multi-Channel Pay Television (DBS)*

DBS customer service operations are carried out mainly by in-house and outsourced call centers, as well as by self-service via interactive voice response, DBS's website and set-top boxes. Field technical support and installations are performed by DBS technicians and subcontractors.

DBS's sales operations are carried out via door-to-door sales personnel, call centers and third party dealers. DBS focuses its marketing strategy on media campaigns with high presence on television as well as other media such as radio, newspapers, Internet and billboard commercials, using well-known international actors and marketing special offers. DBS's campaigns highlight its role as a global technology pioneer with leading value-added services (VOD, PVR, HD, yes MultiRoom, streamer and mobile applications). DBS also highlights its relationships with other well-known, popular brands.

## **Networks**

### *Domestic Fixed-Line Communications (Bezeq)*

Bezeq offers private and business customers, as well as communication providers, a wide variety of services through a nationally deployed, fully-owned, advanced communication networks. Bezeq was the first fixed-line communications company in the world to provide a national NGN deployment. Over the past four years, Bezeq has deployed thousands of street cabinets, equipped with MSAG systems containing ADSL2+ and VDSL2 cards, through which Bezeq supplies its customers with telephone services, Internet access, data and value-added services, all on a unified IP network. The thousands of street cabinets are fiber optically linked through a metro Ethernet network, reaching dozens of aggregation sites leading to Bezeq's nationally distributed mega points of presence (POP) sites. The street cabinets are distributed in a manner by which the average distance from the customer does not exceed several hundred meters, enabling Bezeq to offer its customers, using VDSL2 technology, up to 100 Mbps bandwidth.

NGN network deployment and the transition to providing the array of services on a unified IP network has generated significant operational savings, by enabling Bezeq to gradually "shut down" the old PSTN network, as a result of which many structures that were formerly used to store the PSTN switches became redundant and are offered for sale upon removal of the PSTN switches (certain structures have already been sold) and following the removal of the copper cables in segments that were replaced by fiber optics.

Bezeq operates an extensive national network of optic fibers, providing relay and data communication services for business customers, government offices and security forces, as well as communication operators, while utilizing a wide variety of technologies, including SDH, metro Ethernet, IPVPN and more, with a wide variety of bandwidths. Bezeq recently began an initiative to extend the optical fiber network to be as close as possible to buildings and customer homes (FTTB/FTTH). This activity is expected to result in ultra-fast data transfer rates, significantly higher than the maximum rate provided on the current network (100 Mbps).

The data communication networks consist of thousands of switches and routers spread throughout hundreds of sites nationwide, as well as tens of thousands of kilometers of optical fiber, usually installed within duct infrastructures, enabling simple and rapid installation and maintenance. This array is deployed in a ring configuration, enhancing survivability.

#### *Cellular Telephony (Pelephone)*

Pelephone has a resilient and advanced network system in Israel, allowing it to offer its services with nationwide coverage and consistent high quality. Pelephone's cellular telephony license is valid until September 8, 2022. During the years ended December 31, 2013, 2014 and 2015, Pelephone had net capital expenditures of NIS 315 million, NIS 321 million and NIS 426 million (approximately \$109 million), respectively, for its network infrastructure.

Pelephone currently operates communications networks using the 4G LTE, UMTS/HSPA and CDMA technologies.

The 4G LTE technology is based on GSM standards. The advantages of this technology are greater data communication capacity and faster download rates than with the 3G technologies. All the terminal devices that support this technology also support the 3G technologies and the transition between the technologies is seamless.

UMTS/HSPA is a digital technology based on the GSM standard. This technology is globally widespread, and enables subscriber identification and services to be provided through a SIM card, which can be moved from one handset to another. The advantage of this technology, inter alia, is that it supports download speeds of up to 42 Mbps and upload speeds of up to 5.7 Mbps. This communication network is Pelephone's primary network.

CDMA digital technology is less prevalent worldwide than UMTS/HSPA and subscriber identification is via identification details burned onto the subscriber's terminal equipment rather than by means of a SIM card. To date, this network serves a limited number of subscribers who seldom use the network. Since the UMTS/HSPA network was launched, Pelephone is working to transfer existing subscribers from CDMA to UMTS/HSPA, offering to upgrade their handsets to the new network. Pelephone is not expanding its investment in this network beyond the needs of current maintenance.

At present, Pelephone's network the infrastructure is based on two switch farms that are connected to more than 2,200 sites. Pelephone's network is interconnected with the networks of Bezeq and HOT in several locations across Israel. Pelephone's network is also connected to all of the cellular networks in Israel, the eight Israeli ILD operators, the fixed-line telephone network of Paltel and the cellular network of Wataniya, and indirectly to the cellular network of

Jawwal in the Palestinian Authority.

Pelephone's transmission network is made up of leased lines (fiber optic) from Bezeq and Pelephone's own microwave links. Pelephone's UMTS base stations are connected using a hybrid connection (ATM for voice calls through Bezeq's SDH network and IP for data calls through Bezeq's metro Ethernet network).

Pelephone's networks cover substantially all of the population in Israel. Pelephone is continuing to expand and improve the coverage, capacity and quality of its 3.5G UMTS/HSPA+ network. Pelephone's network architecture is based on two mobile telephone switching offices (MTSOs), each one with an IP based core network that can support all the traffic in the network.

In April 2014, Pelephone signed an agreement with Ericsson to upgrade its network center to support LTE, purchase and install radio equipment and implement additional adjustments to the network to support LTE. The equipment to be supplied to Pelephone will also support Advanced 4.5G LTE technology.

In September 2014, Pelephone signed a three-year framework agreement under which Ericsson will be Pelephone's exclusive supplier for expanding the deployment of the 4G LTE radio network. The agreement is an extension of the agreement signed in April 2014 for deploying the first stage of the network.

The cost of establishing the network, including payments to Ericsson and additional costs linked to the deployment and adaptation of the network, is expected to amount to NIS 600 million through 2017, including NIS 96 million paid to acquire frequencies in a governmental auction. In addition, over the coming decade, Pelephone will be required to continue to establish new broadcasting sites, among other things, to comply with the terms of the cellular license.

Under its cellular license and the Wireless Telegraph Ordinance, Pelephone has rights of use of frequencies in the 850 MHz spectrum ( CDMA network), the 850 MHz and 2100 MHz spectrums (UMTS/HSPA network), and in the 1800 MHz spectrum ( LTE technology network).

*Ministry of Communications policy concerning infrastructure sharing*

Pursuant to the recommendations of an inter-ministerial team established by the Ministry of Communications in May 2014, the Ministry published a “Policy for sharing broadband access networks belonging to holders of a general license, for providing mobile radio telephone services,” or the Policy Paper.

The main points of the Policy Paper are:

The Ministry of Communications encourages and will continue to encourage the active sharing of network sites and masts, as well as the active sharing of antennas, among all operators.

In general, the Ministry of Communications believes that in order to streamline the frequency spectrum, the active sharing of antennas, frequencies and radio equipment (multi-operator core network (MOCN)) is preferable to active sharing of antennas and radio equipment without the sharing of frequencies (multi-operator radio access network (MORAN)). However, the Ministry did not rule out the possibility that under special circumstances it would consider it appropriate to approve a MORAN agreement, if requested.

In general, the Ministry of Communications will allow the sharing of transmission from cellular sites to centralized radio-based stations in a bandwidth-sharing configuration, nonetheless, under exceptional conditions, and at the Ministry’s discretion, it may allow sharing of transmission from the cellular sites to centralized radio-based stations as well.

When reviewing individual network-sharing agreements, the Ministry of Communications will take into account the considerations specified in the Policy Paper with regard to four key aspects: (i) the existing level of competition and the potential for harm to the competition; (ii) the existing and expected inventory of frequencies and how efficiently they are being used; (iii) the survivability and redundancy of the networks from the national perspective; and (iv) ensuring the level of telecommunications services over time.

Based on the foregoing, the Ministry outlined guidelines for examining each individual network-sharing agreement submitted for its approval, which provide, among other things, that MOCN-based sharing will not be allowed for two cellular operators with fully deployed 3G networks, but may be considered regarding a new operator with a partially deployed 3G network with an established operator with a fully deployed 3G network, and that the Ministry will allow

MOCN-based sharing, provided that at least three independent wireless access networks are being operated in every region in Israel. Other conditions are also prescribed in the Policy Paper.

The Ministry of Communications does not intend to permit any sharing of radio infrastructure, including shared transmission to radio base stations, between Bezeq Group and HOT Group, which are the only owners of fixed-line infrastructure in Israel.

The Minister of Communications will consider revoking all or some of the network sharing approvals, depending on the circumstances, if it appears that the level of competition, coverage or customer service is harmed.

*Infrastructure sharing agreements and providing right of use of networks*

***Partner - HOT Mobile***

In April 2015 Partner and HOT Mobile announced that the Minister of Communications had approved their agreement to establish a partnership for maintaining, developing and operating a single state-of-the-art cellular network for both companies, in which each company will hold an equal part. Subsequent to the foregoing approval, Partner and HOT Mobile set up a joint company that received a special license to provide cellular radio infrastructure services to a MVNO operator. This license is valid for 10 years.



***Cellcom - Golan Telecom***

In 2014, Cellcom announced that it had signed a 4G network active radio segment sharing agreement with Golan Telecom that had been hosted on Cellcom's network since its establishment. This agreement is in addition to the agreement to provide usage rights on Cellcom's 2G and 3G networks, which was entered into in December 2013. These agreements are subject to the approvals of the Ministry of Communications and the Antitrust Commissioner. Cellcom's announcement also noted that it is continuing its efforts to implement network sharing, including the sharing of the passive components at the cellular sites.

In March 2015 the Minister of Communications announced that the infrastructure sharing agreements between Cellcom and Golan Telecom require essential amendments before the Ministry of Communications would re-examine the agreements in detail.

In November 2015, Cellcom announced that it entered into an agreement to purchase 100% of the shares of Golan Telecom for NIS 1.17 billion. In March 2016, the Israeli Antitrust commissioner informed Cellcom that it is considering opposing the current terms of the proposed purchase of Golan Telecom.

***Pelephone - Cellcom***

In September 2014, Pelephone entered into a collaboration agreement with Cellcom for the maintenance of passive components at the cellular sites owned by the two companies, which is expected to reduce maintenance costs at these sites. The agreement provides for maintenance of the shared sites through a supplier that will be selected by Pelephone and Cellcom. The supplier, which will be chosen through a tender, will sign separate agreements with Pelephone and Cellcom for a period of at least 5 years.

In July 2015, the Antitrust Commissioner determined that the foregoing arrangement will be exempt from the conditions for approval of a restrictive agreement. Pelephone and Cellcom have not yet commenced their collaboration as yet. At present, Pelephone is reviewing a project that would lower the maintenance costs of the passive components by using its own employees.

The infrastructure sharing model provides potential for reducing the costs for establishing and ongoing operation of the network. Consequently, if Pelephone does not receive permission to operate under any network sharing model, the costs of Pelephone's network are likely to be higher than those of its main competitors.

*MVNO - Mobile Virtual Network Operator*

Further to the government's decision to encourage competition in the cellular market, several MVNO licenses were granted to virtual operators. Only a few holders of MVNO licensees operate in the private market, which is dominated by Rami Levy. In October 2015, Pelephone completed the acquisition of a MVNO operator, Alon Cellular Ltd. Some of Alon Cellular's subscribers were hosted on Pelephone's network. As part of the acquisition, Pelephone gained approximately 70,000 new subscribers.

In June 2014, the Ministry of Communications announced that there will be hearing regarding the ruling that in hosting agreements drawn up between cellular operators and MVNOs, the cellular operators may not demand hosting tariffs that are higher than the lowest tariff given to business customers in cellular agreements. Pelephone submitted its objection to this ruling.

*Amendments to Cellular Licenses (consumer related)*

In February 2016, the Ministry of Communications announced that it is proposing 41 amendments to the cellular companies' licenses, all related to consumer relations. Pelephone is reviewing the various issues arising from the proposed amendments and their ramifications.

*Construction and Operation of Sites: Permits, Licenses*

Once a new coverage area has been identified, Pelephone's technical staff determines the optimal base station location and the required coverage characteristics. The area is then surveyed to identify network sites. In urban areas, typical sites are building rooftops. In rural areas, masts are usually constructed. Technical staffs also identify the best means of connecting the base station to the network. Once a preferred site has been identified and the exact equipment configuration for that site decided, Pelephone begins the process of obtaining necessary approvals.

The construction and changing of most of these network sites requires building permits from local or regional authorities, as well as a number of additional permits from governmental and regulatory authorities, such as construction and operating permits from the Ministry of Environmental Protection, permits from the Civil Aviation Authority, in certain cases, and permits from the Israeli Defense Forces.

Pelephone uses software and computer systems, some under purchased licenses and others which were developed by Pelephone's IT department. Many of these licenses are limited in time, and are periodically renewed. The primary systems used by Pelephone are: Oracle Application ERP system and Amdocs customer management and billing

system.

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*ISP, ILD, Domestic Services and ICT (Bezeq International)*

In December 2011, Bezeq International completed the deployment of a new high-speed submarine optical fiber communications cable system connecting Israel and Europe, which was launched in January 2012 and has increased bandwidth (capacity and speed) at affordable rates and positioned Bezeq as the sole Internet service provider in Israel to own and operate such infrastructure. This high-speed optical fiber system named JONAH, covers 2,300 kilometers across the Mediterranean, is fully redundant (i.e., utilizes two equipped fiber pairs) and leverages Alcatel-Lucent's advanced submarine communications networking technology. The cable system can operate at 100 gigabits-per-second data transmissions to enable data capacity of over 7.0 Tbps between Tel Aviv and Bari, Italy. This ultimate data capacity could allow the simultaneous download of 100,000 MP3 files in one minute and the streaming of 15,000 HDTV channels. The system integrates Alcatel-Lucent OALC-5 cable, optimized with coherent submarine fiber (CSF), repeaters and the 1620 Light Manager submarine line terminal which is designed to accommodate 10G/40G/100G wavelengths in the same platform, enabling seamless capacity upgrades on a flexible grid for channel spacing without traffic interruption. This solution, which features advanced optical coherent technology, offers a pathway to multi-terabit capacity using 100G channels, far exceeding the maximum capacity achievable with 40G. This protects the investment from the risk of obsolescence or capacity limitations due to changes in transmission technology. Bezeq International's submarine optical fiber communications cable is extended from Bari terrestrially through Interoute's network to major European cities such as London, Frankfurt and Milan.

In parallel with the completion of the deployment of JONAH in the fourth quarter of 2011, Bezeq International invested in the purchase of a submarine fiber pair connecting Israel to Cyprus, known as the ARIEL cable, which extends to Marseilles, France via the ALEXANDROS submarine cable. In addition, Bezeq International holds multiple 10Gbps capacity indefeasible rights of use via the MedNautilus submarine cable system.

Bezeq International's capacity on the JONAH, ARIEL and MedNautilus submarine cables allows the delivery of faster connectivity to Israel and the Mediterranean region, fostering the delivery of innovative IP-based services for which capacity and speed are critical elements to meet end-users' demand. Bezeq International is the only telecom operator in Israel that provides three different routes of multiple 10Gbps to Europe.

In July 2014, Bezeq International launched the "Bigger" service for the business sector in which it offers an innovative digital platform for managing the marketing and advertising of small and medium size businesses.

*PBX services*

Bezeq International markets and maintains communication systems for the entire Israeli market, and PBX exchanges, telephony networks and IP communications, mainly for its business customers. As part of its service contracts, Bezeq

International provides maintenance services for various PBX exchange manufacturers. These include services for gateways, PBX exchanges and network end points (NEP) for lines used as both internal and external lines.

The following table provides a breakdown of Bezeq International's revenue (in NIS millions) over the last three years:

	2015	2014	2013
Voice services	379	395	401
% of total revenue	24.02%	26.26%	27.98%
Revenue from business Internet and telecommunication services (ISP, PBX, ICT, data)	1,199	1,109	1,032
% of total revenue	75.98%	73.74%	72.02%
Total revenue	1,578	1,504	1,433

The following table provides a breakdown of revenue to private and business customers (in NIS million) over the last three years:

NIS million	2015	2014	2013
Revenue from private customers	555	529	535
Revenue from business customers	1,023	975	898
Total revenue	1,578	1,504	1,433

*Multi-Channel Pay Television (DBS)*

DBS is the sole DTH provider in Israel. DBS uses space segments from the Amos 2 and Amos 3 satellites, operated by Spacecom. DBS is currently using 12 space segments (ten space segments on Amos 2 and two space segments on Amos 3). In November 2013, DBS entered into an agreement with Spacecom, extending the leases for space segments leased on the Amos 2, Amos 3 and Amos 6 satellites or another satellite to be agreed between the parties, until the end of 2028.

DBS operates a hybrid platform of satellite and IPTV OTT. DBS's IP platform, based on progressive download technology, enables DBS to provide its VOD service, which was launched in March 2010 using OTT technology, with a versatile and user friendly interface in HD quality incorporated into the electronic program guide.

As of December 31, 2015, DBS offers 150 television channels including 20 HD channels transmitted over 12 space segments (36 MHz each) on Amos 2 and 3. The main uplink site in Kfar Saba transmits content over eight carriers, while the secondary site of RRsat Global Communications Network Ltd., or RRsat, transmits content over four space segments. Up to six transport-streams can be transferred from the main site of DBS to its secondary site and be uplinked from RRsat. Ten transport-streams are transmitted using MPEG2 and DVB-S parameters and the two HD transport-streams are transmitted using MPEG4 and DVB-S2 standards.

DBS owns the satellite dishes and other endpoint devices that carry and receive the signals from such satellites to subscriber residences and set-top boxes. In addition, DBS leases some of the set-top boxes and cards that decode the coded signals received from the satellite to its subscribers, while other set-top boxes and cards are provided to subscribers for a deposit (an immaterial number of set-top boxes are sold to subscribers).

Additionally, DBS offers an extensive VOD library based on an OTT content solution, making it accessible to all households with an Internet connection with bandwidth of at least 2.5 Mbps. The VOD platform is comprised of transport-streams which reside in DBS's data center and components which reside in two points of presence ("POPs") of two ISPs.

*Competition in the Israeli Telecommunications Market*

The telecommunications industry in Israel has developed rapidly in recent years, both the technology and regulations governing the industry, and is expected to continue to undergo significant changes. As a result of consolidation in recent years, competition has become concentrated among large telecommunication groups operating in most, if not

all, of the segments of the telecommunications market. The Israeli telecommunications market is dominated by four main groups, the Bezeq Group, the Cellcom Group, the HOT Group and the Partner Group, each of which have interests in some or all of the main telecommunications segments in Israel.

*Cellcom Group.* The Cellcom Group provides communications services through Cellcom and its wholly-owned subsidiary, Netvision. These companies provide cellular telephony services (including cellular Internet), fixed-line telephony services (mainly to business customers) through Cellcom's own infrastructure and fixed-line telephony services using VoB technology, transmission and data communication services for business customers through Cellcom's own transmission network, ISP services and international telephony services. In December 2014, Cellcom launched an Internet-based television service which includes VOD services, Internet content and the integration of the Idan+ channels.

*HOT Group.* The HOT Group provides communications services through HOT and its wholly-owned subsidiaries HOT Mobile, HOT Net and HOT Telecom. The HOT Group owns a cable infrastructure deployed nationwide and provides multi-channel cable television services, as well as fixed-line telephony services, cellular telephony services, ISP services and transmission and data communications services.

HOT provides a range of communication services and interactive applications over its Internet infrastructure which is deployed throughout Israel. This network is the principal alternative to Bezeq's infrastructure in the private sector. The upgrading of the infrastructure and the service bundles marketed by the HOT Group, and the Ministry of Communication's decision regarding the cancellation of NDSL services, increased the level of competition. The HOT Group is subject to limitations of structural separation which are generally less stringent than those that apply to the Bezeq Group. While HOT was compelled to provide wholesale services, including BSA services, it does not yet actually provide them.

#### *Competition from ISPs and Telecommunication Companies*

The operation of the wholesale market enables ISPs and telecommunication companies (holders of a single license) to offer customers service bundles that include also Internet infrastructure based on the infrastructures and services of Bezeq (in exchange for supervised tariffs that will be paid by the telecommunication providers to Bezeq).

*Competition from the Partner Group*

The Partner Group provides communications services through Partner and its wholly-owned subsidiary, 012 Smile, which provide cellular telephony services (including cellular Internet), fixed-line telephony, transmission and data communications, ISP services, international call services and fixed-line telephony using VoB technology.

*Internet*

In April 2015, a network sharing agreement was signed between Partner and HOT Mobile. Partner and HOT Mobile subsequently established a joint company that received a special license to provide cellular radio infrastructure services to a cellular operator. The Antitrust Commission's approval was granted with conditions stipulating that HOT Telecom will refrain from limiting or blocking the option given to customers to use any service or application provided on the Internet at any time, directly or indirectly, including by setting rates or through technology, and that HOT Telecom's Internet infrastructure services will be sold and supplied under equal terms to all its customers, whether they purchase additional communication services from HOT or not.

Other operators in the market include Golan Telecom, MVNO cellular operators, international operators and ISPs, including service providers in the wholesale market.

Recently, the use of "service bundles" (packages including various combinations of several different communication services) has increased. Communications groups market, or are likely to market in the future, "joint" service bundles consisting of different communication services of the companies in each group. As a rule, the marketing of joint bundles enables the communications group to offer its customers tariffs that are more attractive than purchasing each service separately (in some cases with "cross-subsidization" among the bundle's components), and a total solution that does away with the need for subscribers to use a number of different providers. These trends are strengthening with implementation of wholesale BSA services that allow operators that do not own infrastructure and operators are not part of a communications group to offer a full end-to-end service package (including infrastructure) to their customers.

Unlike the other communications groups, Bezeq Group is currently subject to the stricter restrictions described below.

The convergence trend has strengthened due to the Minister of Communications' decision of November 17, 2014 to allow unified general license holders to provide all services previously provided under specialist domestic carrier, mobile virtual network operator (MVNO), international service, ISP service and NEP service licenses under their unified general license. According to the decision, communications groups holding more than one MVNO,



international services, special general domestic carrier licenses, or a unified license may apply to obtain a single license for the group of services, unless the Ministry approves a deviation from this principle. Unified licenses have been granted to an increasing number of operators, including 013 Netvision, Xfone, Golan Telecom Cellcom Fixed Line Communication and Partner Fixed-Line Communication Solutions.

In August 2014, Pelephone launched a LTE network to provide LTE technology 4G services using a 5 MHz frequency bandwidth within the 1800 MHz spectrum it received from the Ministry of Communications.

In January 2015, Pelephone participated in a governmental tender for the allocation of 4G (LTE) frequencies. Under the tender, Pelephone received 15 MHz within the 1800 MHz spectrum. The frequency allocation was issued in August 2015. Pursuant to the provisions of the tender, receipt of a license for the frequencies is contingent upon an amendment to the existing license. Under the license amendment, the requirements regarding deployment and quality of service through the 4G network are more stringent as compared with the previous standards. Further deployment of the network is currently underway.

*New Fixed-Line Infrastructure Company.* In August 2013, IBC, a telecommunications joint venture between the government-owned IEC and a consortium of non-government companies that was selected by the IEC in a tender procedure, was granted a general license for the provision of telecommunications infrastructure services (including data services, digital transmissions and VPN) via fiber optic networks to telecommunication services providers. According to the license, IBC will enter into an agreement with the IEC to use the IEC's fiber optic network in Israel to provide such wholesale products to telecommunication services providers. If IBC is successful, it would compete with Bezeq and HOT in the wholesale market, as well as providing such services directly to large business customers. IBC has begun operating in several cities and announced its intention to begin operating in additional cities in 2015. The number of IBC subscribers is currently insubstantial.

### *Fixed-Line Telephony Services Market*

The fixed-line telephony segment has been characterized by a decline in demand and in prices in recent years. The decline in demand is reflected in the decline in the number of existing fixed telephone lines and in a gradual erosion of the number of calls originating in fixed-line networks. Bezeq believes that this trend is primarily due to the rise in the number of cellular subscribers and the volume of use of cellular telephones in the comprehensive call-minute packages the cellular companies have marketed extensively over the last few years (Bezeq estimates that 80% of all calls originate in the cellular network), and from an increase in VoIP calls. In 2015, the number of Bezeq fixed lines declined by about 0.1% (compared with a decline of 0.5% in the number of lines in 2014). Likewise, the number of call minutes (incoming and outgoing) declined by 7% on Bezeq's fixed telephone lines compared with 2014. The average monthly revenue per phone line declined by approximately 5%.

HOT is Bezeq's main competitor in fixed-line telephony. In addition to Bezeq and HOT, fixed-line telephony services can also be purchased from providers of VoB services (a service that allows users to make and receive telephone calls over the Internet through an Internet connection).

The fixed-line telephony market in Israel is also characterized by:

**Pricing Pressure:** The price erosion experienced in recent years has been partly driven by a reduction in termination rates and the increase in competition, including from cellular telephony operators that introduced unlimited packages in 2012, resulting in the decline of fixed-line telephony average revenue per line in Bezeq and HOT's networks.

**Commoditization:** In recent years, fixed-line telephony services have been largely commoditized and uptake has become increasingly dependent on a quality broadband Internet offering by the same provider, or the overall attractiveness of the bundled offerings, which, mainly in the case of bundles offered by Bezeq's competitors, may combine fixed-line telephony with one or more of broadband Internet access, cellular telephony and pay television services. However, while usage of fixed-line telephony is declining, high penetration rates of fixed line telephony services are being maintained.

**Growing Enterprise Data Services:** The enterprise segment has shown an increase in consumption of transmission and data communications services that have partially compensated for the overall decline in fixed-line telephony usage.

**Technology Convergence between Communications Systems:** The transition to solutions based on IP protocol promotes technology convergence between the different communications systems and penetration of integrated products, facilitating various communications solutions on one handset (e.g. cellular and fixed-line telephony on one handset).

*Internet Access-Infrastructure and ISP Services*

Internet service in Israel is structured into two separate elements comprised of infrastructure, or network access services, and ISP services. Infrastructure access service relates to access to the physical network infrastructure within Israel that is required to connect the customer's device to the infrastructure access service provider. This service is provided exclusively by Bezeq and HOT, the only telecommunications operators in Israel that own a national fixed-line network infrastructure. ISP services, which can be provided by any licensed provider, consist of providing customers access to the local and global Internet network utilizing the infrastructure of Bezeq or HOT. ISPs generally also provide certain value-added services such as data protection services, security solutions, e-mail services and system administration services. Accordingly, a customer wishing to subscribe to Internet services in Israel effectively must purchase both fixed-line broadband Internet infrastructure access services and ISP services and retains the choice with regards to the provider of each service.

*Fixed-Line Broadband Internet Infrastructure Access Services Market*

The numbers of subscribers in the Internet segment has continued to grow in recent years. In 2015, there was a 4% increase in the number of fixed-line Internet subscribers in Israel. Furthermore, the Internet segment is characterized by an increase in surfing speeds and by the adoption of advanced services and value-added applications. In 2015, against the background of introduction of bitstream access, an increase of 8% was recorded in the number of Bezeq's subscribers (retail and wholesale) compared to 2014. At the end of 2015, there were 244,000 Internet subscribers on the wholesale platform, amounting to 17% of Bezeq's Internet subscribers). Average monthly revenue per Internet subscriber (retail) increased by 5% compared with 2014. In 2015, Bezeq began providing wholesale BSA services and as of December 31, 2015, Bezeq had 250,000 wholesale Internet lines in its network.

HOT provides broadband services through a hybrid fiber coaxial cable (a broadband network which combines optical fiber and coaxial cable).

*Wholesale Market Regulation.* Following hearings in January, August and November 2014, the Minister of Communications amended the licenses of Bezeq and Hot Telecommunications and delineated the basket of services under the licenses, i.e., managed broadband access and wholesale telephony services. The regulations attached to the Minister's decision contained the obligation to provide the services, including accompanying services and the regulation of maximum rates (which require the Finance Minister's approval) for the provision of the wholesale services. Bezeq expects that the implementation of the wholesale services regulation in the manner specified above could adversely affect its results of operations; however, the possible cancellation of the structural separation and supervision over Bezeq's fees as a result of the wholesale market regulation could positively impact Bezeq. In December 2014, Bezeq filed a petition with the Israeli High Court of Justice, or the High Court of Justice, to cancel the decision, and consequently to cancel the amendment of Bezeq's license, the regulations prescribing the obligation to provide the services and the regulation of the maximum rates for the wholesale services, and to schedule an urgent hearing on the petition.



In a hearing on the petition that took place in March 2015, the Court ordered the parties to return to the negotiation table to discuss various matters that arose in the petition and to notify the Court within 60 days of the outcome. In April 2015, Bezeq received a letter from the Ministry of Communications stating that the Ministry believes that the provision of wholesale telephony services can in fact be implemented with small adjustments, within a short period of time and at minimal cost to Bezeq. The Ministry also suggested possible technological solutions for providing the service. While the Ministry expected that Bezeq would prepare for the provision of the service by May 17, 2015, Bezeq rejected the statements in the letter and sent a detailed response to the Ministry. In its response to the Court, Bezeq rejected the statements of the Ministry of Communications and asserted that: the various solutions proposed by the Ministry for providing telephony services in the wholesale market were not technologically feasible and that the tariffs determined by the Ministry of Communications for the provision of such services were unreasonable. Another hearing took place in October 2015.

On December 10, 2015 the Ministry of Communications published a hearing in the matter of “The Provision of Telephony Services via Resale on the Bezeq Network.” A draft amendment to Bezeq’s general license was attached to the hearing document, addressing the addition of telephony service to the license, in a resale format. The service enables the holder of a general license that is authorized to provide domestic landline operating services, to purchase telephony services from the company, such that will facilitate the sending and receiving of phone calls and the provision of accompanying and value added services provided by the company, as much as possible, in such a manner that the service provider’s subscriber will not discern that he is receiving service through Bezeq, other than with respect to technical support. In this framework the service provider may bundle packages that are marketed to its subscribers in any format whatsoever.

At the hearing the Ministry stated that is considering to allow Bezeq to offer the service as an interim solution for a limited period of one year from the date of the decision at the hearing, following which Bezeq will provide wholesale telephony service. It was further stated at the hearing that the service will be provided immediately after the determination of the operating arrangements with the providers, as the provision of services does not require preparations or changes to Bezeq’s engineering systems, but rather only to the IT systems.

### *ISP Market*

While only Bezeq and HOT provide broadband Internet infrastructure access services in Israel), many telecommunications companies hold ISP licenses, including Bezeq International, 013 Netvision (which merged with Cellcom), 012 Smile (which merged with Partner), HOT Net (a subsidiary of HOT) and numerous minor niche players. Bezeq International’s estimated market share of the ISP market, based on the number of subscribers, was 44% as of December 31, 2015 compared to 42% as of December 31, 2014. The Israeli ISP market is a saturated market and as competitors are typically unable to differentiate themselves based on price, they attempt to differentiate themselves primarily by strengthening customer loyalty; however, competition has led to increased churn rates.

*Broadband infrastructure and ISP Services Markets Trends*

The Internet access market in Israel is characterized by:

**Increasing Broadband Speeds:** Israeli Internet consumers continue to demand increased Internet bandwidth speeds.

**Slow-Down in Market Growth Rates:** Despite the fact that the Israeli fixed-line broadband Internet infrastructure access services market is still growing in terms of the number of subscribers, the increase in penetration rate is slowing compared to previous years as a result of the high penetration levels in the market.

**Increasing Adoption of Services and Value-Added Applications:** Advanced and value-added services, such as data protection services, e-mail, anti-virus and cloud services, are increasingly becoming differentiators in the market, and are believed to enhance customer loyalty and reduce churn rate.

*Cellular Telephony Services Market*

The Israeli cellular telephony market is mature and highly competitive. Three cellular telephony operators, Cellcom, Partner and Pelephone, have historically led the Israeli cellular telephony market. The cellular market growth rate is lower due to “penetration rate” saturation. Penetration rate is the ratio between the number of subscribers in the market and the total population in Israel (excluding foreign workers and Palestinians, although they are included in the number of subscribers). The penetration rate at December 31, 2015 is 124%.

The Israeli cellular telephony market is characterized by a dominant post-paid market (i.e. purchased subscriptions rather than use of pre-paid cards).

In 2015, the trends that began in 2012 continued with increased competition in the Israeli cellular communications market. The entry of the new infrastructure operators, Golan and Hot Mobile, and to a lesser extent the activity of virtual cellular operators, resulted in the erosion of prices and the continued high level of mobility of customers between the companies.

Cellcom and Partner operate nationwide cellular networks based on GSM, UMTS/HSPA and 4G technologies. HOT Mobile and Golan Telecom are able to utilize the existing operators’ networks based on a national roaming model for a period of up to seven years from the launch of their operations (with an option to extend such period for another three years, subject to regulatory approval). HOT Mobile and Golan Telecom have yet to complete the rollout of their networks. HOT Mobile currently uses national roaming services provided by Partner, and prior to 2015, it used national roaming services provided by Pelephone. Golan Telecom uses the national roaming services provided by Cellcom.

In addition, following measures taken by the Israeli government to encourage competition in the cellular telephony market, 11 MVNO licenses were granted by the Israeli government. We believe that only four of the MVNO licensees currently provide services: Rami Levy (which signed hosting agreements with Pelephone), Alon Cellular (whose customers have subsequently been acquired by Pelephone), Azi Communications (which signed a hosting agreement with Pelephone and Partner) and Home Cellular (which signed a hosting agreement with Cellcom). A fifth MVNO, Cellact, signed a hosting agreement with Pelephone.

The main trends that characterize the cellular telephony market in Israel are:

*Increasing Competition, Followed by Potential ARPU Stabilization.* The entry of the new operators as a result of regulatory changes, together with regulations banning exit fees and reducing interconnect fees, led to intensified competition in the cellular telephony market in Israel. Golan Telecom and HOT Mobile had a strong incentive to obtain market share, as depending on their market share after the grant of their license, they could have been required to pay a license fee of up to NIS 360 million and NIS 710 million, respectively. These developments resulted in higher churn rates among the existing operators and a significant decrease in tariffs. In November 2013, HOT Mobile was notified by the Ministry of Communications that as a result of meeting certain market share targets, the vast majority of its guarantee is reduced. We believe that Golan Telecom is expected to receive similar notification in the near future.

*Changing Pricing Dynamics.* Partly as a result of intensified competition, during 2012 the manner of pricing services in the cellular telephony market changed significantly. Instead of charging subscribers for actual usage, the cellular telephony operators are primarily offering packages with unlimited usage. The increased competition and change in the format of the communication packages led to a significant decrease in ARPU and higher churn rates.

*Increasing Demand for Data Transfer Services.* The penetration of smartphones has led to a rise in the supply of alternative applications and services, resulting in a higher level of consumption of data transfer services. The increasing demand for data transfer services has the potential to offset, in part, revenue shortfalls from traditional voice services. In addition, there has been an increase in the rate of use of smartphones that support LTE technology, a technology that allows better browsing. This increase has led to a further increase in consumption of 4G Data.

*LTE Technology.* LTE technology, which is based on an Internet Protocol that can transfer data at higher speeds than the existing Generation 3.5 technology, is used by many operators around the world and is now supported by many smartphones in operation in the Israeli market. In March 2012, the Ministry of Communications published a work plan with respect to the introduction of LTE technology. The Ministry of Communications issued a tender for allocating LTE frequencies in 2014 and Pelephone was awarded 15 MHz on the 1800 frequency band. Pelephone also entered into network sharing arrangements for 4G networks with Cellcom and Golan Telecom, similarly to an agreement reached by Partner and HOT Mobile, both subject to governmental approvals, including the Israeli Antitrust Authority. Technological developments in the area of LTE, could have a significant effect on the market.

In January 2015, Pelephone participated in an online tender held by the State of Israel for the allocation of 4G LTE frequencies. Under the tender, Pelephone was awarded 15 MHz of bandwidth within the 1800 MHz spectrum, at a total cost of NIS 96 million. In August 2015, Pelephone was notified that its license was amended to include the 4G LTE frequencies and those frequencies were allocated.



*Network Sharing Agreements.* In December 2013, Pelephone entered into a network sharing agreement for the construction and operation of a shared 4G network with Cellcom and Golan Telecom for a term of 15 years with an option to extend for an additional 15-year term, and an agreement with Cellcom for the sharing of passive components of cell sites on each company's existing networks for a term of 15 years. The agreements are expected to provide significant cost savings and reduced capital expenditure requirements with respect to the deployment and maintenance of an LTE network, as well as with respect to the maintenance of existing UMTS network. The network sharing arrangements are subject to approvals by the Israeli authorities, including the Israeli Antitrust Authority. The December 9, 2013 agreement followed the November 2013 announcement by Partner and HOT Mobile that they had entered into a 15-year network sharing agreement. On May 15, 2014, the Ministry of Communications published a paper on "policy for sharing the broadband access network of a holder of a general license for the provision of mobile radio-telephone services." From Pelephone's review of the Policy Paper, it emerges that the sharing agreement apparently does not comply with the threshold terms included therein.

In September 2014, Pelephone entered into a cooperation agreement with Cellcom for maintenance of the passive components at their cellular sites, including uniting passive components and reducing costs through a joint contractor. The agreement provides for maintenance of the shared sites through a supplier that will be selected by Pelephone and Cellcom. The supplier, which will be chosen through a tender, will sign separate agreements with Pelephone and Cellcom for a period of at least 5 years.

In July 2015, the Antitrust Commissioner resolved that the foregoing engagement will be exempt from the conditions for approval of a restrictive agreement. Pelephone and Cellcom have not yet, at this stage, executed the engagement in practice. At the same time, Pelephone is reviewing the implementation of a project to lower the maintenance costs of the passive components by using Pelephone's employees.

As part of the regulatory measures adopted by the Ministry of Communications since 2012 with the aim of increasing competition in the cellular telephony market, several additional cellular operators entered the market. The entry of the new operators led to substantial increase in competition among all the cellular operators. The increased competition led to an increase in subscriber churn among the existing operators and to a fierce price war that intensifies from year to year, leading to substantial erosion of prices and profit margins in the private customer market as well as in the business customer market. This trend continued and even intensified in 2015.

Pelephone expects this trend to continue in 2016, leading to further reduction in revenues and profitability. Pelephone is introducing streamlining measures and cost structure adjustments in an effort to reduce the impact on its profit margins.

The table below provides a breakdown of the number of subscribers of Pelephone and its competitors in 2014 and 2015 (thousands of subscribers, approximate).

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		Golan							MVNOs	Total subscribers in market
		Pelephone	Partner	Cellcom	Telecom	HOT Mobile		(1)		
December 31, 2014	No. of subscribers (2)	2,586	2,837	2,967	630	974		130	10,124	
	Market share	25.5 %	28.0 %	29.3 %	6.2 %	9.6 %		1.3 %		
December 31, 2015	No. of subscribers (2)	2,651	2,718	2,835	850	1,229		80	10,363	
	Market share	25.6 %	26.2 %	27.4 %	8.2 %	11.9 %		0.8 %		

(1) Golan Telecom and most of the other MVNOs are private companies that do not publish figures regarding the number of their subscribers and these figures are based on estimates.

(2) The number of subscribers as of September 30, 2015 and December 31, 2014, are based on the public reports issued by Cellcom, Partner and HOT Mobile.

*ILD Market*

As of December 31, 2015, there are eight competitors in the market, including 014 Bezeq International, 013 Netvision, 012 Smile, Golan Telecom and Hot Mobile International Communications. Bezeq International estimates that its market share for outgoing international calls as of December 31, 2015 was 21% compared with a market share of 23% as of December 31, 2014. A new competitor entered the international telephony market when the mobile app WhatsApp launched its call service in April 2015.

*Pay Television Services Market*

Israel's primary television platforms are dominated by pay television, with relatively limited penetration of free platforms such as terrestrial television or free DTH. Approximately 70% of the households in Israel subscribe for multi-channel pay television services from either DBS, which provides multi-channel satellite pay television services, or HOT, which provides multi-channel cable pay television services (Source: Informa Telecoms & Media). DBS, the only company licensed to provide multi-channel pay television broadcasts via satellite to subscribers in Israel, provides encoded and digital multi-channel broadcast services as well as other services. HOT, which provides cable pay television services, focuses its marketing strategy on offering bundles that include multi-channel pay television broadcast services together with other services such as ISP and fixed-line broadband Internet infrastructure access services (known as a "triple play").

Television viewers in Israel are also able to receive free television services through DTT, a terrestrial implementation of digital television technology using an aerial to broadcast to a conventional television antenna (or aerial) instead of a satellite dish or cable television connections. In August 2009, the Second Authority, the public authority that supervises commercial broadcasting in Israel, launched DTT broadcasts on a nationwide basis, enabling the free distribution to the public of five DTT channels free of charge upon purchasing a set top box. DTT currently offers access to only six channels, there is currently no access to premium or thematic content (such as sports, movies or children's programming) and it has no interactive functionalities (such as VOD). DTT has limited capacity to transfer a significant number of channels simultaneously and quality can be affected by the weather. However, pursuant to recent legislation, the DTT array may be expanded to include additional channels (including, among others, channels dedicated to specific themes and HD versions of any of the channels included in the DTT array) and the DTT system may be operated by a private entity instead of the Second Authority, and consequently, DTT could become more attractive in the future.

The transmission of video content over additional communication infrastructures has led to an increase in the amount and range of video content accessible to the public (whether with or without authorization from the holders of title to the content) and to a change in the format in which downloaded content is used for streaming. Viewing the content is by means of various items of terminal equipment, among them computers, televisions, tablets, and mobile phones. This trend allows diverse video content to be provided without the need for establishing specific network

infrastructure (including by international entities) and at present, without regulatory supervision. In December 2014, Cellcom launched its Cellcom TV service, allowing VOD viewing through a special decoder, via the web, as well as DTT content. To the best of DBS's knowledge, other entities are considering launching similar services. The establishment and development of such services could substantially affect competition in the broadcast sector, which is currently based on designated infrastructures, and this effect could intensify if the provision of such content continues without regulatory supervision.

Historically, Bezeq was not allowed to control DBS or offer bundled services that include pay television services. On March 26, 2014, the Israeli Antitrust Authority issued a decision which provides that upon the fulfillment of certain terms, the restrictions imposed on the Eurocom Group with respect to its ownership interest in DBS would be removed and Bezeq's merger with DBS would be allowed. On June 23, 2015, the Ministry of Communications approved the transfer of the means of control in DBS to Bezeq allowing it to obtain 100% control of DBS. Bezeq paid Eurocom DBS NIS 680 million in consideration for the entire holdings of Eurocom DBS in DBS and acquired all the shareholder loans provided by Eurocom DBS to DBS on June 24, 2015. At such time, the director designee of Eurocom DBS to the board of DBS resigned.

In December 2014, Cellcom began providing its Cellcom TV services.

The penetration rates of DBS and HOT are estimated by DBS to be approximately 62% of households in Israel. DBS has indicated that it believes that its chances of penetrating an additional material segment are not high because most of the remaining households are not potential customers for DBS and HOT and have available alternative services to their services. Therefore, there has not been any significant change in the number of subscribers of DBS and HOT in recent years, mainly due to the increasing availability of alternative products. However, in 2015, there was a moderate increase in DBS's share of this market. An increase in the number of subscribers may be accomplished mainly by recruiting subscribers from the competition and recruiting new subscribers following the natural growth in the number of households. The broadcasting sector is characterized by fierce competition, which requires an investment of substantial resources to retain existing subscribers and recruit new ones. In addition to Cellcom entering the sector, in 2015, there was also an increased consumption of pirated broadcasts.

The following table provides a breakdown of DBS and HOT subscriber numbers and market shares to the best of its knowledge, at December 31, 2013, 2014 and 2015.

2015	Market share	2014		2013	
		Subscribers (in thousands)	Market share	Subscribers (in thousands)	Market share
Subscribers (in thousands)					
635	44%	630	42%	600	40%

## Regulatory

### *Permit to Control Bezeq Granted to Members of the Eurocom Group*

The Israeli Communications Law and the Communications Order provide that the control over Bezeq requires a control permit from the Ministers.

As part of the acquisition of the controlling interest in Bezeq, we, B Communications, SP2, SP1, and other members of the Eurocom Group applied for authorization to control Bezeq, pursuant to the Israeli Communications Law and Communications Order. On April 13, 2010, the Control Permit was granted subject to the condition that SP2 is controlled exclusively by the other parties to the control permit. Concurrently, a separate control permit was also granted to Messrs. Shaul Elovitch and Yossef Elovitch, our controlling shareholders (the “Individuals’ Control Permit”). According to the Communications Order, B Communications was not allowed to transfer the control or any Means of Control which will result in a decrease of its minimum holding requirement in Bezeq (30%) without the prior consent of the Ministers. The foregoing includes a transfer of the Bezeq interest in one transaction or a series of transactions, by one party or together with the other parties to the Control Permit or the parties to the Individuals’ Control Permit. However, the parties may transfer the Means of Control of Bezeq among themselves, subject to compliance with certain conditions set forth in the Control Permit.

According to the Control Permit, the parties (through SP2) must hold not less than 30% of any type of Means of Control (as described below) of Bezeq. Such percentage is permitted to decrease below 30% to no less than 29% for a period of six months, in the event of dilution resulting from the exercise of stock options by Bezeq employees. However, the Communications Order prohibits issuance of shares which will result in a decrease of the minimum holding requirement in Bezeq (30%) or the ceasing to control Bezeq without the prior consent of the Ministers (certain permitted issuances do not require the Minister’s prior consent). According to Article 3(a3) of the Communications Order, which is included as part of the Control Permit, the parties to the Control Permit may hold less than 30% under certain circumstances, including the requirement that the parties control Bezeq and maintain at least a 25% ownership interest in Bezeq. Accordingly, the parties are entitled to sell a portion of their Bezeq shareholdings to the extent they

will retain at least 25% of the outstanding Bezeq shares, and no amendment to the Control Permit or the indenture governing our 7% Senior Secured Notes is necessary or required to sell Bezeq shares as long as the parties retain in excess of 25% the ownerships interest in Bezeq.

In accordance with the Control Permit, SP2, which holds the Bezeq shares is required to notify the Ministers of any changes in the composition of its board of directors every six months and if the change represents half or more of the members of the board of directors, within 30 days of the change. We and B Communications are also required to notify the Ministers of any "Exceptional Holdings" in Bezeq (as described below) immediately upon becoming aware of such event. We and B Communications are also required to notify the Ministers in the event a shareholder becomes a "principal shareholder" (namely, holds, directly or indirectly, over 5% of our issued and outstanding share capital) and regarding any 1% or more change in the holdings of a "principal shareholder" within 48 hours of becoming aware of such change. Our Articles of Association require our shareholders to notify us within a specified period of time after crossing any such threshold.

Under the Communications Order, no person may hold, directly or indirectly, "significant influence" over Bezeq or 5% or more of any particular class of Means of Control in Bezeq. The Communications Order defines "holding" as the holding, acquisition, transfer and encumbrance of the Means of Control in Bezeq, defines "significant influence" as the ability to substantially influence the activity of a company, either alone or together with others or using others, directly or indirectly, which arises by virtue of the possession of Means of Control therein or in another corporation, including where such ability is pursuant to the corporation's articles of association, or pursuant to an agreement (whether written or oral) with the controlling shareholder. "Means of Control" is defined under the Communications Order as the right to vote at a general meeting of the company, to appoint a director or general manager of the company, or to participate in the profits of the company or a share of the remaining assets of the company after payment of its debts upon liquidation. Additionally, no person, together with any other person, appoint, elect or dismiss the general manager of Bezeq or cause the election, appointment or dismissal of any director of Bezeq, without the prior written consent of the Ministers. A person shall be deemed to have "significant influence" if (i) he has the right to appoint a director or the chief executive officer; or (ii) if that person holds 25% or more of the Means of Control of a corporation. Additionally, no person, together with any other person, may appoint, elect or dismiss the general manager of Bezeq or cause the election, appointment or dismissal of any director of Bezeq, without the prior written consent of the Ministers.

Subject to certain exceptions, prior written approval of the Ministers is also required to increase the holdings or other rights in excess of those determined in the initial approval, including by means of an agreement (including a voting agreement). Furthermore, under the Communications Order, no person may transfer control, “significant influence” or Means of Control in Bezeq to another, if, as a result of the transfer, the holdings of the transferee would require approval pursuant to the Israeli Communications Law or Communications Order and the transferee is not in possession of the requisite approval. Any such unauthorized holding or acquisition is referred to as “Exceptional Holdings.”

The Communications Order provides that in the event that a person holds “significant influence” or Means of Control in Bezeq, to a degree that requires the Ministers’ prior approval, without receiving prior approval for such Exceptional Holdings (including as a result of the realization of a pledge over Means of Control), such person must report such Exceptional Holdings in writing to Bezeq and must submit an application to the Ministers for approval of such Exceptional Holdings all within 48 hours. Such application is required to be in the form of the questionnaire annexed to the Communications Order and must be accompanied by a power of attorney authorizing Bezeq’s board of directors to sell the applicant’s Exceptional Holdings (unless the Ministers have granted an exemption from providing a power of attorney). Following the submission of the application and all relevant documents, the Ministers have 60 days to inform the applicant and Bezeq as to their decision.

In addition to the possibility of obtaining a retroactive approval as described above, the Communications Order establishes the following procedure for the sale of Exceptional Holdings: (i) with respect to a person who has not applied for approval by the Ministers, as described above, such person must sell his Exceptional Holdings within seven days; (ii) with respect to a person whose permit has been revoked or has expired, and who has not submitted a new application, such person must sell his Exceptional Holdings within 14 days after the date of the revocation or expiration, as the case may be; and (iii) with respect to a person who has applied for approval by the Ministers, including a party whose permit has been revoked or has expired and who has submitted a new application, and whose application has been rejected, such person must sell his Exceptional Holdings within 60 days after the date on which the Ministers informed such person that his application has been rejected. If a person does not sell his Exceptional Holdings as detailed in sub-sections (i)-(iii) and Bezeq holds a power of attorney from such person as required by the Communications Order, Bezeq will sell the Exceptional Holdings within 60 days, on a stock exchange, in Israel or abroad, or through an off-exchange transaction. The proceeds of the sale will be delivered to the holder, less expenses involved in the sale.

In accordance with the Israeli Communications Law and Communications Order, and as set forth in our Articles of Association, a holder of Exceptional Holdings (including a holder that submitted an application for approval which was submitted to the Ministers, whether such application was rejected or has not yet been approved) will not be entitled to any rights in respect of its holdings in Bezeq, including with regard to the receipt of dividends, unless and to the extent permitted under the Communications Order. Accordingly, a holder of Exceptional Holdings will not have any voting rights at a general meeting of shareholders. Each shareholder participating in a general meeting of shareholders is required to certify to us prior to the vote or, if the shareholder is voting by a proxy or any similar instrument, on such proxy card or similar instrument, as to whether or not his holdings in our company or his vote require the approval of the Ministers pursuant to the Israeli Communications Law and Communications Order. In addition, no director may be appointed, elected or removed from office by virtue of the vote of a holder of Exceptional

Holdings. If a director is appointed, elected or removed from office by virtue of the vote of a holder of Exceptional Holdings, such appointment, election or removal from office shall have no effect.

The holding of control, “significant influence” or 5% or more of any particular class of Means of Control without the required approval or in violation of the terms of the approval constitutes a criminal offense and could subject the holder to criminal penalties as follows: (i) a person transferring control of Bezeq or acquiring and holding control over Bezeq without the required approval is subject to three years imprisonment or a fine currently in the amount of NIS 2.26 million as well as an additional fine for each day the offense continues (currently in the amount of NIS 14,000 per day); (ii) a person holding “significant influence” or more than 5% of the Means of Control of Bezeq without the required approval is subject to six months imprisonment or a fine currently in the amount of NIS 226,000 as well as an additional fine for each day the offense continues (currently in the amount of NIS 14,000 per day); and (iii) a person transferring “significant influence” or Means of Control of Bezeq, knowing that as a result of the transfer, the holdings of the transferee require approval pursuant to the Israeli Communications Law or the Communications Order, without being first shown the appropriate approval by the transferee, shall be subject to a fine currently in the amount of NIS 226,000.

According to the Control Permit, SP2 must at all times be held by an “Israeli Party,” as defined in the Communications Order, to the following extent:

At least 19% of each of the Means of Control of SP2 must be held by an Israeli Party at all times; or

At least 19% of the rights to vote at the general meeting of shareholders of SP2 and the rights to appoint directors of SP2 must be held by an Israeli Party at all times; and

The right to appoint at least one-fifth of the directors of Bezeq and Bezeq’s subsidiaries and not less than one director of each such company will be held by an Israeli Party at all times, provided that the percentage of the Israeli Party’s direct or indirect shareholdings in Bezeq is not less than 3% of any of the Means of Control of Bezeq. Indirect shareholdings will be calculated as the product of the Israeli Party’s lowest rate of holdings in each of the Means of Control in SP2, multiplied by the percentage of the holdings of the parties to the Control Permit in each of the Means of Control in Bezeq.



The Ministers have determined that we and B Communications are deemed to be “Israeli Parties,” so long as we and B Communications are controlled by a citizen and resident of Israel and that the ownership interest of Messrs. Shaul Elovitch and Yossef Elovitch in our company and B Communications does not fall below 50% at any time.

The parties to the Control Permit may not be controlled by any foreign country, foreign government company or a foreign company controlled by a foreign government company. The Control Permit will terminate if the foregoing condition ceases to exist with respect to any such party without the approval of the Ministers. The Ministers may authorize a foreign government company to hold an interest in any such party, provided that the foreign government company’s aggregate direct or indirect holdings in Bezeq do not exceed 5% of any type of Means of Control of Bezeq and that it does not control such party.

According to the Communications Order a “principal shareholder” or a person with “significant influence” in Bezeq shall not be one of the following:

a hostile state, a citizen or resident of a hostile state, a corporation registered or incorporated in a hostile state or a corporation controlled by a citizen or resident of a hostile state; or

a government corporation, unless approved by the Ministers.

In the event the Ministers find that the information they were provided in the application for the control permit is incorrect, that there has been a material change in the details provided by the parties to the Control Permit which justifies its cancellation, or such parties failed to submit a required report, and the Ministers determine that there is probable cause to believe that the provision of the services that Bezeq is required to provide pursuant to its general license (including basic telephone, infrastructure, transmission and data transmission services and ancillary services) or the grounds for determining that any such service has been harmed, the Ministers may take action to cancel the Control Permit. Upon its cancellation, all the shareholdings purchased under the Control Permit will be deemed Exceptional Holdings as described above.

The Control Permit also authorizes an interested party in B Communications and our company that is not a party to the Control Permit or the Individuals’ Control Permit to hold Means of Control in Bezeq, provided that such interested party does not hold more than 15% of any type of Means of Control of B Communications and our company. The foregoing authorization is subject to the condition (among others) that the percentage of holdings of the parties to the Control Permit in our company, of our company’s holdings in B Communications and of Eurocom Communications’ holdings in our company exceed 50% of the Means of Control in each of such companies at all times. We and B Communications are required to notify the Ministers of the share ownership of any such interested party.

If we, B Communications or any other member of the Eurocom Group subject to the Control Permit fails to comply with the terms of the Control Permit or with other regulatory provisions relating to the control of Bezeq, such permit could be revoked and our rights with respect to our Bezeq interest would be adversely affected.

Any event in which a receiver is appointed with respect to our holdings in SP2 or SP2's holdings in Bezeq will constitute grounds for the cancellation of the Control Permit. In the event that the Control Permit is cancelled and an application to reissue a Control Permit is denied, B Communications' holdings in Bezeq must be liquidated within 15 to 60 days (depending on the cause for such cancellation) pursuant to the Communications Order.

The provisions of the Control Permit are subject to the terms of the Communications Order and Israeli Communications Law, as they may be amended from time to time.

### **Sale of an Ownership Interest in Bezeq**

As indicated above, according to Article 3(a3) of the Communications Order, which is included as part of the Control Permit, the parties to the Control Permit may hold less than 30% under certain circumstances, including the requirement that the parties control Bezeq and maintain at least a 25% ownership interest in Bezeq. Accordingly, the parties are entitled to sell a portion of their Bezeq shareholdings to the extent they will retain at least 25% of the outstanding Bezeq shares, and no amendment to the Control Permit or the indenture governing our 7 % Senior Secured Notes is necessary or required to sell Bezeq shares as long as the parties retain in excess of 25% the ownerships interest in Bezeq.

On February 2, 2016, B Communications announced that its wholly-owned subsidiary, SP2, sold 115,500,000 Bezeq shares. As a result, B Communications received gross proceeds of NIS 8.50 per share, or NIS 982 million in the aggregate (approximately \$248 million). B Communications retained a 26.34% ownership interest in Bezeq following the closing of the transaction.

According to the terms of the indenture for B Communications' 7 % Senior Secured Notes, the net proceeds from the sale of any Bezeq shares held by B Communications or its subsidiaries SP1 and SP2 must be deposited into our "Lockbox Account" and are subject to other customary conditions and covenants relating to asset sales and release of liens on sold assets. In addition, according to the terms of the indenture, B Communications must make an offer within 365 days to the holders of the notes to purchase notes with the proceeds deposited in the lockbox account at a cash offer price equal to 100% of the principal amount of the notes, plus accrued and unpaid interest to the date of purchase.

## **The Concentration Law**

In December 2013, the Knesset passed the Concentration Law, which regulates the following principal matters: (i) limitations on the control over companies with publicly held debt or equity securities through a pyramidal ownership structure by imposing a limitation on the number of public companies (tiers) in such pyramidal structure; (ii) authorizes financial regulators to set forth limitations on the amount of credit that financial institutions are permitted to provide to a corporation or a group of companies under the control of the same controlling shareholder; and (iii) limitations on the holdings by a significant non-finance company in a significant finance company or the holdings of both kinds of companies under common control; and (iv) requires governmental authorities responsible for the award of rights in public assets (including in the communications field) in certain events to consider control concentration factors and industry-specific competitive factors.

### ***Limitations on the control of public companies through a pyramidal ownership structure***

#### ***Prohibition on a second-tier company controlling another tier company***

The purpose of the Concentration Law is to limit the possibility to control a "tier company" (generally defined as a company with publicly held debt or equity securities that are subject to reporting obligations under the Israeli Securities Law) through a pyramidal structure of additional tier companies. Each of B Communications, our company and Bezeq is considered a "tier company" for the purposes of the Concentration Law. A "second-tier" company is a tier company that is directly controlled by a first-tier company, and accordingly, our company is deemed a "second-tier" company under the Concentration Law.

The Concentration Law prohibits a second-tier company from controlling another tier company. In the case of existing pyramidal structures, a second-tier company is entitled to continue to control another tier company that it controlled on the publication date of the Concentration Law for a period of six years from the date of publication of the Concentration Law (until December 10, 2019).

In the event that a second-tier company controls another tier company contrary to the provisions of the Concentration Law, a district court may appoint a trustee, who will be awarded the means of control (including voting rights and right to appoint directors) in such tier company for the purpose of selling such means of control. The trustee shall act pursuant to the orders of the district court with respect to such means of control and will be entitled to petition the district court to rule, among other things, that an appointment of directors in the tier company that was made prior to the trustee's appointment is void, to cancel transactions between the controlled tier company and its controlling shareholder or transactions in which the controlling shareholder had a personal interest if they have not yet been completed and to order the cancellation of a dividend distribution that was not in the tier company's interests which occurred prior to the trustee's appointment. The district court may, instead of appointing a trustee and under certain circumstances, order that the means of control held by the controlling shareholder shall not provide any rights whatsoever. Until the appointment of a trustee by the district court, the means of control held by a second-tier company that illegally controls another tier company shall not grant any voting rights at the illegally held tier company's shareholder meetings.

The Concentration Law sets forth certain mechanisms intended to enable a tier company, which is subject to the prohibition of controlling another tier company, to make various arrangements for the repurchase of its publicly-held shares and the early redemption of publicly-held debt in order to comply with the provisions of the law. These mechanisms enable the repurchase of publicly-held shares and the early redemption of publicly-held debt securities under a court-approved scheme of arrangement pursuant to the Israeli Companies Law, at fair value and in accordance with the conditions prescribed by the Concentration Law, while providing certain relief from shareholders or debenture holder majority requirements for the approval of the arrangement.

*Appointment of directors and the composition of the board of a “third- tier” company during the transition period*

Beginning six months after the publication of the Concentration Law and until the end of the six years’ transition period during which a “third-tier” company can no longer be controlled by a second-tier company, the board of directors of a company that is a “third-tier” company (such as Bezeq) must be comprised of a majority of “independent directors,” within the meaning of the Israeli Companies Law, and the number of “external directors” pursuant to the Israeli Companies Law shall be at least half the number of the company’s directors less one (rounded upwards) but not less than two. The election of such external directors will be by a majority vote of the shareholders and the controlling shareholder’s vote will not be counted for such purpose. The Israeli Minister of Justice is authorized to enact regulations setting forth a lower number of required external directors, provided that such number will not be lower than one-third of the board members.

In June 2014, the Regulations to Promote Competition and Reduce Concentration (Relief with Regard to the Number of External Directors), 2014, were published. Pursuant to these regulations, if a director of a company who is appointed according to the proposal of a representative labor union under a collective labor agreement serves in another tier company, the number of external directors in the tier company required under the Concentration Law who meet the provisions of the law may be reduced, provided that the external directors account for at least one-third of the board members. Bezeq complies with the provisions of the Concentration Law in this respect.

*Limitations on the provision of credit to corporations and issuer groups*

The Minister of Finance and the Governor of the Bank of Israel are authorized to enact regulations and directives limiting the amount of credit provided by financial institutions in Israel, cumulatively, to a corporation or a group of companies under the control of the same controlling shareholder. Such regulations have not yet been enacted.

**The Bezeq Group**

The Bezeq Group is subject to various regulatory requirements and obligations including communications and broadcasting laws (including provisions applicable to providers of essential services), general antitrust law, securities and companies laws, consumer protection laws, planning and construction laws, environment, health and safety laws, as well as technical and other regulations. The communications and broadcasting industry in Israel is highly regulated and requires service providers to obtain licenses from, and comply with the terms of such licenses and the policy statements of, the Ministry of Communications or the Israeli Council for Cable and Satellite Broadcasting, or the Broadcasting Council, with respect to the various communications and broadcasting services, respectively, before offering such services to the public. Holding Means of Control in telecommunications services providers is also subject to regulation, including certain prohibitions on cross-holdings in communications companies. The

ever-changing regulatory environment has had and will likely continue to have a material effect on the Bezeq Group's activities. Certain key provisions of the regulations governing the Bezeq Group's activities are set forth below. This description is not intended to be an exhaustive description of all regulations nor a review of specific obligations which have been imposed on the Bezeq Group.

As a general matter, the regulatory principles are set forth in the laws enacted by the Knesset, primarily the Israeli Communications Law. These laws are amended from time to time upon enactment by the Knesset. The laws authorize the Ministry of Communications (in some cases with the approval of the Economic Affairs Committee of the Knesset) to issue regulations which provide for specific requirements based upon the principles set forth in the applicable laws. In addition to the regulations, the Ministry of Communications issues policy statements after a public review and consultation process. These policy statements expand upon the Ministry of Communications' policy with respect to certain basic issues in the relevant market. The Ministry of Communications grants licenses in accordance with the Israeli Communications Law and regulations. Bezeq was also declared a provider of essential services under the Communications Order and is subject to the provisions of such order.

### *General*

#### *Structural Separation*

Bezeq is subject to a duty to maintain structural separation between itself and its subsidiaries set forth in its domestic fixed-line license (including Pelephone, Bezeq International and DBS). Separation is required between the managements of Bezeq and its principal subsidiaries, as well as separation between the financial and marketing systems, assets and employees.

The structural separation limitations result in high administrative overheads and place the Bezeq Group in an inferior competitive position compared with other Israeli communications groups that are subject to certain structural limitations, but not of the same scope.

In July 2013, the Knesset approved an amendment to the Israeli Communications Law, providing, among other things, that the authority of the Minister of Communications to mandate structural separation between two license holders for the purpose of providing certain services also includes separation between the provision of services to another license holder and the provision of services to a subscriber. According to the explanatory notes to the draft amendment, the existing form of structural separation in the Israeli communications market is expected to be gradually cancelled; however, structural separation between the provision of services to a subscriber and the provision of services to another license holder is expected to be required if a wholesale market does not develop or if its development encounters difficulties such as price discrimination and high barriers for entry.



In October 2013, the Ministry of Communications published a hearing for public comment regarding the implementation of new a regulatory regime in the ILD market. Under the proposed regime, domestic fixed-line operators and cellular telephony operators would be allowed to provide ILD services as part of the service packages they offer to their subscribers. The proposed regime would also allow domestic fixed-line operators and cellular telephony operators to provide international data transfer and transmission services. If such regulatory regime is approved, it could have a significant impact on Bezeq International's ILD operations.

#### *Limitations on Marketing of Bundles*

Historically, the structural separation limitations prevented Bezeq from marketing joint service bundles. Since May 2010, following the decrease of Bezeq's market share of the private fixed-line telephony services market to below 85%, Bezeq has been permitted to offer joint service packages with its subsidiaries to private subscribers, and since July 2012, Bezeq has been permitted to offer joint service packages with its subsidiaries to business subscribers, subject to approvals by the Ministry of Communications and other conditions contained in Bezeq's license, including the following:

The joint service packages must be able to be "unbundled" so that each service included in a package must be offered separately and on the same terms; and

At the time a request for approval of a joint service package is submitted, all of the services to be offered must be marketed as a package to private subscribers by a license-holder which is not a subsidiary of Bezeq, or a group that includes license holders that are not affiliated with Bezeq.

When filing a request for marketing a bundle of services, which includes any of ISP service, international calls service or VoB service, Bezeq must allow any licensee that is capable of providing such services to offer its own services as part of Bezeq's bundle, alongside the bundle with the subsidiary (Bezeq International).

Joint service packages marketed by Bezeq's subsidiaries that include the services of Bezeq are also subject to similar limitations, including "unbundling" (except for a bundle offered by a subsidiary that only contains its ISP service with Bezeq's fixed-line broadband Internet infrastructure access service).

Despite the easing of the limitations on offering "unbundled" joint service packages, the Israeli Antitrust Authority informed DBS and Bezeq that the marketing of "unbundled" joint service packages by Bezeq and DBS constitute a restrictive arrangement which requires an exemption under the Israeli Antitrust Law and that the Commissioner does not intend to grant such exemption. Consequently, such packages were not offered. The recent merger between DBS and Bezeq ratified new limitations regarding possible bundling, including:



Bezeq will sell and provide Internet infrastructure services and TV services under equal conditions for all of Bezeq's customers; and

Bezeq and DBS will not have any exclusivity arrangements pertaining to TV productions that are not "original productions."

These limitations, and in particular the "unbundling" obligation, limit the Bezeq Group's ability to offer discounts on the components of a joint service package and effectively prevent the Bezeq Group from offering bundles, except for a bundle that contains fixed-line broadband Internet infrastructure access service and ISP service. Competing Israeli telecommunications groups are not subject to similar limitations in marketing joint service packages (other than a limitation on marketing bundles by HOT Net and other companies in the HOT Group).

*Additional Limitations on Cooperation between the Bezeq Group Companies—Antitrust Laws and the Provisions of Bezeq's Domestic Fixed-Line License*

Additional regulatory provisions impose limitations on cooperation between members of the Bezeq Group including provisions of Bezeq's domestic fixed-line license that obligate Bezeq to provide its services on an equal basis to all and to ensure that its relationships with its subsidiaries do not result in favoring them over their competitors. Bezeq is also subject to the Israeli Antitrust Law and regulatory orders issued by the Commissioner. Bezeq was declared a monopoly in its main fields of activity under the Israeli Antitrust Law, as discussed in the *Fair Competition and Antitrust Laws* section below.

### *Wholesale Market Regulation*

In May 2012, the Ministry of Communications published the Wholesale Market Policy Document concerning expansion of the level of competition in the fixed-line communications market, primarily adopting the main recommendations of the Hayek Committee.

The key points of the Wholesale Market Policy Document are as follows:

Owners of universal fixed-line access infrastructures that provide retail communications services, including Bezeq and HOT, will be obligated to sell wholesale services to other telecommunications services providers, including BSA, lease of access segments, dark fibers, duct access and transmission services, on an equal and non-discriminatory basis and with no discounts for size. In this regard, a procedure was established for negotiating an agreement for these services and as soon as such agreement is signed, the infrastructure providers are required to publish a “shelf offering” for the sale of the services based on the agreement and which also includes additional services as the Ministry of Communications may determine from time to time and such services’ prices. In this regard, the term “agreement” will apply to an agreement entered into by an infrastructure owner and a substantial service provider that is not an affiliate of the infrastructure owner. When the Minister of Communications believes that an agreed term or price is (i) unreasonable; (ii) might hinder competition; (iii) might harm the public’s interest, or (iv) might harm a services provider’s interest, the Minister has the power to establish conditions or prices for the services. The infrastructure providers must submit to the relevant telecommunications services providers the information relating to distribution of their existing infrastructures, with exceptions to be defined.

If a license holder or a company affiliated with a license holder sets a tariff for a retail communications service in a manner that may hinder competition, the Minister of Communications will take measures to amend the wholesale tariff that is relevant for the provision of the retail service accordingly.

The ancillary activities, services and arrangements relating to the wholesale services (rental of space, maintenance, etc.), and the arrangements for ordering, payment terms, provisioning and their tariffs, will also be negotiated by infrastructure owners and service providers, and the infrastructure owners will be allowed to demand reasonable and non-discriminatory prices. In the absence of agreement between the relevant license holders, the Minister of Communications will determine such terms.

The Ministry of Communications will make use of a model for enforcement and supervision, which will help the Ministry of Communications to (i) ensure that the tariffs set in the shelf offering are in accordance with the conditions set out above, (ii) monitor the actual provision of the wholesale services in a reasonable and non-discriminatory manner, and (iii) track the level of implementation of the wholesale market.

Infrastructure owners will provide, on an ongoing basis, information about ordering of wholesale services and the deployment of existing infrastructure to other license holders in accordance with the requirements of the Ministry of Communications, subject to exceptions that will be determined by the Ministry of Communications.

The “shelf offering” will be published on the websites of both the infrastructure owners and the Ministry of Communications. Upon publication of such “shelf offering,” other entities (including affiliates of the infrastructure owner) may also purchase wholesale services on the same terms from the infrastructure owner, as long as such services shall be provided concurrently to any other entity, on a non-discriminatory basis. Under this procedure, Bezeq will be able to provide wholesale telephony services to its subsidiaries that are not supplied over a broadband network, provided that these services are also available to third parties without discrimination.

Within nine months of publication of the “shelf offering,” the Minister of Communications was to eliminate the structural separation between the infrastructure provider who published the aforementioned offering and the ILD providers and ISPs that are affiliated with such infrastructure provider, replacing it with an accounting separation, unless the Minister believes that this will adversely affect competition or the public interest. As a result, Bezeq would be able, for example, to offer bundles that include local and ILD services, broadband Internet infrastructure access services and ISP services.

The Ministry of Communications will determine indicators or conditions under which the Minister of Communications may conclude that the level of development of the wholesale market and the level of development of competition based on joint service packages which include fixed-line telephony and cellular telephony services in the private sector, permits the grant of relief from the structural separation between an infrastructure owner and an affiliated cellular telephony operator, or the elimination of the structural separation and its replacement with an accounting separation.

If the Minister of Communications determines that the wholesale market has developed and the degree of competition based on joint service packages consisting of fixed-line services and cellular telephony services in the private sector permits, the Minister will consider eliminating the structural separation between an infrastructure provider and a cellular telephony operator who is affiliated with such provider.

The Minister of Communications will examine the matter of the unbundling of broadcasting services included in the joint service packages which also include Bezeq services (fixed-line telephony or cellular telephony) or broadband access services. The structural separation between the infrastructure providers and multi-channel television services providers will be eliminated if there is a reasonable possibility in the Israeli market to provide a basic television service package over the Internet by service providers with no nationwide infrastructure.

If a wholesale market does not develop in a satisfactory manner (based on parameters to be defined for this purpose) within 24 months of the publication of the Wholesale Market Policy Document, the Minister of Communications will take action to implement structural separation between the infrastructure and the services provided by general domestic fixed-line license holders.

Within six months of publication of the “shelf offering,” the Minister of Communications is required to take action to change the method of control over Bezeq’s tariffs so that tariffs will be controlled by setting a maximum price.

Within nine months of publication of the “shelf offering,” the Ministry of Communications is required to formulate a regulatory scheme aimed at increasing the investment in and upgrade of fixed-line communications infrastructures in Israel.

The Amendment to the Communications Law in the Economic Arrangements Law, July 2013 expands the powers of the Minister of Communications to oversee competition in the era of a wholesale market. The Minister of Communications was empowered (by the Minister of Finance) to determine payments for a license holder to use Bezeq installations operated by another license holder, to establish maximum or minimum tariffs for a license holder’s services, and this, in part, based on cost plus a reasonable profit or on a benchmark point derived from parameters prescribed in the law. The Minister may also request a report on the tariffs before services commence, he may instruct the tariff that a license holder may ask for a service, and may instruct the license holder to take action to prevent an immediate infringement of the competition. The amendment also prescribes provisions concerning a basic package of broadcasts, its content and payment for the package.

In accordance with the policy document on the expansion of competition, the structural separation which is currently in place will gradually be phased out. Nevertheless, the Minister's power to impose structural separation also applies vertically (between services rendered to subscribers and services rendered to a license holder), and that the directive may be applied if a wholesale market does not develop at all, or problems emerge in the development of such a market, in part due to price discrimination, high entry barriers, etc.

The following actions were subsequently taken by the Ministry of Communications:

In January 2014, the Ministry of Communications issued a list of the services that Bezeq will be obligated to offer as a wholesale service to the service providers. The list of services included: managed broadband access (Bitstream Access) (for a countrywide, regional or local connection); Sub Loop Unbundling (at this stage only on the Bezeq network); use and access to Bezeq's physical infrastructure, and wholesale telephony service.

In November 2014, the Minister of Communications issued a decision on the regulation of wholesale services and the format for the provision of wholesale services and the setting of rates for these services on Bezeq's network.

The Minister of Communications adopted the recommendations of the Ministry's professional echelon to amend the licenses of Bezeq and Hot Telecom and to detail the basket of services covered by the license - managed broadband access (including Multicast) and wholesale telephony service. These services must be provided within 3-6 months from the date of the decision. The regulations that were included in the Minister's decision define the obligation to provide the services, including accompanying services and the maximum tariffs for these wholesale services to be provided by Bezeq (to date, no tariffs have been prescribed for HOT Telecom's services).

In accordance with the Minister's decision, the tariffs are as detailed below:

	2015	2016	2017	2018	Unit
Access service – excluding telephony	32.56	32.70	32.87	33.21	NIS per line per month
Access service – including telephony	39.43	38.53	38.80	39.13	NIS per line per month
Subloop unbundling service (or SLU)	19.34	20.04	20.74	21.47	NIS per line per month
Data transfer service on the network's core	30.36	24.11	18.73	14.18	NIS per MB per month
Data transfer in multicast configuration <sup>1</sup>	15,517	12,267	9,456	7,236	NIS per MB per month
Creating a phone call	0.01	0.01	0.01	0.01	NIS per minute
Access service to the duct <sup>2</sup>	398	398	400	400	NIS per km per month
First dark fiber on a line	484	484	487	485	NIS per km per month
Additional dark fiber on a line (up to a total of 4 fibers)	2.18	2.14	2.11	1.99	NIS per km per month
Technician house call service	158	158	158	158	NIS per visit

1) The price for reaching customers connected to a maximum of 1,000 MSAG boxes. The prices for greater numbers of MSAG boxes are stated in the draft regulations.

2) Including access to pits, boxes and poles.

#### *Implementation of a wholesale market, petition to the Supreme Court and wholesale telephony*

In December 2014, Bezeq petitioned the Israeli Supreme Court to repeal the decision and as a result, to cancel the amendment of Bezeq's license, cancel the regulations prescribing the obligation to provide the services and the maximum tariffs for the wholesale services, and to schedule an urgent hearing of the petition.

In the petition, Bezeq argued that the decision was unreasonable and impossible to implement. Bezeq also argued that the decision-making process was improper.

The Ministry of Communications held discussions with Bezeq and the relevant operators with respect to operating the service and in February 2015, issued various appendices to the BSA wholesale service file. Following their issuance, Bezeq began to provide wholesale services. Until May 2015, customers were transferred from retail subscribers to wholesale subscribers in a non-automated procedure (a manual procedure requiring involvement of Bezeq's staff). Thereafter, the transfer was automated and does not require human involvement.

In March 2015, the Supreme Court ruled that it would hold a round table discussion with Bezeq and the State of Israel to examine Bezeq's arguments (professional or technical in nature), in order to clarify topics, if possible, and make the necessary amendments, and that a notice from Bezeq and the State of Israel should be submitted within 60 days.

In May 2015, the Minister, the Minister of Finance and the Ministry of Communications submitted an update notice to the Supreme Court, indicating that after holding meetings with Bezeq following the Supreme Court ruling, the Ministry of Communications reached the conclusion that wholesale telephone services can technically be implemented by Bezeq and if Bezeq had made prior preparations, there would have been no technical obstacle to opening the wholesale market in this segment on the scheduled date of May 17, 2015. With regard to the economic aspect, the Ministry of Communications concluded that Bezeq's arguments that the tariffs are unreasonable were unacceptable. However, after reexamining Bezeq's claims, it ascertained that certain changes should be made regarding the demand for data consumption and the quality requirements of the service defined in the service file (which, in the Ministry's opinion, do not affect the tariffs), including the Ministry's intention to publish a market-wide hearing and not to enforce the service quality requirements at that stage.

Thereafter, Bezeq submitted an update notice on its behalf where it rejected the State's update notice and noted that contrary to the State's conclusions: (1) the different solutions proposed by the Ministry for provision of telephony services in the wholesale market are not technologically possible; and (2) the tariffs prescribed by the Ministry of Communications for provision of the wholesale market services are unreasonable. Bezeq also argued that the Ministry of Communications had not completed the meetings to examine Bezeq's claims, as requested by the Supreme Court, and retained its decisions, so they remained unreasonable. An engineering opinion by an external expert and an economic opinion of an internal economist (together with an external comparative study indicating that the wholesale price in European countries on which the Ministry relied is more than double the price prescribed by the Ministry in Israel) were attached to Bezeq's update notice.

On October 8, 2015, the Ministry of Communications filed a notice to the Court, according to which, without derogating from its position, it believes that due to the importance it places on the ability of the service providers to offer services to their subscribers immediately, including telephony services, and in order not to allow continued delay in provision of this service, it is formulating a hearing in which it intends to publish as soon as possible, with respect to compelling Bezeq to provide telephony services to the service providers for resale and to establish the maximum tariffs for provision of this service. In the notice, the Ministry noted that it was a different wholesale service which also Bezeq believes does not require any preparations or changes in its engineering systems. Therefore, it could be offered immediately and is offered as a temporary solution for a limited period of a year.

On October 11, 2015, a hearing of the petition was held in which, due, among other things, to the Ministry's notice regarding publication of a new hearing, the Court dismissed the petition insofar as it relates to wholesale telephony services and ruled that update notices would be submitted on the subject of tariffs, which is still pending.

On December 10, 2015, the Ministry of Communications published a hearing regarding "the supply of telephony services for resale on Bezeq's network." A draft amendment to Bezeq's general license adding telephony services in a resale format was attached to the hearing document.

The service allows a general unified license holder that is entitled to provide domestic fixed-line services, to purchase telephony services from Bezeq, to allow outgoing and incoming calls, and provision of accompanying and added value services by Bezeq wherever possible without the service provider being able to distinguish that it is receiving services through Bezeq, other than with respect to technical support. In this regard, the service provider will be able to build packages to be sold to its subscribers in any manner.

At the hearing, it was stated that the Ministry is considering allowing Bezeq to offer the service as a temporary interim solution for a limited period of a year from adoption of the decision at the hearing, after which Bezeq will provide wholesale telephony services, and also that the temporary arrangement will apply as long as Bezeq is obligated to provide telephony as a product that can be unbundled, and it will also be canceled (and Bezeq will be compelled to provide wholesale telephony) if maximum tariffs for Bezeq's retail services are prescribed in place of the tariffs set out in the payment regulations. It was also stated at the hearing that the service will be provided immediately after establishment of the operating arrangement with the service providers, since provision of the service does not require any preparations or changes in Bezeq's engineering systems, but only in its IT systems.

The following tariffs were presented at the hearing:

Package	Wholesale payment (derived from the retail price less VAT)
Speak 100	NIS 23.03
Speak 300	NIS 28.15
Speak 600	NIS 35.85
Speak 750	NIS 38.41
Speak 1000	NIS 46.10



The above payments includes payments for interconnection for calls to Bezeq subscribers and in addition, the service provider will pay an interconnection fee for outgoing calls from its network for every subscriber of another operator other than Bezeq's subscribers. The service provider will also be eligible to payment for every incoming call.

Excess minute price - NIS 0.0923 per call minute.

Payment for additional services - the payment prescribed in bundles is decreased by 40%.

On January 10, 2016, Bezeq submitted its response to the hearing, according to which it is impossible to determine that after a certain period (or upon establishment of maximum tariffs or cancellation of the unbundling obligation) the service format anchored in the service file will apply automatically, since the format is impossible to implement and postponing it will not lead to a solution. The only way that enables Bezeq to provide the service in the service file format entails switch replacement and compelling Bezeq to perform a complex, disproportionate unauthorized and unjustified procedure. Moreover, a wholesale telephony service in the service file format is essentially unnecessary and unjustified (as testified by the various arguments for the service, each of which was concealed and another raised in its place) and all its aspects deviate from the global trend. With regard to the price of the service, it is clarified that it is inappropriate to reduce it by 40%, since it is a resale service with almost no costs to the telecommunication providers or saving for Bezeq and that the standard discount rate worldwide is between 10% and 20% maximum. It is further clarified that the "Kav Kal" (light line) is irrelevant and cannot be included in the resale arrangement and that interconnection fees will only be paid for outgoing services to another network and will be received for incoming calls from another network not belonging to Bezeq. It was further clarified that they are aimed at improving the cooperation between Bezeq and the service providers.

On January 11, 2016, the State submitted an update notice to the Court, which does not contain anything materially new compared with the previous update notice, and stipulates that the Ministry intends to review making fundamental changes in two issues raised by Bezeq (the issue of data consumption demand forecasts and the service quality requirements defined in the BSA and telephony service file). In view of the contents of the notice, the State requested dismissal of the petition and charging Bezeq for the expenses.

On February 7, 2016, Bezeq submitted a revised notice on its behalf, according to which the tariffs of the wholesale services set out by the Ministry of Communications are unreasonable and lack jurisdiction. Bezeq petitioned the Court to issue a conditional order, as set out in the petition. Due to the contents of the revised documents, the Court scheduled a hearing for the file.

### **Imposition of fines**

In the initial wholesale BSA service implementation period, the Ministry of Communications held supervisory proceedings against Bezeq claiming that Bezeq breached some of the provisions set out mainly in the service attachments issued as described above on the eve of the reform. On May 11, 2015, Bezeq received the Ministry of Communication's notice of its intention to impose fines regarding implementation of the broadband reform (the "Notice"), claiming that according to the supervision report attached to the notice, the Ministry discovered that Bezeq fails to comply with the provisions set out in the service file as required and that this conduct by Bezeq is a breach of an addendum to the Communications (Telecommunications and Broadcasts) Law, 1982. Therefore, the Ministry stated that it intends to impose a fine of NIS 11,343,800, which is the maximum amount possible under the law. Bezeq rejected the notice and submitted counterclaims, including its rejection of the groundless statements and declarations in the notice regarding the failings of the reform and the impairment to competition. Bezeq presented the Ministry's unreasonable behavior and the update of the service file without jurisdiction, ignoring the complexity of the non-automated procedures and the time allocated to them.

Subsequently, on December 16, 2015, Bezeq received a demand for payment of a fine of NIS 8.5 million. On January 31, 2016, Bezeq filed an administrative petition against imposition of this fine.

### **Use of terminal equipment in the wholesale market**

On December 30, 2015, the Ministry published an administrative instruction regarding the use of wholesale terminal equipment and a draft agreed arrangement sent for a response on August 31, 2015), according to which until February 17, 2016, a service or infrastructure provider who lends or leases terminal equipment to a subscriber and that subscriber switches to another service provider under the BSA service file, will not prevent the abandoning subscriber from making regular and proper use of the terminal equipment, will under no circumstances limit and will allow the

abandoning subscriber to make such use of the terminal equipment in its possession ("Transition Period") and as from February 18, 2016, will not prevent or limit and will allow such use for 21 business days from the switch notice. The payment will be made by the abandoning subscriber in the same way as previously made prior to switching service providers. In its decision, the Ministry also determined that the service or infrastructure provider may not restrict the use of terminal equipment previously sold to the former subscriber.

**Passive wholesale services (physical infrastructures and SLU):**

On January 27, 2015, Bezeq received the Ministry of Communications ruling regarding regulation of the wholesale services - service files, access to physical infrastructures and service loop unbundling (SLU) prescribing that Bezeq must start providing these services beginning August 1, 2015.

The Director General of the Ministry of Communications noted in his decision that while the obligation of the infrastructure owners to provide wholesale services to service providers was already prescribed, a ruling regarding the duty of reciprocity (between the infrastructure owners) is an initial decision, and since the Authority is committed to exercising restraint in making decisions regarding all those matters for which action is not especially pressing or urgent, it was appropriate for this matter to be determined by the next government.

The Minister of Communications' decision of November 17, 2014 set out the passive service tariffs, while the volume and content of the services have yet to be determined. Bezeq petitioned the Supreme Court to cancel the tariffs.

Bezeq allows use of its physical infrastructures - access to passive infrastructure (pits, tubes, communication cabinets, over ground network, etc.), available-for-transfer communication cables or use of available dark fibers out of Bezeq's available optic cables, while in order to connect the service provider's infrastructure to Bezeq's infrastructure, the service provider must set up a passive infrastructure (pit, cross-connect cabinet, connection box, etc.) near Bezeq's passive infrastructure facility. A dispute erupted between Bezeq and one of the service providers regarding the option of using the physical infrastructures as part of this service for cellular subscribers. Measures are also being taken to test the SLU service with Cellcom, and Bezeq conducts meetings and tours with interested service providers for provision of the services.

With respect to the SLU service - according to the administrative instruction, Bezeq provided Cellcom and Partner (under secure conditions) with information regarding the geographic location of certain of its facilities and sites. The instruction will apply with regard to this type of information delivery to every unified general domestic carrier license holder wishing to receive it from Bezeq as part of preparations to implement the wholesale SLU service

Hearing regarding establishment of a format for reviewing a margin squeeze by the fixed-line broadband network owners:

On November 17, 2014, Bezeq received a Ministry of Communications hearing aimed at establishing policy and means of control to prevent a margin squeeze - a situation where the infrastructure owners reduce their retail prices and minimize the margin between their retail prices and wholesale price of the infrastructure input purchased by the service providers to a level that erodes the margin of the service providers to the point of being economically unfeasible to continue their operations.

According to the hearing, the infrastructure owners will be required to send every marketing offer to the Ministry of Communications for review and the Ministry will inform them within 14 days whether they are prohibited from marketing the package because of the concern of a margin squeeze. Bezeq sent its response to the hearing document. This review mechanism and the derived restriction on determining retail service tariffs, if implemented, may impair Bezeq's ability to market offerings of its wholesale services.

With respect to the effect of implementation of the wholesale market, as at the end of 2015, there were 250,000 wholesale lines in Bezeq's network. Implementation of wholesale telephony services for resale according to the outline of the hearing may increase the churn rate of Bezeq's BSA service subscribers and implementation of the transition to using Bezeq's physical infrastructures may lead to increased competition in the data communication segment by launching of services that compete with those of Bezeq using these infrastructures. These lines also include lines which were not originally in Bezeq's network (new or from a competitor's network). Bezeq believes that 11% of the fixed-line subscribers in Israel are part of the wholesale BSA services.

### **Cancellation of Structural Separation**

In Bezeq's opinion, the Ministry of Communication must retract the structural separation applicable to it for the following reasons: (i) the conditions set out in the competition expansion policy document were met; (ii) there exists an intense competition in the cellular service segment; and (iii) and there are companies providing television services over the Internet.

*Merger with DBS*

Until March 25, 2015, Bezeq held 49.78% of the shares of DBS and it also owned stock options which entitled it to acquire 8.6% of the shares of DBS. In view of a decision of the Supreme Court in 2009 not to approve the merger of Bezeq and DBS, Bezeq ended its control in DBS and from August 21, 2009, it ceased to consolidate the operations of DBS in its financial statements and its investment in DBS was presented according to the equity method. The balance of DBS shares were held by Eurocom D.B.S. (A company controlled (indirectly) by Messrs. Shaul and Yossef Elovitch, controlling shareholders of Bezeq and our company).

On March 26, 2014, the Antitrust Authority issued a decision permitting the merger between Bezeq and DBS under certain conditions.

A sub-committee of the Board of Directors of Bezeq was appointed to deal with the topic, and the Audit Committee and Board of Directors as well as a General Meeting of the shareholders of Bezeq approved the transaction between Bezeq and Eurocom DBS to acquire all the holdings of Eurocom DBS in DBS, which represented 50.22% of the issued share capital of DBS (41.62% on a fully diluted basis) as well as all the shareholders' loans that Eurocom had provided to DBS (NIS 1,538 million as at December 31, 2014). It was also decided that prior to the purchase of the Eurocom interest, Bezeq and DBS would accept the merger conditions established by the Antitrust Authority and Bezeq would exercise its option to acquire 8.6% of the issued share capital of DBS for no consideration. On March 25, 2015, Bezeq exercised the option to acquire 8.6% of the issued share capital of DBS, resulting in its holding 58.4% of the issued share capital of DBS. Subsequently, Bezeq received notice from the Antitrust Authority of the cancellation of the limitations that were imposed on Eurocom Group with respect to its holdings in DBS.

On June 23, 2015, approval was received from the Minister of Communications to transfer the means of control in DBS in such manner that Bezeq will control DBS and will hold the entire issued and paid-up capital of DBS. On June 24, 2015, Bezeq acquired the shares of DBS held by Eurocom and Eurocom assigned to Bezeq its entire rights in the shareholders' loans that it had provided to DBS in consideration of NIS 680 million. Upon completion of the transaction, DBS became a wholly owned subsidiary (100%) of Bezeq.

In addition to the cash payment of NIS 680 million, Eurocom D.B.S. will be entitled to two additional contingent payments consisting of: one additional payment of up to NIS 200 million payable in accordance with the tax synergy that may be generated from the transaction and an additional payment of NIS 170 million that will be payable upon the business results of DBS reaching certain milestones in the next three years.

*The Concentration Law-Limitations on the Allocation of Rights in Public Assets*

The Concentration Law establishes a procedure that governmental authorities are required to follow when granting rights (such as a license, franchise or an agreement with the State of Israel, or the State, for the operation of essential infrastructure) in “Essential Infrastructure Fields” to an entity that is a “Concentrating Entity.” “Essential Infrastructure Fields” include activities for which certain telecommunication licenses are required (excluding a specialized domestic operator (such as a VoB operator) and radio and cellular phone operator), broadcast licenses, various types of licenses in the energy field, water production, natural resources and other areas.

A “Concentrating Entity” is an entity that will be included in the list of concentrating entities that will be promulgated under the Concentration Law, which will include, among others, a significant non-finance company - a corporation or group whose sales turnover exceeds NIS 6 billion, or NIS 2 billion in a monopoly market, or whose total credit exceeds NIS 6 billion, as well as an influential entity in the field of broadcasting or printed media (including, among others, newspapers and publishers, broadcasters, news producers, cable and satellite television broadcast licensees).

On December 11, 2014, the Antitrust Authority published the list of concentrated entities according to the law. Bezeq, the corporations it controls and that are controlled by its controlling shareholders, and DBS are all included on the list and are considered "concentrated entities."

The Concentration Law contains provisions according to which a governmental authority is entitled to not grant rights in an Essential Infrastructure Field to a “Concentrating Entity,” after finding that not granting such rights is unlikely to cause significant harm to the relevant field and its regulation. A governmental authority may not award, and may not determine conditions for the award of rights, in Essential Infrastructure to a “Concentrating Entity,” before considering control concentration factors and consulting the Committee for Reducing Concentration that will be established in accordance with the Concentration Law, which must, in turn, provide its opinion within a period of 60 days from the governmental authority’s referral. The governmental authority and the Committee are obliged to consider, among other things, factors concerning the prevention of the expansion of the operations of the “Concentrating Entity.”

The extension of existing licenses in an Essential Infrastructure Field for a cumulative period exceeding ten years will be considered an “award of rights” and will, therefore, be subject to the foregoing provisions. In addition, the procedure described above will also apply to the grant of approval for the transfer to a “Concentrating Entity” of means of control of companies held by the State or that were previously State-owned companies (such as Bezeq).

The foregoing provisions were effective in December 2014, except that the provisions concerning the extension of existing licenses will become effective December 2017.

In addition, a governmental entity must consider factors relating to the promotion of an industry's competitiveness when awarding certain types of rights, which include rights in "Essential Infrastructure" as well as licenses for fields of activity that are not considered as Essential Infrastructure if the number of workers in the industry subject to the award of rights is restricted. The Commissioner will publish a list of rights whose award may have a significant impact on competition and an entity will be required to consult with the Commissioner before awarding any of the listed rights.

#### *Consumer Protection*

Changes in consumer legislation regularly affect the operations of Bezeq and its subsidiaries. The Bezeq Group is subject, among other things, to the Israeli Consumer Protection Law and regulations promulgated thereunder. The Israeli Consumer Protection Law allows consumers to cancel transactions and to disconnect from on-going services and requires service providers to obtain the express consent of a customer to continue the service after the end of an initial term of the contract. The Israeli Consumer Protection Law also sets forth provisions concerning a refund of charges that were collected from subscribers not in accordance with the terms of the agreement with them, as well as a maximum waiting time for a human response in call centers. In addition, a number of pending legislative proposals provide for additional consumer protection and may affect the conduct of Bezeq and its subsidiaries with their subscribers.

#### *Limitation on the Exit Fees a License-Holder May Collect From a Subscriber*

Under the Israeli Communications Law, fixed-line telephony subscribers, ILD subscribers and pay television subscribers whose average monthly bill is less than NIS 5,000 and who entered into an agreement after August 8, 2011 cannot be charged exit fees, nor can the subscriber be denied a benefit that he or she would have received had he or she not terminated the agreement. Commencing November 8, 2011, the amendment also applies to subscribers who entered into agreements before the amendment became effective and subsequently cancelled their agreements. In addition, a telecommunications license-holder may not demand immediate payment of the balance owed for terminal equipment in the event of cancellation of the agreement.

Similar provisions applied to cellular telephony operators with respect to subscribers with a certain number of phone lines. In April 2012, an amendment to the Israeli Communications Law was published, eliminating exit fees for cellular telephony customers that hold up to 100 phone lines and who entered into agreements with the cellular telephony operator subsequent to November 1, 2011.

In October 2013, the Ministry of Communications delivered to Bezeq an initial inspection report stating that Bezeq prevents subscribers that terminate their agreement with Bezeq from receiving a refund for terminal equipment (routers), allegedly in violation of the provisions of the Israeli Communications Law. Bezeq submitted its response to the Ministry of Communications objecting to the initial determination reflected in the inspection reports. We believe that Bezeq acts lawfully.

#### *Interconnect Tariffs and Royalties*

The Communications Law states that a holder of a license for providing telecommunication services will pay royalties to the State out of its revenues from the services enumerated in the Regulations. The Royalties Regulations obligate the various license holders (including Bezeq, Pelephone, Bezeq International, DBS and B.I.P.) to pay royalties on certain specified revenues. Over the last few years, the rate of the royalties has been gradually reduced, and in accordance with the amendment to the Royalties Regulations that is applicable to the Bezeq Group, commencing in 2013, 0% royalties apply to all of the license holders.

#### *Change in interconnect tariffs*

The Group's telecom companies (Bezeq, Pelephone and Bezeq International) pay interconnect fees to other carriers for calls that are terminated on the networks of those carriers, and some of them (Bezeq and Pelephone) receive interconnect fees for calls that are terminated on their networks and from international communications operators for outgoing calls on their networks.

In 2011, the tariff payable to cellular operators was decreased substantially and in 2012 the tariff payable to domestic carriers was reduced significantly. The changes in the interconnect tariffs have an offsetting effect at the Bezeq Group level, as a result of the decrease in the expenses of Bezeq and its subsidiaries.

#### *Restriction of the exit penalty a license-holder can collect from a subscriber*



Pursuant to several amendments to the Communications Law, most of which became effective in 2011, the following restrictions apply to the Bezeq Group's companies with respect to the collection of disconnect fees when certain subscribers cancel an agreement

Holders of domestic carrier licenses, ITS licenses and broadcast licenses (including Bezeq, Bezeq International, DBS and B.I.P.) may not collect disconnect fees from subscribers who cancel agreements if their average monthly bill is less than NIS 5,000. Additionally, license holders may not withhold a benefit from a subscriber that would have been given had the agreement not been terminated and they may not demand immediate repayment of any outstanding payments for terminal equipment if the agreement is canceled. Bezeq believes that these legislative amendments have led to an increase in the churn rate.

Cellular operators (including Pelephone) may not collect disconnect fees from customers who hold up to 100 phone lines and who entered into an agreement with the license holder. Beginning on January 1, 2013, the cellular operators may not condition a contract for cellular services on an agreement to purchase, rent or lease terminal equipment ("unlocking").

***No discrimination in the offering of benefits and special tariffs***

On October 31, 2010, the Director General of the Ministry of Communications sent a clarifying document to the cellular operators on the applicability of certain clauses in their licenses that address equality and discrimination, including the offense of discriminating against subscribers belonging to the same group of subscribers by offering special benefits and tariff plans.

In its position submitted to the Tel Aviv District Court in January 2014, as part of a number of class actions that were consolidated against several communications operators, the Ministry of Communications stated that the licenses of the ISPs do not permit them to offer their customers "individualized tariff plans" tailored to the needs of individual customers and their ability to "haggle", and that they must offer a standard price for each service package, subject to certain exceptions.

On April 30 2015, the Ministry of Communications clarified its opinion with respect to "individualized tariff plans", "packages" or "service bundles" marketed to new subscribers, indicating that a new subscriber is someone who at the time of the inquiry to the license holder did not have an agreement with the license holder. Therefore, license holders may not demand a "waiting period" from anyone wishing to contract with them again and they must allow anyone to join any plan under the terms offered to new subscribers. In addition, according to the clarification, all subscribers have the option of switching between the different plans offered at the time of the request, without discrimination, including plans marketed to new subscribers. However, this clarification does not lessen the license holders' right to determine switching terms.



### *Administrative Enforcement*

During 2011, the Israeli Securities Law was amended, and during 2012, the Israeli Communications Law and the Israeli Antitrust Law were amended. All the amendments introduced administrative enforcement procedures and authorized the relevant regulators to impose monetary sanctions for violation of these laws, the regulations promulgated thereunder and regulatory orders issued thereunder. Administrative enforcement was also introduced to labor laws with the legislation of the Enforcement of Labor Laws Law, 2011.

### *Copyright/Trademark Laws*

Israel grants copyright protection to original literary, dramatic, musical and artistic works, as well as sound recordings and computer programs under the Israeli Copyright Law. Copyright protection automatically exists with respect to works which comply with the terms set forth in the Israeli Copyright Law and generally runs from the date of creation until the end of the seventieth year after the year of the death of the author.

In Israel, trademarks are governed by the Trade Marks Ordinance (New Version), 1972. A trademark registration is valid for 10 years from the date of the trademark application and the registration may be renewed for further periods of 10 years after each renewal. The Bezeq Group has numerous registered trademarks and trademark applications, see “*Description of our Business—Intellectual Property.*”

### *Hearing About Call Center Waiting Times*

On August 18, 2014, the Ministry of Communications published hearings with respect to the communications license holders, including holders of cable and satellite licenses, telecommunications, fixed communications, virtual operators and ISPs, relative to the response times of call and support centers that serve private and business subscribers of the license holders. The main provisions in the proposed amendments determine a maximum average waiting time and its measurement; the possibility to leave a telephone number to receive a return call; operation of specific malfunctions centers throughout all hours of the day and a customer service call center for 13 hours (in DBS, 15 hours a day); access to service centers via toll-free numbers; submission and publication of reports and service data on the website of the license holders; definition of a menu for human and automated responses; possibility to cancel a service by phone; recording of calls in all call centers; and a memorandum for the amendment of the Communications Law that determines a compensation without proof of damage in the event the response time in the call centers is higher than defined, and compensation for overcharge for an amount up to 10 times the amount overcharged. Responses to the hearing opposing the arrangements proposed were submitted. If the proposed arrangement is approved, an increase in the operation costs of the Bezeq Group’s call centers is expected.

*Amendment of Licenses Relative to Ensure Operational Continuity of Communication Companies in Emergencies*

On March 1, 2015, the licenses of communications operators were amended, including the licenses of Bezeq, Pelephone and B.P.I. In accordance with the amendment, the license holders must comply with minimum requirements to ensure operational continuity in emergencies. Operational continuity includes a business continuity plan and a plan for the recovery of the network from a disaster. In this respect, the license holders must implement a work plan that includes a risk assessment, as well as service and recovery objectives. Furthermore, the amendment to the licenses includes provisions relative to the management's and Board of Directors' responsibility, emergency management, preparation of personnel for each area of operation to enable operational continuity, as well as provisions relative to security of information systems, back up and survivability of the network and the infrastructure (including electricity and energy), agreements with vendors and subcontractors, and more.

***Bezeq***

*Communications Order*

Bezeq was declared a provider of essential telecommunications services under the Communications Order. By virtue of that declaration, Bezeq is required to provide certain types of services and may not interrupt its provision of such services or narrow them. Among these services are basic telephony services, infrastructure services, transmission services and data communication services including, interconnect, and other services listed in the schedule to the Communications Order. The main provisions of the Communications Order are:

Limitations on the transfer and acquisition of Means of Control, which includes a prohibition on holding “significant influence” over Bezeq or 5% or more of Means of Control of a certain kind without the prior written approval of the Ministers. Transferring, holding or acquiring control in Bezeq requires the approval of the Ministers by means of a control permit. Any unauthorized holding or acquisition is referred to as “Exceptional Holdings.” Exceptional Holdings must be sold within the periods prescribed by the Communications Order. Nationality requirements were established for the controlling shareholder in Bezeq. For more information see “*Regulatory—Regulations of Control Over Bezeq—Permit to Control Bezeq Granted to Members of the Eurocom Group.*”

A duty to report to the Ministers upon demand is imposed on Bezeq with respect to any information on matters relating to provision of an essential service.

75% of the members of the Board of Directors of Bezeq must be Israeli citizens and residents who have security clearance from the General Security Service.

The Chairman of the Board of Directors of Bezeq, the external directors (within the meaning of the Israeli Companies Law), the chief executive officer, the deputy chief executive officer and other office-holders in Bezeq as listed in the Communications Order, must be Israeli citizens and residents and have a security clearance appropriate to their functions.

The approval of the Ministers is required for the grant of rights in certain assets of Bezeq (switches, cable network, transmission network and data bases). In addition, the grant of rights in Means of Control in the subsidiaries of Bezeq, including allotment of more than 25% of the shares in a subsidiary, requires the approval of the Ministers.

Provisions were established for the protection of computerized systems and the purchase of hardware and software.

Certain actions of Bezeq require the approval of the Minister of Communications, including voluntary liquidation, a settlement or arrangement between Bezeq and its creditors, a change or reorganization of the structure of Bezeq and a merger or split of Bezeq.

The ongoing management of Bezeq and the center of its business must be in Israel, and Bezeq's board and shareholder meetings must be held in Israel.

#### *Bezeq's Domestic Fixed-Line License*

Bezeq was granted a general domestic fixed-line license for an unlimited period. The principal provisions of the license include:

*Scope of license*-Bezeq must provide its services to all on equal terms for each type of service, irrespective of the location or unique cost. The Minister of Communications may modify or cancel the license or make it contingent. The license and any part of it cannot be transferred, no charge can be imposed on it, nor can it be subject to attachment.

*Structural separation*-Bezeq must operate under the principles of structural separation (see —*The Bezeq Group—General—Structural Separation*”).

*Marketing joint service packages*—Bezeq may request permission to market joint service packages, subject to certain limitations (see “—*The Bezeq Group—General—Limitations on Marketing Bundles*”).

*Tariffs*-If Bezeq provides a service or package of services for which no tariff is set under the Israeli Communications Law, such service or services must be offered at a reasonable price to all, without discrimination and at a uniform tariff.

*Operations of networks and service standards*-Bezeq is required to maintain and operate its network and provide its services at all times, including at times of emergency, in an orderly and proper manner commensurate with the technical requirements and the nature of the service, and to work towards improving its services on an ongoing basis. The license includes an appendix, “Service Standards for the Subscriber,” which is to be amended after Bezeq provides the Ministry of Communications with data. Bezeq submitted its proposal for an amendment to the appendix, adapting it to the current state of affairs and the licenses of other operators, but the amendment has not yet been adopted.

*Duty to provide services*-Bezeq is required to provide interconnect services to other public switching networks and to allow other telecommunications license holders to use its network. Bezeq has a duty to provide infrastructure services to other telecommunications license holders on reasonable and equal terms and must refrain from providing preferable terms to its affiliates. Bezeq is also obliged to provide some of its telecommunications services to the entire public in Israel. According to the Ministry of Communications’ interpretation of this provision and the provisions regarding the provision of infrastructure services to license-holders, Bezeq is also obliged to provide infrastructure and transmission services to competing communications operators for services which compete with those of Bezeq.

*Security arrangements*-Bezeq’s license includes provisions relating to the operation of its network in times of emergency. Bezeq is required to design and operate its network in a manner that will prevent its collapse in an emergency. Bezeq provides special services to the security forces and is required to provide telecommunications services and maintain terminal equipment infrastructure for the security forces in Israel and abroad, as provided in its agreements with the Israel Defense Forces. Bezeq is required to appoint a security officer and to comply fully with the security instructions contained with the applicable provisions in its license.

*Supervision and reporting*-The license imposes on Bezeq extensive reporting requirements to the Ministry of Communications. In addition, the Director General has the authority to enter the facilities and offices used by Bezeq and to seize documents.

*Revocation of the License*-Pursuant to the Israeli Communications Law and the provisions of Bezeq's license, the Minister of Communications may revoke the license in certain events, including, among others, in the event of a material breach of the license by Bezeq or an immaterial breach of the license that was not cured in accordance with the instructions of the Minister of Communications, in the event that certain insolvency or liquidation proceedings are initiated against Bezeq, failure to comply with certain instructions provided under the Israeli Communications Law or to perform the services in an adequate manner, or if the public interest requires the revocation of the license.

*Miscellaneous:*

The license includes limitations on the acquisition, maintenance and transfer of Means of Control pursuant to the Communications Order, as well as on cross-ownership, which are mainly a prohibition on cross-holdings by entities with an interest in another material domestic fixed-line licensee, and limitations on cross-holdings by entities with domestic fixed-line licenses or general licenses in the same segment of operation.

Bezeq is required to prepare a draft of the standard agreement it plans to offer to subscribers and to submit them for the review by the Director General upon demand. The Director General has the authority to instruct that changes be made. Bezeq is in the process of preparing such an agreement.

Pursuant to the requirement of the license, Bezeq provided a \$10 million bank guarantee to secure its fulfillment of the terms of the license and to indemnify the State of Israel against any loss it may incur due to violations. The Minister of Communications may declare the guarantee or part of it forfeit based on the terms of the license.

The Director General has the power to impose a monetary sanction for violation of any of the terms of the license.

During a calendar year, Bezeq may invest up to 25% of its annual income in activities not connected with the provision of its services (the income of its subsidiaries is not considered income for this purpose). The Minister of Communications is authorized to grant a variance from that percentage.

*Fair Competition and Antitrust Laws*

Provisions prohibiting Bezeq from engaging in anti-competitive practices can be found in its domestic fixed-line license, in the various communications regulations and in the Israeli Antitrust Law.

Bezeq was declared a monopoly under the Israeli Antitrust Law in its main fields of activity, including basic fixed-line telephony services, provision of communications infrastructure services, transfer and transmission of broadcasting services to the public, provision of high-speed access services through its access network to subscribers and provision of high-speed access services for ISPs through a central public telecommunications network.

In October 2010, Bezeq began to provide infrastructure and transmission services to competing telecommunications operators following an examination carried out by the Ministry of Communications. In October 2011, the Israeli Antitrust Authority informed Bezeq that the Commissioner was considering issuing a ruling to the effect that Bezeq had violated the provisions of the Israeli Antitrust Law by, among other things, not providing fixed-line infrastructure and transmission services for telephony and Internet services to its competitors, Cellcom and Partner.

On October 16, 2013 and October 5, 2014, the Minister of Communications published a hearing document regarding new regulation in the international communication services market. According to the proposed regulation, any domestic fixed-line carrier or cellular operator will be able to provide international communication services as part of the service packages offered to subscribers. The proposed regulation also includes the provision of international data communication and transmission services by domestic fixed-line carriers and cellular operators. Bezeq sent its response to the hearing supporting the proposal under different terms. However, on February 1, 2015, the Ministry published a secondary hearing regarding special regulation for Bezeq Group and HOT Group for the interim period until cancellation of the structural separation obligation in these groups, according to which Bezeq and HOT will only be able to provide these services through other operators. Bezeq objected to the proposed change.



On November 16, 2014, Bezeq received the decision of the Deputy Commissioner of the Antitrust Authority finding that Bezeq had abused its position as a monopoly and determined unfair purchase and sale prices of a service in a monopoly, in contravention of the Antitrust Law, in that it determined prices for Internet and telephony services that were lower than the prices Internet for infrastructure only, in a campaign in which it had offered new subscribers a special introductory six month rate. The Commissioner claimed that given that the Internet access infrastructure service is a critical input for the supply of Internet-based telephony services, then the price set by Bezeq places competitors who wish to offer this service at a disadvantage, as the price of the critical input for supply of the service was higher than the price of the final service which Bezeq offered its customers.

On March 31, 2015, Bezeq filed an appeal against the Antitrust Tribunal's decision, together with an affidavit and the opinion of an expert economist, pursuant to which Bezeq requested the Court to find that the decision is null and void or alternatively to order its cancellation. In the appeal, Bezeq claimed that there was no "negative margin", that the decision ignored various tests for existence of a negative margin and margin squeezes, that under the circumstances of the matter there is no concern for harm to competition, that there was no actual harm to competition and that there was no breach of any sections of the Antitrust Law. Bezeq also pointed out a breach of administrative duties of the authority while forming the decision and its very publication, which must also lead to cancellation of the decision. On September 8, 2015, the Commissioner's response to the appeal was submitted, in which the Court was requested to dismiss the appeal and leave the decision intact.

Bezeq has adopted an internal compliance procedure containing guidelines and an internal reporting and control system in order to make sure that the activities of Bezeq and its employees are carried out in accordance with the provisions of the Israeli Antitrust Law.

#### *Control of Bezeq's Tariffs*

Bezeq's telephony tariffs and certain other tariffs are prescribed in regulations. As a result of a deliberate regulatory policy, the monthly usage tariff for a fixed-telephone line is set at a level that does not cover the costs involved in providing it (a situation known as "accessibility deficit"). This deficit has been reduced over the years, but still exists. The tariffs are updated according to a formula set forth in the regulations. Bezeq's controlled tariffs are reviewed by a public committee every few years, at which time Bezeq is exposed to material changes in its tariff structure and tariff levels. The mechanism for the update of the tariffs has resulted in the erosion of the tariffs over time.

Control of the tariffs creates or could create difficulties for Bezeq in providing an appropriate and competitive response to changes in the market and in offering competitive prices on short notice. In addition, the restrictions on granting discounts on tariffs limit Bezeq's ability to participate in certain tenders.

Under the Israeli Communications Law, Bezeq may apply to the Minister of Communications and the Minister of Finance, for an approval for an alternative payment package for a set of services for which tariffs are prescribed in the regulations, subject to certain conditions. Unless either the Minister of Communications or the Minister of Finance announces his objection within the period set forth in the Israeli Communications Law, Bezeq may offer the alternative payment package.

Under the Israeli Communications Law, a telecommunications license holder can demand reasonable payment for a telecommunications service for which the tariff is not set in the regulations. Bezeq sets the tariffs for these types of services.

### *Deployment of Communications Facilities*

The deployment and manner of set-up of communication facilities in Israel are regulated by the NOP 36 and NOP 56. These plans were designed to ensure coverage for transmitting and receiving radio, television and wireless communications, while avoiding radiation hazards, minimizing damage to the environment and simplifying and increasing the efficiency of the processes involved in setting up new facilities.

Part A of NOP 36 deals with guidelines for erecting small and miniature broadcasting installations. Bezeq has obtained building permits for most of its small broadcasting installations in accordance with NOP 36A. From time to time, a need arises to add broadcasting installations which require that building permits be obtained in accordance with NOP 36A. Given the exemption granted under the orders of the Planning and Construction Law and of the Israeli Communications Law, we believe that Bezeq is not obliged to obtain building permits for miniature broadcasting installations, which are “wireless access facilities” under those laws. There are a number of initiatives to cancel this exemption, and its cancellation could have materially adverse implications, including making it difficult for Bezeq to provide universal service as required by the provisions of its license.

NOP 56 became effective in June 2008 and regulates the manner of construction and licensing of communications facilities in the Palestinian Administered Territories. NOP 56 has transition provisions for facilities erected with a permit for small installations. The guidelines also include a requirement for obtaining a communications license and the receipt of necessary consents from the Commissioner of Government Property at the Civil Administration. Bezeq has obtained licenses for 76 installations in the Palestinian Administered Territories and is in the process of obtaining licenses for an additional five installations in the Palestinian Administered Territories.

As a result of a process initiated by the State of Israel, IBC, a third fixed-line communications infrastructure company was established, 40% of which is held by the government-owned IEC and 60% of which is held by a consortium of non-government companies that was selected by the IEC in a tender procedure in June 2013. In August 2013, IBC was granted a general license for the provision of telecommunications infrastructure services (including data services, digital transmissions and VPN) via fiber optic networks. According to the license, IBC will enter into an agreement with the IEC to use the IEC's fiber optic network in Israel to provide wholesale products to telecommunication services providers. In addition, IBC was granted a five-year special license to provide wired domestic data communications services, according to which it is entitled to provide IPVPN services and broadband data communications services.

*Authority with respect to real estate*

Pursuant to the provisions of the Communications Law, the Minister of Communications granted Bezeq certain powers in connection with real estate. The law distinguishes between land owned by the State, the Development Authority, the Jewish National Fund, a local authority or a corporation lawfully established and owned by one of them, and a road ("Public Land"), and other land ("Private Land"). With regard to Public Land, Bezeq and any person authorized by it, can enter and perform work there, provided that approval for deployment of the network has been granted by the local Planning and Construction Committee. Under the provisions of the Telecommunications (Installation, operation and maintenance) Regulations, 1985, if Bezeq is of the opinion that providing a telecommunications service to an applicant requires the installation of a telecommunications device for transmission or switching on the applicant's premises (or in shared premises or common property), Bezeq is permitted to request that the applicant, as a prerequisite for providing the requested service, allocate a suitable place on the premises for installation of the device, for the sole use of Bezeq, and it may use the device to provide service to other applicants also.

Deployment of a network on Private Land requires the consent of the landowner, the lessee in perpetuity or the protected tenant, as the case may be. Pursuant to the provisions of the Planning and Construction (application for a permit, its terms and fees) Regulations, 2010, an applicant for a permit to erect a residential building has a duty to install infrastructures for telephone, radio, television and Internet services so that the customer can choose whichever provider it prefers. In commercial buildings, if preparations for communications are installed, an underground infrastructure must be laid. At the same time, Bezeq's license was amended (as were the licenses of HOT Telecom and DBS), so that if Bezeq uses the internal wiring for providing its services, it is obliged to provide maintenance services for that internal wiring (the portion of the access network installed in residences and in apartments, and which is aimed to be used by those residences only), installed by the permit's applicant, without this granting it any proprietary rights in the internal wiring.

On May 7, 2015, the Ministry of Communications published a hearing regarding wiring in residential buildings, in which it determined that a building permit holder must install three leads (pipes) from the border of the property to the building communication cabinet, and for IBC's complaints regarding a lack of free leads, that is the Ministry is considering determining that the Bezeq Group and HOT will each use one lead between the property border and the

building communication cabinet and floor communication cabinets and that they will vacate leads in existing buildings and make adaptations due to IBC's demands under certain circumstances. Bezeq submitted its position, which opposes such determinations, among other things, due to a lack of justice, proportionality and need. The Ministry is holding a "round table" discussion with Bezeq, DBS, HOT and IBC to reach an arrangement regarding installation of infrastructure in new buildings.

*Exemption from a Permit to Add Antennas to Existing Lawful Broadcasting Facilities*

On August 1, 2014, the Planning and Building (Works and Buildings that are Exempt from a Permit) Regulations, 2014, entered into effect. These regulations provide that the addition of an antenna to an existing, lawful broadcasting facility is exempt from a permit, subject to meeting a combination of conditions and exclusions, including that it is consistent with the plans and applicable spatial instructions, to be determined by the local planning committees. Bezeq began to add antennas to its broadcasting facilities pursuant to the provisions of these regulations.

## *Pelephone*

### *Cellular Telephony Licenses*

Pelephone has been granted a general license to establish and operate a cellular telephone network in Israel, which is valid until September 8, 2022. In addition, in April 2001, the Civil Administration for the Administered Territories granted Pelephone a general license for the provision of cellular telephony services in the Administered Territories that is valid until September 2022 and the provisions of the general license granted to Pelephone by the Ministry of Communications are also applicable to this license. The following are the principal provisions of Pelephone's general cellular telephony license:

Under certain circumstances, the Minister of Communications is entitled to modify, restrict or suspend the terms of the license, and in certain instances to revoke it.

The license is non-transferable, and it contains restrictions on the acquisition or transfer (including by means of a charge), directly or indirectly, of control or of 10% or more of any Means of Control in Pelephone, unless the Minister of Communications has given his consent beforehand. The license includes certain prohibitions on crossholdings in Pelephone and in other telecommunications operators.

Pelephone is obliged to provide interconnect services under equal terms to all other operators and must refrain from any discrimination in the implementation thereof.

Pelephone must refrain from giving a preference in providing its infrastructure services to a licensee with an interest (as defined in the license), such as a related party, over another licensee.

Pelephone is generally not entitled to sell, lease or mortgage any of the assets used for the implementation of the license without the consent of the Minister of Communications, except as stipulated in the license.

In periods of emergency, the relevant governmental authority may issue certain instructions to Pelephone with respect to its mode of operation and/or manner of provision of services.

The license sets forth the types of payments that Pelephone may collect from its subscribers for cellular telephony services, mechanisms for setting tariffs, reports that Pelephone must submit to the Ministry of Communications and also the duty of serving notice to the Ministry of Communications prior to modifying its tariffs. The license also determines the Minister's power to intervene in setting tariffs in certain instances.

The license commits Pelephone to provide a minimal standard of service, including setting up of service call centers, the determination of a maximum period for repair of malfunctions, an accounts collection procedure and protection of the privacy of the recipient of the service.

To secure Pelephone's undertakings and to compensate and indemnify the State of Israel for any damage that may be caused by acts committed by Pelephone, Pelephone is required to furnish bank guarantees to the Ministry of Communications. In May 2015, Pelephone deposited guarantees in the amount of NIS 80 million with the Ministry of Communications, which replaced the previous guarantees given in the amount of USD 10 million, as required under the 4G LTE frequency allocation tender.

Pursuant to the Israeli Communications Law and the provisions of Pelephone's license, the Minister of Communications may revoke the license in certain events, including, among others, in the event of a material breach of the license by Pelephone or breach of certain obligations specified in the license, in the event that certain insolvency or liquidation proceedings are initiated against Pelephone, if officers of Pelephone are convicted of committing certain offenses, or if the public interest requires the revocation of the license.

#### *Hearing in regard to the required coverage and quality*

In July 2014, the Ministry of Communications published a hearing directed to holders of a general license for providing cellular services, including Pelephone. The hearing discusses an amendment to the operators' licenses that will tighten the coverage and quality requirements for public telecommunications systems using 2G and 3G technology with nationwide deployment and in the Administered Territories. Pelephone submitted its comments and reservations to the hearing. If the coverage and quality requirements are amended as specified in the hearing, Pelephone and the other operators will likely face significant additional costs.

#### *Allocation of Frequencies*

The Telegraph Ordinance regulates the use of the electromagnetic spectrum, and is applicable to Pelephone's use of radio frequencies as part of its infrastructure. Under the Telegraph Ordinance, the establishment and operation of a system using radio frequencies requires a license and the use of radio frequencies requires designation and allocation of a suitable frequency. The Telegraph Ordinance imposes license fees and fees for designation and allocation of frequencies.

For several years, there has been a shortage of radio frequencies for public use in Israel (due in part to the allocation of many frequencies for security uses), and the Israeli government has limited the number of licenses issued for the use of frequencies, while increasing fees payable in respect of the allocation of frequencies. The shortage of frequencies may also cause difficulties in implementing certain technologies (e.g. advanced technological infrastructures such as LTE).



LTE technology, which is based on an Internet Protocol that can transfer data at higher speeds than the existing Generation 3.5 technology, is used by many operators around the world and is now supported by many smartphones in use in the Israeli market. The Ministry of Communications issued a tender for allocating LTE frequencies in 2014 and Pelephone was awarded 15 MHz on the 1800 frequency band, at an aggregate cost of NIS 96 million. The adoption of the of LTE technology could have a significant effect on the market.

#### *Network Site Permits*

The set-up and operation of a wireless communication infrastructure, including cellular communications, are subject to the provisions of the Planning and Construction Law and the Israeli Radiation Law and permits from the Ministry for Protection of the Environment are required.

#### *Local Building Permits*

Pelephone's cellular telephony services are provided through cellular sites spread over Israel in accordance with engineering requirements. The constant need to upgrade and improve the quality of the cellular telephony services requires setting-up cellular sites and changes in configuration and existing antenna systems. Pelephone has deployed two main types of broadcasting sites: (i) macro sites that require a building permit from planning and building councils; and (ii) wireless access devices, which historically did not require a building permit. Under a temporary order of the Israeli Supreme Court initially issued in September 2010, Pelephone is currently not subject to certain limitations with respect to the construction of new wireless access devices absent a permit, as described below.

The licensing of cellular broadcasting sites is governed by the National Outline Plan for Communications 36, or NOP 36. The purpose of NOP 36, which came into effect in 2002, is to regulate the deployment and manner of setting-up broadcasting facilities, so that the entire country is covered for transmission and reception, with minimal damage to the environment and the landscape. Pelephone and its competitors have encountered difficulties in obtaining some of the required approvals and in particular, approvals from planning and building authorities. There is a pending proposal to amend NOP 36, which may result in more stringent regulations that could complicate and impede the process of obtaining building permits for cellular sites.

At the same time, criticism has been leveled at NOP 36 by various entities, including the contention that it is not applicable to 3G frequencies, which has led to a proposal to amend NOP 36. The amended NOP 36 is currently pending government approval.



As part of the “pergola reform,” on August 1, 2014, Amendment 101 to the Planning and Building Law, 1965, the Planning and Building (Works and Buildings that are Exempt from a Permit) Regulations, 2014, entered into effect. Regulation 34 provides, among other things, that the addition of an antenna to an existing, lawful broadcasting facility is exempt from a permit, subject to compliance with a combination of conditions and exclusions, including consistency with the plans and the applicable spatial instructions, to be determined by the local planning committees.

On July 27, 2014 the Forum for Cellular Sanity and others filed a petition to the High Court of Justice for an order instructing the Minister of Interior to explain why Regulation 34 of the Planning and Building Regulations (Works and Buildings that are Exempt from a Permit), 2014 is invalid or alternatively, should be revoked, and to issue an order deferring the effectiveness of Regulation 34 until a ruling is issued otherwise under the petition.

On August 3, 2014 the State filed its response to the petition with the High Court of Justice asking that it be denied. Pelephone's response to the petition was filed on August 10, 2014, wherein Pelephone requested that the Court deny the petition.

On March 9, 2015 a hearing was held on the petition and the petitioners arguments were heard, claiming that the petition in question is related to another petition for which an order was granted and arguments were heard. The petitioners argued that the link between the petitions should not be severed and that the hearing be deferred until after a ruling is made with respect to the other petition. The High Court of Justice also stipulated that if a ruling is not made with respect to the other petition within six months, the petitioners may return and request that a hearing be held.

More than six months after the date of the hearing on the petition and in the absence of a ruling in the other petition, application was filed with the High Court of Justice on January 21, 2016 to fix a hearing date on the petition filed by the Forum for Cellular Sanity. In view of the foregoing, on January 25, 2016 the High Court of Justice determined that the petition will be fixed for a hearing before a panel and on January 28, 2016 a summons was received according to which a hearing was set for July 18, 2016.

Pelephone's ability to maintain and preserve its cellular service quality as well as its coverage is partially dependent on its ability to set up cellular sites and install infrastructure equipment, including broadcasting sites. Any difficulties encountered by Pelephone in obtaining the required permits and approvals may adversely affect the performance of its existing network and the establishment of additional cellular sites required by the network. The inability to resolve these problems on a timely basis may prevent Pelephone from attaining the service quality goals specified in its license.

There are administrative or other delays in some planning and building councils regarding the issuance of building permits for sites. As a result, Pelephone operates a number of broadcasting sites that have not yet received permanent building permits. Pelephone has applied to the planning and building authorities for the building permits and these applications are at various stages of discussion and approval.

The establishment of a broadcasting site without obtaining a building permit constitutes, among other things, a breach of the Planning and Construction Law, and in some instances, this has resulted in demolition orders against sites, indictments or the initiation of civil proceedings against Pelephone and some of its officers. Pelephone has succeeded in most of these instances to avoid demolition or to delay the execution of demolition orders pursuant to arrangements it reached with the planning and building authorities to resolve the lack of licensing. These arrangements have not required any admission of guilt by officers of Pelephone or their conviction. However, it is not certain that this will continue in the future, or that there will be no further instances in which demolition orders are issued and indictments are filed in respect of building permits, including against officers.

Pelephone has also established broadcasting sites using wireless access devices, which require specific radiation permits according to the Israeli Radiation Law, but historically did not require a building permit if they were constructed pursuant to the conditions provided in an exemption provision pursuant to the Israeli Communications Law and the planning and construction law. Some local authorities disputed the applicability of the exemption provision to wireless access devices and to their use. Pelephone's position regarding the applicability of the exemption was accepted in a number of rulings and decisions by local courts and the use of such facilities and the supporting equipment were approved. One verdict provided an opposite ruling. Appeals have been filed for some of these rulings and decisions. Under a temporary order issued by the High Court of Justice on September 15, 2010, as amended on February 16, 2011 and July 17, 2012, and as extended on September 30, 2013, Pelephone, Cellcom and Partner are permitted under the exemption provision to exchange wireless access devices with another wireless access device for maintenance purposes, provided that the new device is in the exact same location as the replaced device and subject to other conditions in the temporary order, but are prohibited from erecting new wireless access devices under the exemption provision. HOT Mobile and Golan are temporarily permitted to deploy wireless access devices, under more lenient conditions.

On September 15, 2014 a hearing was held on petitions filed with the High Court of Justice and the arguments of all the parties were heard. In this context, the High Court of Justice recommended that the parties attempt to reach an arrangement that will balance the conflicting interests and move the process of promulgating the regulations forward in the spirit of the draft regulations from March 2010. The High Court of Justice further instructed the State to file an updated notice within 120 days which will include, among other things, the Minister of the Interior's current position, the current position of the Minister of Communications with respect to both the draft regulations and the existing regulations, the current position of the Antitrust Commissioner and an update of the Knesset Economic Affairs Committee discussions. The parties were also granted permission to respond to the State's position within 30 days of receipt. The High Court of Justice also instructed the parties to advise, no later than January 20, 2015 as to whether they had reached agreement and determined that after receiving notice from all the parties, the High Court of Justice will decide on how the cases will continue. In the State's update notice to the High Court of Justice dated January 19, 2015 the State explained, among other things, that the Minister of the Interior at that time, Gideon Saar, announced his decision to resign and consequently the terms of office of the relevant ministers changed. The State further stated that

on December 8, 2014, the Knesset passed a bill to dissolve itself, ending the session and the Knesset went to pre-election recess. Under these circumstances, the State requested an extension to file its update notice until July 15, 2015, and on January 21, 2015 the High Court of Justice granted the requested extension.

Under this notice the State announced, among other things, that on May 14, 2015 a new government was formed in Israel and it was decided to transfer most of the authority of the Minister of the Interior under the Building and Planning Law to the Minister of Finance. The State further announced that on July 13, 2015 the Knesset approved the transfer of authorities from the Minister of Interior to the Minister of Finance. The State added that the Minister of Finance should be given reasonable time to address the issue of regulating regulations under the Building and Planning Law, and to formulate his opinion regarding the matter. Under the circumstances that were created and to enable the Minister of Finance as well as the Ministers of Communications and Environmental Protection to address the issues in the petition and to formulate their opinions, the State requested a further extension for filing its updated notice by December 15, 2015. On July 19, 2015 the High Court of Justice awarded the requested extension.

On December 24, 2015 an updated notice was filed with the High Court of Justice by the State according to which the State announced that it is reviewing the options recommended by the Minister of Finance, to whom the authority to regulate regulations of the Building and Planning Law was transferred. The State further announced that the Deputy Attorney General would hold a hearing on the matter in the near future. Under these circumstances the State requested additional time to review the options for regulating "balanced" regulations and to file, another notice on a date that will be fixed by the High Court of Justice.

On November 19, 2015, Partner Communications Ltd. and HOT Mobile Ltd. filed a petition to the High Court of Justice requesting that the temporary injunction of September 16, 2010 be limited. In the State's response, that was attached to the petition, the State made its consent to limiting the temporary injunction subject the companies dismantling and removing no less than 300 wireless access installations within one year. On January 5, 2016 Cellcom Israel Ltd. filed a petition on its behalf asking that the limit contained in the temporary injunction would also apply to it, but without application of the condition to dismantle access installations, based on the arguments set out in its petition. On January 12, 2016, Pelephone Communications Ltd. also filed a similar petition regarding limiting the applicability of the order, and Pelephone also requested that the obligation to dismantle access installations should also not apply to it.

In view of the foregoing, on January 27, 2016 the High Court of Justice issued a decision requiring the State to file its response to the petitions of Cellcom and Pelephone to limit the temporary injunction, with reference to their request not to dismantle part of the access installations that they hold, by February 3, 2016.

Pelephone believes that if the Access Installation Regulations are approved as proposed, the option of using the building permit exemption track in order to erect cellular access installations will be severely restricted. A restriction of this track, together with the proposed tightening of the terms for construction of base sites in the parallel Proposed New NOP 36A track is likely to lead to noticeable increase in the obstacles restricting the construction of new broadcasting sites and access installations, and would have an adverse effect on the quality of the cellular network. At present, Pelephone operates 461 wireless access installations.

Pelephone's ability to maintain and preserve the quality of its cellular services as well as its coverage is based partly on its ability to construct cellular sites and install information equipment, including broadcasting sites. The difficulties encountered by Pelephone in obtaining the permits and approvals required may have an adverse effect on the existing infrastructure, network performance and on the construction of the additional cellular sites required by the network. Any inability to resolve these issues in a timely manner will likely prevent Pelephone from achieving the service quality targets established in the cellular license.

A few sites constructed years ago still lack approvals from the Civil Aviation Administration and the IDF, even though applications for such approvals were submitted years ago. In addition, there are administrative or other delays in some of the building and planning committees for issuing building permits for sites. Consequently, Pelephone operates several broadcasting sites prior to obtaining the requisite building permits. Building permit applications submitted by Pelephone to the building and planning authorities are at various review or approval stages.

Construction of a broadcasting site without a building permit constitutes a breach of the law and in some cases it has led to the issuance of demolition orders of sites or the filing of indictments or instigation of civil proceedings against Pelephone and some of its officers.

Pelephone has succeeded in most of the above cases in delaying implementation of the demolition orders as part of arrangements made with the planning and building authorities in order to attempt to regulate the missing licensing. These understandings did not require admission of guilt and/or conviction of Pelephone's officers. Notwithstanding, there is no certainty that this situation will continue in future, or that there will be no further cases where demolition orders will be issued and indictments will be filed, including against officers, because of the failure to obtain building permits.

Like other cellular operators in Israel, Pelephone might be required to dismantle broadcasting sites before the requisite approvals and permits have been obtained, on the dates stipulated in the law. Pelephone uses access installations to provide coverage and capacity for highly populated areas. If legal grounds are established to require the simultaneous demolition of sites in a given geographic area, service in that area may deteriorate until alternative broadcasting sites can be established.

*Permits of the Ministry of Environmental Protection*

The Minister for Environmental Protection has promulgated regulations pursuant to the Israeli Radiation Law that address issues such as fees for permits, the method of measuring radiation, etc.

In January 2009, the Radiation Supervisor at the Ministry for Environmental Protection published guidelines regarding safety ranges and maximum permitted exposure levels with respect to radio frequency radiation, including from cellular aerials.

In 2010, the Ministry of Environmental Protection notified Pelephone of a new condition for all of its network site operation permits, according to which it must install in its systems software (provided by the Ministry of Environmental Protection) that monitors and reports the level of power created in real time from the operation of its network sites.

*Additional Environmental Regulation*

Israeli Consumer Protection Regulations (Information regarding Non-Ionizing Radiation from a Cellular Telephone), 2002 specify the maximum permitted radiation level for a cellular telephone measured in units of Specific Absorption Rate (“SAR”) and require Pelephone to notify its customers regarding the maximum permitted radiation level. As far as we are aware, all of the cellular telephones that Pelephone markets comply with the relevant SAR standards.

Pelephone conducts periodic radiation tests in order to ascertain its compliance with permitted operation standards and the standards of the International Radiation Protection Agency. These tests are outsourced and performed by companies authorized by the Ministry for Protection of the Environment. Pelephone has an internal enforcement procedure for supervision of implementation of the provisions of the Israeli Radiation Law, which is supervised by a senior manager. The purpose of the procedure is to incorporate the provisions of the Israeli Radiation Law into the procedures of Pelephone and limit the possibility of violations.

Pelephone is subject to laws that define obligations to publicize and inform customers about the sources of the radiation that it operates and the mobile handsets that it supplies. The Radiation Supervisor at the Ministry for Protection of the Environment publishes information on the Ministry’s website about active cellular broadcasting facilities and those that are under construction. The Ministry for Protection of the Environment continuously monitors the cellular broadcasting facilities that Pelephone erects and operates, as it does to the other operators. On its website, Pelephone publishes information about radiation emitted from cellular phones and Ministry of Health regulations regarding preventive caution when using cellular phones.

*Cellular Infrastructure Sharing*

In July 2011, the Ministry of Communications issued a press release listing the following main recommendations of the inter-ministerial committee on the sharing of infrastructures in the cellular market.

In May 2013, the Ministry of Communications, Ministry of Health and the Ministry of the Environment announced that a pre-condition to the deployment of fourth generation cellular infrastructure is the implementation of the inter-ministerial task force’s recommendations regarding the sharing of cellular infrastructures.

*Separation between the Sale of Terminal Equipment and the Sale of Cellular Telephony Services*

In January 2013, an amendment to the Israeli Communications Law became effective, under which a cellular telephony operator may not make a subscriber's commitment to receive cellular telephony services dependent on that subscriber's agreement to purchase, rent, borrow or lease terminal equipment. In the past, Pelephone's principal sales method was to offer discounts on the price of cellular telephony services subject to the purchase of terminal equipment. This amendment has had a negative effect on the sale of terminal equipment.

*Ministry of Communications Hearing Concerning WiFi*

On August 6, 2014, the Ministry of Communications published a hearing report on the issue of amending Bezeq International's ISP license (corresponding with the bill discussed by the Economic Affairs Committee). The main points of the amendment are expansion of the existing obligation under the provisions of the Communications Law to inform customers and offer them an opportunity to protect themselves against offensive content by means of basic filtering software that is provided free of charge. As part of the hearing, the Ministry sought, among other things, to require Bezeq International to offer its customers more advanced filtering software free of charge, allowing them to choose between an applicative filter (which must be compatible for all devices) and the use of a network filter. Some of these solutions cannot be applied at the present time.

**Bezeq International**

On February 21, 2016, Bezeq International's license was amended by the General Director of the Ministry of Communications and was replaced by a unified general license to provide telecommunications services, or the Unified License.

The Unified License cancels and replaces the general license for providing international telecommunications services that was granted to Bezeq International on June 2, 1996, and the special general license for providing fixed-line domestic telecommunications services granted to B I P Telecom. Ltd. on February 8, 2009. In addition, the Unified License also cancels and replaces the special licenses for providing NEP and Internet services previously granted to Bezeq International. The Unified License, which is valid until May 2, 2025, covers all the services that Bezeq International was permitted to provide to date. Pursuant to Ministry of Communications requirements, Bezeq International provided a bank guarantee of NIS 5 million in compliance with the terms of the Unified License.

On July 9, 2014, the Minister of Communications granted Bezeq International the powers pertaining to land that are listed in Chapter 6 of the Communications Law, including access to land for the purpose of laying and maintaining a network.

*Amendment to the Communications Law with respect to filtering of offensive content*

In August 2012, the Ministry of Communications amended the licenses of the ISPs, adding provisions to the licenses concerning filtering of offensive sites and content, as a supplementary measure to the existing provisions of the law with regard to this issue. The amendment stipulates that a license holder will be required among other things, to inform its subscribers about offensive websites and content which are not suitable for children and teenagers and to include details of methods for blocking access to such sites and content. Likewise, the license holder must offer its subscribers an effective service for filtering offensive sites and content, for no additional payment.

On August 6, 2014 the Ministry of Communications published a hearing on the issue of amending Bezeq International's ITS license (corresponding with the bill discussed by the Economic Affairs Committee). The main points of the amendment are expansion of the existing obligation to inform customers and offer them an opportunity to protect themselves against offensive Internet content and requiring Bezeq International to provide its customers, free of charge, with the most advanced filtering software; solutions that in part are not applicable at this time.

**DBS**

The television broadcasting industry in Israel is highly regulated. Broadcasting is carried out pursuant to various broadcast licenses and is subject to the ongoing supervision of the Ministry of Communications and the Broadcasting Council. DBS's operations are regulated by and subject to an extensive system of laws that apply to the area of broadcasting, including the Israeli Communications Law and regulations thereunder and the Communications Rules, as well as administrative directives and Broadcasting Council decisions. Pursuant to the Communications Rules, various obligations and restrictions apply to DBS, including those relating to broadcast content and the amount and manner of investment in local productions. In addition, DBS may own up to 30% of the local channels broadcast by it.

Operations in the broadcasting sector are subject to extensive regulation under the Communications Law, with a strict licensing and monitoring regime and Ministry of Communications' policy decisions. Broadcasting operations are also under the ongoing supervision of the Council for Cable TV and Satellite Broadcasting, or the TV Council, which sets policy, makes rules and monitors many areas of the sector, including broadcasting content, compliance regarding original Israeli content, broadcasting ethics, consumer protection and approval of the channels broadcast and price controls. Non-licensed broadcasters providing multi-channel television services are currently not subject to the foregoing supervision.

In September 2014 the Prime Minister and Minister of Communications appointed an advisory committee, or the Filber Committee, to formulate recommendations regarding regulation of the broadcasting and content sector, including applicability to new players and formulating legislative amendments. On February 3, 2016 the Filber



Committee submitted its interim recommendations which include, among other things, applicability of broad regulatory duties (including the duty to invest in and present original productions) and soft regulation (that includes the duty to mark and classify content and restrictions on marketing content) for major providers that are defined as audio-visual service providers whose market share exceeds 20% of the television provider market revenues (and so long as the market share is no less than 15%), and applicability of soft regulation only for non-major audio visual providers.

The Committee also intends to review the relief of regulation applicable to the broadcasting segment with regard to basic bundles and narrow bundles, regulating the launch and removal of channels, broadcasting dates and times and broadcasts in various languages, as well as the TV Council's rules relating to original productions, relief regarding the length of series, production adequacy and premier broadcasting duties.

The Committee further recommended that a gradual four year plan be drafted regarding investments in high-end original productions, according to which, among other things, such investment duty will apply to DBS and HOT in an amount that will not fall below 4% of its revenues in the first year of implementation of the recommendations and no less than 3% of revenues in the fourth year

#### *The broadcasting license*

The broadcasting license provides provisions regarding the types of fees the licensee may collect from its subscribers for services provided under the license, and those fixed in DBS's price list. The vast majority of subscribers join special campaigns offering DBS services, including various content combination packages, related services, as well as the receipt and installation of terminal equipment at prices below the listed price.

The vast majority of subscribers join special offers, including different combinations of content packages, related services, as well as receiving and installation of terminal equipment at prices below the listed price for all components of the special offer and they appear in the DBS price list. The Council chairperson may intervene in campaigns or reductions offered by DBS if he/she finds that they are misleading to the public or discriminate among subscribers.

Under the Communications Law, the license may stipulate maximum prices that can be charged to subscribers. At present, no such prices have been set. Furthermore, under the Communications Law, the Minister may set the price for the basic package.

In December 2015, the TV Council issued a hearing document regarding setting a price policy and applicability of transparency provisions, addressing the multi-channel television market, including DBS. Prior to issuing the Hearing Document the Council chairperson decided not to permit DBS to raise the price for its VOD services. At the same time, the Council chairperson also decided not to approve the various price hikes announced by HOT. The Hearing Document stated, among other things, that based on the economic test conducted by the TV Council, the Council assumes that the current price structure in the multi-channel television market significantly harms competition and allegedly also raises concerns of discrimination and misrepresentation. Therefore, the Council initiated a hearing regarding its intention to prescribe comprehensive policies regarding prices in the multi-channel television market that will be based on various recommendations brought before the TV Council, including the recommendation to deny the option of raising the price of the current campaign within the period of the campaign; to provide that new campaigns will apply for subscribers for a limited period of 4 months only; to prohibit offering preferential prices to subscribers who threaten deserting or who are in the stages of disconnecting; to establish a prohibition on discrimination between campaigns and tracks offered at any given time; and to explore the option of canceling price gaps between existing customers unrelated to the date on which they joined and the track that they chose, as well as to define a standard uniform price for these subscribers.

The Hearing Document also stated that a recommendation was brought before the TV Council that if the reform and setting of a price policy will not be achieved within a reasonable period of time, the required objectives (as set out in the Hearing Document - significant improvement in transparency and simplifying the customers' ability to compare prices and the scope of the competitiveness), a more thorough investigation will examine applying price controls on the multi-channel television companies. The Hearing Document further stated that in view of the economic study presented before the Council, and with special attention to the significance of the principle of transparency, the Council decided that it should order the disclosure of all the price lists and campaigns of the companies in the multi-channel television market, by amending the licenses of the companies so that they will be required to publish on their websites all the campaigns offered to all of the customers of the companies. The TV Council also decided to temporarily freeze price hikes in the multi-channel television market and to not allow companies to offer new campaigns (this decision regarding a temporary freeze was canceled in February 2016, also due to HOT and DBS undertaking to publish new campaigns). In February 2016, DBS filed its response to the Hearing Document. The implementation of the proposal of the Council could have a substantial adverse effect on DBS's revenues and profitability.

#### *Obligation to invest in local productions*

Under the provisions of the broadcasting license and the TV Council's decisions, in 2015 DBS was required to invest an amount no less than 8% of its revenue from subscription fees in local productions, and according to the communications regulations and the decisions of the TV Council, DBS is required to invest different amounts of these investments in various genres of local productions. In 2015, DBS also supplemented investment shortfalls set by the Council for certain genres. The obligation to invest in local productions in 2016 remains at 8%, of revenues. In November 2015, the TV Council decided that the rate of investment in local production applicable for 2017 onwards will increase to 9% of revenues, so long as the TV Council does not order otherwise and so long as there is no decline in DBS's revenues or the number of its subscribers, in a manner that is to be prescribed in the decision.

*Requirement to transmit channels*

In accordance with the requirements under the law and license, DBS is required to allow the producers of channels set out in the law to use its infrastructures to transmit broadcasts to its subscribers in exchange for a payment to be determined in the agreement. Lacking agreement the payment will be determined by the Minister, after consulting with the TV Council.

Pursuant to the amendment to the Communications Law in 2010, niche channels are exempt from fees other than to HOT and DBS.

Content of the broadcasts and obligations with respect to subscription

The broadcasting license sets out provisions that relate to the content of DBS's broadcasts, including an obligation to obtain the Council's approval of the channels broadcast by DBS. The Communications Law forbids holders of broadcast licenses to broadcast commercials, other than a few exceptions. The broadcast license also includes provisions regarding the subscriber service terms, including discrimination prohibition.

*Ownership of broadcast channels*

Pursuant with the Communications Rules, DBS, including its affiliates as defined in the Communications Rules, may own up to 30% of the domestic channels it broadcasts (compared with the 20% applicable to HOT.) DBS is restricted under the Communications Law with respect to ownership of news broadcast productions, however under the Communications Law (Telecommunications and Broadcasts) (Amendment No. 59 and Temporary Order), 2014 and the Council's decision of March 2014, DBS has broadcast domestic news since April 2014. The Temporary Order was issued for two years as of April 2014.

*General provisions regarding the broadcasting license*

The Minister and the Council have parallel authority to amend the broadcast license. The Minister was authorized to cancel or postpone the broadcast license for causes set out in the Communications Law and the broadcast license. The Communications Law and broadcast license stipulate restrictions on the transfer, attachment and encumbrance of the broadcast license and any of the assets of the broadcast license. The broadcast license requires receipt of the approval of the Minister for specific changes in the holding of the means of control in DBS and imposes a reporting requirement regarding the holders of the means of control; harming competition by way of an agreement, arrangement or understanding with a third party in terms of provision of broadcasts and services is prohibited, unless approved in advance and in writing by the Council; the obligation to file reports to the Ministry of Communications was defined as well as conditions regarding the regulation of the activity of the licenses; an obligation was stipulated to provide bank guarantees that are currently NIS 40 million to the Ministry of Communications to guarantee DBS 's undertakings under the license (in order to issue these guarantees, DBS shareholders provided securities to the issuing banks).

*Wiring in subscribers' homes*

In October 2012, the Ministry of Communications announced that it would cancel the administrative order applicable at that time, regulating subscriber churn between DBS and HOT, and reciprocal use of the infrastructure in subscribers' homes which in some cases is owned by the other provider. This announcement was further to the request by DBS and HOT to amend the administrative order, primarily to cancel the advance notice obligation for a subscriber connecting to another service provider. In 2013, DBS and HOT applied to the Ministry of Communications to amend this decision, so that the administrative instruction is not canceled but will be amended as they requested. The Ministry of Communications' position on this issue has not yet been received.

*Offering service bundles*

Under the broadcast license, DBS may offer joint service bundles that include service provided by Bezeq and service by DBS, subject to obtaining Ministry of Communications approval (and if no objections are raised within the period specified in the license, such approval will be deemed granted) and subject to conditions, the most important of which are the "unbundling" obligation, and the existence of a corresponding bundle marketed by a licensee that is unrelated to Bezeq. A joint service bundle that includes Bezeq's Internet infrastructure service only, does not require Ministry of Communications approval and the unbundling obligation does not apply.

DBS believes that in view of the development of competition between the communications groups and the growing importance of the supply of comprehensive communications services, if the restrictions with regard to Bezeq's collaboration with DBS remain in place, the adverse impact of such restrictions on DBS's results may increase.

On March 10, 2016, the TV Council laid out certain decisions, including, among else that each main special deal (a deal including the broad basic package, the narrow basic package or any other basic package that will be offered in the future) will be priced for a defined and fixed period of 4 to 18 months only during which no price increase will be permitted.

*Regulation of the transmission of video content via media infrastructures*

In July 2015, the committee that was appointed to examine regulation of the commercial broadcasts in 2014 submitted its final report. This report contains, among other things, the following recommendations: the establishment of a unified regulatory authority in the communications industry that will prescribe a list of issues that will be arranged through mutual regulation and a code of ethics, the duty to label and classify services, mandatory reporting dates for those entities that are required to report and measurable parameters for checking the level of competition in the communications sector.

The committee's decisions, if applied, may affect the developing trend of video content transmitted over the web.

DBS believes that the VOD services it provides over the web, are not subject to the regulations currently applicable to the multi-channel television broadcasts and as far as it is aware, the other services it provides via the Internet (such as yesGo) are also not subject to such regulation. Nonetheless, from the Council's various decisions it appears that the Council believes it is authorized to also regulate these services regarding DBS. In the event the foregoing regulations will be formulated or applied, they may affect the services provided by DBS.

## **DTT**

The Second Authority for Television and Radio, or the Second Authority, operates a digital terrestrial television and radio broadcasting system, or DTT, commercially known as Idan Plus, through which certain channels are broadcasted to the public, free of charge. It currently broadcasts the channels of the Broadcasting Authority (Channel 1 and Channel 33), the commercial channels (Channel 2 and Channel 10) and the Knesset Channel (Channel 99). The DTT operator may broadcast additional channels including radio channels, educational channels and special topic channels. These channels will generally carry broadcasting fees, but the Ministers of Communications and Finance may elect to subsidize the broadcasting fees for subject-based channels and niche channels. The subject-based channels may, under the law, finance their broadcasts by charging a subscription fee in addition to the alternative financing through commercials. The Ministers of Communications and Finance may appoint a private entity to operate the DTT system, in place of the Second Authority. At present, the DTT provides a limited alternative product to the multi-channel television broadcasts. DBS believes that an increase in the number or range of channels broadcast via DTT, as well as the possibility of a private entity operating the DTT system, could increase the scope of programs broadcasted and may therefore have a material detrimental effect on DBS's results.

### *Narrow Package Offering*

In accordance with a decision of the TV Council, beginning December 2012, DBS and HOT must allow subscribers to purchase, in addition to the basic package of channels that the licensees are obligated to offer to all their subscribers by law, a package of channels that includes certain basic channels and at least four channels produced in Israel, including a sports channel and a channel for pre-school children or a channel for children and teens based on the conditions defined in the Broadcasting Council's decision. According to the decision, DBS and HOT were required to offer these channels until May 31, 2013. In May 2013, the TV Council announced an extension of the period during which DBS and HOT may offer the limited group of channels until August 31, 2013.

In July 2013, the Knesset passed a second and third reading of provisions concerning the offering of a basic package in cable and satellite broadcasts as part of the Law for the Change of National Priorities (Legislative Amendments for Achieving Budget Targets for 2013-2014), 2013. According to such law, the Minister of Communications will stipulate the number of channels and price of the package and he will be authorized to stipulate the policy concerning the specifications of and types of channels in the package. The TV Council will issue instructions for implementation of the Minister of Communications' stipulations, including with respect to the specification, content, standard and scope of the channels. The Minister of Communications' stipulations will remain in force for a period of no more than three years, but the Minister of Communications' may, after consulting with the Broadcasting Council, instruct an extension for additional periods. Payment may not be collected from subscribers for the basic package for related services (including installation fees or the cost of installation and for terminal equipment) if subscribers are not charged for other packages, and in any event such payment will not exceed the payment requested from subscribers of other packages without permission from the TV Council.

In August 2013, the TV Council announced that it is considering amending the Communications (Broadcasting Licensee) Rules, 1987 and adopting a different model from the present model. According to the new model, DBS and HOT will be obligated to offer their subscribers a basic package of broadcasts which will include the mandatory channels as well as a number of additional channels which the subscriber will be able to choose from the broadcast channels offered by the license holder (except for a small number of channels), so that the basic package will include, together with the mandatory channels, between 17 and 24 channels.

*Transmission of Video Content via Media Infrastructures*

In February 2014, the Minister of Communications appointed a committee to review the regulation of commercial broadcasts that will apply to all companies engaged in broadcasting of audio visual content. The committee was also required to make recommendations regarding the possible inclusion of commercials in HOT and DBS broadcasts. The committee was required to formulate its recommendations by August 2014. Further to a request from the committee, DBS submitted its position on the foregoing issues to the committee in April 2014.

In August 2014, the Committee submitted its recommendations to the Minister of Communications in an interim report. The committee recommended, among other things, that a license need not be required to provide audio-visual services over the Internet; that the regulations applicable to the new providers be imposed on a gradual basis, based on qualifying tests to be defined and the number of subscribers; and that a national communications authority be established to serve as a central regulator, which will incorporate the Ministry of Communications, the Second Authority and the Council. In September 2014, DBS submitted its response, in which it argued that licensing requirements should also apply to new suppliers, that the regulations should apply equally to holders of broadcast licenses and to new providers, and that if the regulations are applied gradually, the date on which the regulations become applicable should be limited (not only by quantitative measures). As of the date of this report, the committee is has not submitted its final report. The committee's decisions, if applied, may affect the developing trend of video content transmitted over the web.

DBS believes that the VOD services it provides over the web are not subject to the regulations currently applicable to the multi-channel television broadcasts and as far as it is aware, this is the position of the Ministry of Communications. DBS also believes that the other services it provides via the Internet (such as yesGo) are also not subject to such regulation. Nonetheless, if other regulations will be formulated or applied, they may affect the foregoing services provided by DBS.

## Suppliers

The Bezeq Group has important relationships with several suppliers of hardware, software and related services that are used to operate its businesses. During 2015, no supplier accounted for more than 5% of the Bezeq Group's total annual purchases, nor did any supplier account for more than 10% of total purchases in a specific segment of operation.

### *Bezeq*

Most of the equipment purchased by Bezeq for data communication, switching, transmission and radio systems has been specially modified or developed for its use, and the ability to obtain support other than through the manufacturer is limited.

Bezeq relies on manufacturer support from a number of its key suppliers for certain of its systems, and may have difficulty replacing them. Bezeq's key suppliers include: (i) Alcatel Group (represented in Israel by Alcatel Telecom Israel Ltd.) in the areas of public switching and metro transmission, (ii) Dialogic Networks (Israel) Ltd. for migration exchanges for linking operators to Bezeq's switching network, (iii) Comverse, Inc. for switching exchanges for end customers on the NGN network, (iv) the NGN of Adtran Holdings Ltd., (v) Oracle in the area of databases, (vi) EMC for hardware solutions for back-up, recovery and archiving of systems and infrastructures, (vii) VMware for infrastructure for the entire virtualization of Bezeq's servers, and (viii) ECI Telecom for systems that connect Bezeq's network and business customers on its transmission network.

Agreements with the key suppliers are generally long-term and usually include a warranty period for a specified period, followed by another period of maintenance or support. Where necessary, Bezeq may enter into an agreement with a supplier for the supply of support and/or maintenance services for further periods. These agreements usually contain various forms of recourse for Bezeq should the supplier breach the agreement.

### *Pelephone*

Pelephone sells a wide range of cellular handsets and auxiliary accessories (such as batteries, hand-free kits, earphones, data cables and chargers). Pelephone also maintains spare parts to supply repair services to its customers and an inventory of used handsets.



Pelephone purchases handsets and accessories from a variety of suppliers and importers. Contractual engagements with most of the suppliers are based on framework agreements, which also set forth the technical support provided by the supplier for the equipment and spare parts and turnaround time for repairs. These agreements generally do not include a commitment of Pelephone to acquire a minimum quantity of devices and acquisitions are made by means of purchase orders. Generally, if an agreement with a particular supplier of equipment is cancelled, Pelephone can increase the quantity purchased from other suppliers or purchase equipment from a new supplier.

Pelephone has an agreement with Apple Distribution International for the purchase and distribution of iPhone handsets in Israel, which is in effect until May 2016. The agreement includes Pelephone's undertaking to purchase a minimum quantity of iPhone handsets. These handsets account for a substantial percentage of the handsets sold by Pelephone. If Pelephone fails to meet the minimum quantities it may be in breach of the agreement, which may involve payment of damages. Other than Apple Distribution International, Pelephone is not dependent on any supplier for the purchase of handsets.

Pelephone acquires the UMTS/HSPA+ network equipment from Ericsson and has a long-term agreement with Ericsson for the maintenance, support and upgrading of software for its UMTS/HSPA+ network. We believe that Pelephone could be deemed to be dependent on Ericsson for the support of its UMTS/HSPA+ network. The CDMA network equipment is acquired from Nortel and Motorola, and Pelephone maintains such equipment independently. In addition, the cellular networks use transmission facilities for which Bezeq is Pelephone's main supplier.

#### *Bezeq International*

Bezeq International has cooperation agreements with approximately 200 foreign operators for approximately 240 destinations worldwide. Since fixed-line broadband Internet infrastructure access services are provided to its subscribers by Bezeq and HOT, Bezeq International is dependent upon Bezeq and, to a lesser degree, HOT for domestic capacity in the provision of its ISP services and for connecting the subscriber to the international exchange.

Under its agreement with MedNautilus, Bezeq International purchased indefeasible rights of use to an unparticular non-specific part of the communication capacity of the undersea cable system operated by MedNautilus between Israel and Europe for a period of up to 15 years from the date on which it started using this capacity (with an option to extend the period of use). The periods of use are at least until 2027, depending on the date of the start of use of the capacity. In consideration for such rights of use, Bezeq International paid a non-recurring payment around the date on which it started using the capacity. In addition, in October 2011, Bezeq International entered into an agreement with MedNautilus to expand and change the existing rights of use in the international optic network that it operates, so that such rights of use will serve as a backup for Bezeq International's JONAH submarine cable.

On January 18, 2010, Bezeq International signed a partnership agreement with British Telecom for the provision of global communications services to Israeli and multi-national companies operating in Israel. As part of the strategic agreement, Bezeq International operates as a BT Alliance partner in Israel and markets IT services and products from British Telecom's global range of services.

#### *DBS*

DBS purchases set-top boxes from three suppliers. Under a framework agreement entered into in August 2000, as amended from time to time, among DBS, Advanced Digital Broadcast S.A., or ADB and Eurocom Digital. DBS purchases set-top boxes (including the PVR set-top boxes) from Eurocom Digital, which imports them from ADB and provides the warranty for the set-top boxes. Eurocom Digital is controlled by Mr. Shaul Elovitch, who is a controlling shareholder of Bezeq. In addition, DBS purchases HD set-top box zappers from Pace Micro Technology PLC and HD set-top box zappers DSD 4145 STB from Altech Multimedia International (Pty) Ltd.

In 2015, DBS acquired from NDS Limited development, licensing, assimilation, maintenance and warranty services with regard to the operating systems of the broadcasting system and the decoders, and the hardware related to these services, including those connected to the encoding of DBS services, and viewing cards that allow the foregoing encoded content to be viewed.

Since January 2016, DBS purchases these services and products from Cisco Group companies, or Cisco, which is an affiliate of NDS, under an agreement signed between Cisco and DBS which has replaced the engagement with NDS. According the agreement between Cisco and DBS, Cisco provides DBS with similar services to those provided by NDS, and provides products connected with the relevant systems and provides DBS with various licenses required for operating the systems and decoders. DBS is dependent upon the regular supply of these services and products, inc