



The Israel Electric Corporation Ltd.

Financial Reports

For The Year Ended
December 31, 2014

FILES INDEX

The financial reports, for the year ended December 31, 2014, are presented in a primary order.

Each chapter is numbered separately by its internal sequence.

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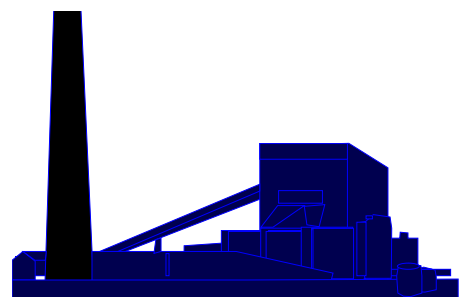


The Israel Electric Corporation Ltd.

Chapter A

Description of the Company's Business Affairs

For the Year Ended
December 31, 2014



Prominent Disclaimer

This English translation of the **“Description of the Company's Business Affairs”** for the year ended December 31, 2014 ("English Translation") is provided for information purposes only.

In the event of any conflict or inconsistency between the terms of this English Translation and the original version prepared in Hebrew, the Hebrew version shall prevail and holders of the Notes should refer to the Hebrew version for any and all financial or other information relating to the Company.

The Company and its Directors make no representations as to the accuracy and reliability of the financial information in this English Translation, except that the Company and its Directors represent that reasonable care has been taken to correctly translate and reproduce such information, yet notwithstanding the above, the translation of any technical terms are, in the absence of generally agreed equivalent terms in English, approximations to convey the general sense intended in the Hebrew version.

The Company reserves the right to effect such amendments to this English Translation as may be necessary to remove such conflict or inconsistency.

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Chapter A – Description of the Company's Business Affairs ¹

Part 1: Description of the General Development of the Business Affairs of the Company

1. The Company's operations and a description of the development of its business affairs

1.1 General

The Israel Electric Corporation Ltd. ("**Company**") was incorporated in Israel on March 29, 1923, under the name of the Palestine Electric Corporation Ltd. In 1961, the Company was renamed to its current name. The Company is engaged in the generation, transmission, distribution, sale and supply of electricity to most of the consumers in Israel. See Section 2 for details on the fields of activity of the Company.

In 1926, the authorities in the British Mandate for Palestine granted the Company a concession that is known as the "Jordan Concession", and a concession that is known as the "Yarkon Concession" (which was granted to Pinchas Rothenberg, the founder of the Company) was endorsed to it (hereinafter: the "**Concessions**").

The Concessions received statutory validity within the framework of the Electricity Concessions Order - 1927 (hereinafter: the "**Electricity Concessions Order**").

The validity of the Concessions was set for a period of seventy (70), years, which ended on March 3, 1996, and from that time on, the provisions of the Electricity Sector Law - 1996 (hereinafter: the "**Electricity Sector Law**"), which replaced the Electricity Concessions Order, and the regulations that have been promulgated thereunder, apply to the operations of the Company. See Section 21.1 for details on the highlights of the Electricity Sector Law.

The Company generates, transmits, distributes and supplies most of the electricity that is consumed in the Israeli national economy pursuant to the licenses that have been granted to it for each such type of operation, in accordance with the Electricity Sector Law, which have been extended over the years. The Company also engages in the setup of the infrastructures that are required for the stated operations and also operates as an electricity system administrator. In addition, the Company owns a license to distribute and supply electricity in the area of the State of Israel. Additionally, the Company holds an "essential service supplier license" (as this term is defined in the Electricity Sector Law) and holds licenses for the generation of 84.2% of the total output of the power stations in the electricity sector for which generation licenses have been issued². The system administration activity is performed by the Company within the framework of the "the General License" (as this has been defined in Section 21.1.2) although it has not been given a special purpose license on this matter. See Section 21.1.2 for details

¹ With respect to positions or estimates of the Company included in this report, it should be clarified that the positions or estimates of the Company included herein do not serve to bind the discretion of the State Of Israel or any of its establishments to act and/or decide by any law in a manner differing from the positions or estimates of the Company as set forth.

² The data regarding the extent of the generation licenses and regarding the installed production capacity that appear in the report do not take into account data regarding private electricity producers with a smaller installed production capacity with whom the Company has not engaged with and therefore has no data regarding them. Additionally, the data do not include conditional license owners.

The licenses of the Company have been extended from time to time over the years. On December 31, 2014, it was published in the Official Gazette that the Minister of National Infrastructure, Energy and Water (the “**Minister**” or “**Minister of Energy and Water**”), and Acting Minister of Finance, extended the licenses of the Company until January 1, 2016, by an order that was granted by the Ministers³, after consultation with the Public Services Authority Electricity (“**Electricity Authority**”), the Government Companies Authority (“**Companies Authority**”), and with the approval of the Economics Committee of the Knesset. According to the provisions of the Electricity Sector Law as of the reporting date, extending the licenses of the Company to a date later than January 1, 2016 entails legislation amendment.

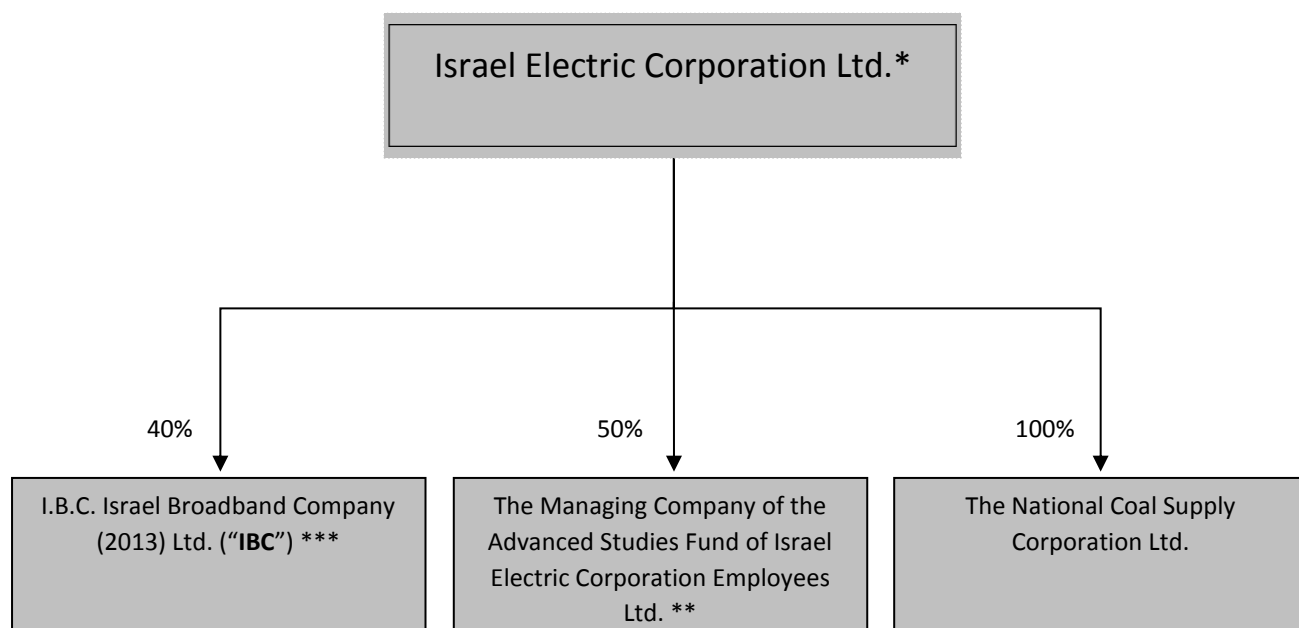
The shares of the Company were traded for a certain period⁴ on the Tel Aviv Stock Exchange Ltd. (hereinafter: the “**Stock Exchange**”), but following a purchase offer that the State of Israel published on September 30, 1986 to the shareholders of the Company, which was accepted by a majority of the shareholders at the time, the shares of the Company ceased to be traded on the Stock Exchange. As of the date of the report, the Company has bonds (series 24) and (series 25), that are backed by State guarantee, and traded on the stock exchange, and which have been originally issued according to a prospectus of the Company from June 26, 2012. As of the date of this report, the State of Israel holds approximately 99.846% of the issued, paid-up share capital of the Company, and therefore, the Company is a “government company” as this term has been defined in the Government Companies Law - 1975, (hereafter: the “**Government Companies Law**”) and the Company and its operations are also subject to the provisions of that law. The balance of the issued and paid up capital of the Company, at a rate of approximately 0.154%, is held by approximately 120 individuals.

In February 2005, following an application that was made by the Company to the Companies Authority, in order to clarify the issue of the status of the Company as a public or private company, the Company was provided with an expert opinion by the legal adviser to the Companies Authority, according to which, in the opinion of the Companies Authority, the Company is a public company, as this has been defined in the Companies Law - 1999 (hereafter: the “**Companies Law**”). In accordance with the expert opinion, the fact that the source of the shares that are held by the public cannot be identified with certainty does not warrant the denial of the protections that are conferred upon the shareholder public pursuant to the Companies Law, and the Company bears the burden of proving that all of its shares in accordance with that which has been stated above originate merely from private issues. In view of the above mentioned expert opinion and in view of the definition of the term “public company” in the Companies Law, the Company operates as a public company. Pursuant to its status as a public company and pursuant to the issue of Bonds by prospectus as detailed above and their holdings by the public, the Company is subject to the provisions of the Securities Law - 1968 (hereafter: the “**Securities Law**”).

³ “**The Ministers**” – the Minister of Finance and the minister appointed by the Government to be in charge of the affairs of the government company (to the date of the report, the minister in charge of the affairs of the company is the Minister of National Infrastructures, Energy and Water).

⁴ The Company does not currently have in its possession information as to the time and manner in which the shares were offered to the public.

1.2 Diagram of the holding structure of the Company



* In addition, the Company has immaterial holdings (a holding rate of close to zero) in the following companies: Israel Chemicals Ltd., Binyanei Ha'Uma Ltd., and the Israel Farmers Company Ltd., as well as a holding of 8.33% of the share capital and voting rights in the Israeli Institute of Energy and Environment. The Company also has holdings at a rate of 49.99% of the shares and equity interest in the energy resources development company Ltd., which to the best of the Company's knowledge and as of the date of the report is inactive. For additional information, see Section 29.2 below. Additional subsidiaries of the Company, which are inactive, have not been included in the diagram: "Jordan Properties Ltd."**** and "Migrashei Hakablanim Ltd."

** The Company holds 50% of the management shares and of the rights to appoint directors, without rights to share profits. The remaining 50% is held as follows: the Mutual Help Society of Israel Electric Corporation Employees in the Southern Region (Final Holder) (25%), the Society of Israel Electric Corporation Workers in the Northern Region (RA) (Final Holder) 16.667% and the Savings and Mutual Help Fund of Israel Electric Corporation Workers in Jerusalem Ltd. (Final Holder) (8.333%).

*** The Company is allowed to appoint two to four directors of I.B.C., subject to the number of directors that will be appointed by the Company at any time being less than the number of directors that will be appointed by the controlling shareholder of I.B.C., as long as the only shareholders in the I.B.C. Company are the Company and the controlling shareholder. As of the date of the report, five directors are serving at the I.B.C. Company, of which two were appointed by the Company.

**** "Jordan Properties Ltd." has two fully owned subsidiaries, both of which are inactive: "Banks of the Jordan Ltd." and Palestine Construction Company Ltd.

1.3 The nature and the results of each significant structural change, merger or acquisition

For details regarding the structural change outlined under the Electricity Sector Law, and regarding the publication of the draft of recommendations of the steering team for executing a reform in the electricity sector and the Electric Company ("**Steering Team**"), and the decisions of the Courts of Labor in this matter and regarding details relating to a letter that was sent by Mr. Uri Yogev, to Mr. Avi Nisenkorn, Chairman of the New National Labor Federation, regarding the "Position of the State regarding the Israel Electric Company Ltd." (the "**Yogev Letter**") see notes 1.e and 1.f to the financial Statements of the Company as of December 31, 2014 (the "**Financial Statements**").

For details regarding a letter from the Antitrust Authority received by the Company, according to which the general Director of the Antitrust Authority is considering to instruct the Company to refrain from a future increase of its electricity production capacity, see section 7.1.3.

*The information included in this report, and within the framework of the Financial Statements of the Company, with respect to the Company's estimations regarding the manner of implementation of the structural change and its cost, including the possibility of implementing a structural change in the Electricity Sector in accordance with the draft of recommendations of the Steering team, insofar as will be adopted, or in accordance with the Yogev Letter and decisions of the regulatory entities that are required with respect to this and with respect to the forecast of the Company with respect to the extension of its licenses and the period of extension, constitutes forward looking information, as per its definition in the Securities Law, 1968 ("**Securities Law**"). This information as stated is based on future data, and its realization is not certain and is not under the control of the Company, but is dependent on receiving regulatory approvals and agreements, and on relevant legislation amendments, as far as will be required. In addition, this information is based on estimates of the Company as of the date of the report, and the position of the Company with respect to the manner of implementation of the structural change in the Electricity Sector. Such estimates may not be realized or may be realized partially or differently than expected (including that the Company may be required to implement the structural change as it is outlined in the Electricity Sector Law), due to, inter alia, the continued progress in negotiations between the parties and due to changes in the position of the Government, the Ministers, the regulators who supervise the Company's operations or the applicable law, all of which are not under the Company's control*

2. Fields of Activity

The Company operates, as mentioned, as a single combined, coordinated system that engages, as set forth, in the supply of electricity to consumers, from the stage of generation of the electricity to its transmission, distribution, supply and trade. In addition, the Company engages in the establishment of infrastructures that are required for the operations that have been set forth above and operates as the administrator of the electricity system.

As of the time of the report, the Company has three (3) primary fields of activity, which are known as segments in the Financial Statements, in accordance with that which has been stated below⁵:

- 2.1 Generation of electricity** – the operations of the Company in this field includes all of the operations that are involved in the generation of electricity at the generation sites of the Company. See Section 7 for further information.
- 2.2 Transmission and transformation of electricity** – the operations of the Company in this field includes the transmission of electricity from the generation sites using high and extra high voltage lines to the switching stations⁶ and major substations⁷, and between the switching stations and major substations to the substations, through high voltage transmission lines and transformation via connection transformers (from extra high to high voltage) and output transformers (from high to medium voltage). See Section 8 for additional details.
- 2.3 Electricity distribution** – the operations of the Company in this field includes the transfer of electricity from substations to consumers via high voltage lines and low voltage lines and the supply and sale of electricity to consumers. See Section 9 for additional details.

For details with respect to financial information on the fields of operation of the Company, the principles and results of the attribution of profit and loss and balance statements according to the segments of operation, see Section 5 and Notes 35 and 38 to the Financial Statements.

3. Investments in the Company's equity and transactions in its Shares

To the best of the Company's knowledge, during the two years that preceded the date of the report, no investments were made in its equity and nor were there any material transactions in its shares.

4. Distribution of dividends

- 4.1** For details of the assignment of profits and dividend distribution policy see Note 26 of the Financial Statements.
- 4.2** The Company did not distribute dividends in the two years preceding the date of the Report.

4.3 Distributable profits

The balance of the distributable profits of the Company as of December 31, 2014 is approximately NIS 13,792 million.

⁵ It shall be noted that the sectors of activity in accordance with the Electricity Sector Law include also system administration, supply and trading of electricity. See Note 1 to the Financial Statements. As of the date of the report, the activity of system administration is included both in the generation segment and in the transmission segment and the activity of electricity supply and trading is included in the distribution segment.

⁶ A switching station is a station that has 400 kV input voltage.

⁷ In accordance with Section 2 of the Electricity Sector Law, a "substation" is a transformation station that connects electricity grids of different types that has transformers that increase or decrease voltage.

Part 2: Other Information

5. Financial information of the Company's fields of activity (in NIS million)

Details on variable costs and fixed costs by segments follow:

For the year ended December 31, 2014

Data for 2014 – segments				
In million NIS adjusted to NIS of December 2014				
	Generation	Transmission	Distribution	Total
<u>Fixed:</u>				
Wages	1,319	260	1,199	2,778
Depreciation	2,356	943	1,221	4,520
Financing.....	1,261	610	916	2,787
Others	1,603	1,449	588	3,640
	6,539	3,262	3,924	13,725
<u>Variable:</u>				
Fuels.....	7,884	-	-	7,884
Transfer of fuels to regulatory asset	3,435	-	-	3,435
	11,319	-	-	11,319
Total assigned costs	17,858	3,262	3,924	25,044

For the year ended December 31, 2013

Data for 2013 – segments				
In million NIS adjusted to NIS of December 2014				
	Generation	Transmission	Distribution	Total
<u>Fixed:</u>				
Wages	1,524	248	1,200	2,972
Depreciation	2,819	927	1,171	4,917
Financing.....	981	485	701	2,167
Others	1,555	1,099	560	3,214
	6,879	2,759	3,632	13,270
<u>Variable:</u>				
Fuels.....	10,941	-	-	10,941
Transfer of fuels to regulatory asset	4,324	-	-	4,324
	15,265	-	-	15,265
Total assigned costs	22,144	2,759	3,632	28,535

For the year ended December 31, 2012

Data for 2012 – segments				
In million NIS adjusted to NIS of December 2014				
	Generation	Transmission	Distribution	Total
Fixed:				
Wages	1,882	325	1,414	3,621
Depreciation	2,660	853	1,162	4,675
Financing.....	1,214	601	870	2,685
Others	2,065	918	688	3,671
	<u>7,821</u>	<u>2,697</u>	<u>4,134</u>	<u>14,652</u>
Variable:				
Fuels.....	19,871	-	-	19,871
Transfer of fuels to regulatory asset	(5,258)	-	-	(5,258)
	<u>14,613</u>	<u>-</u>	<u>-</u>	<u>14,613</u>
Total assigned costs	<u>22,434</u>	<u>2,697</u>	<u>4,134</u>	<u>29,265</u>

The main types of expenses that the Company has are: fuels, depreciation, wages, financing, suppliers, contractors, equipment and materials and other expenses. The costs of fuels in the Company are mainly variable costs. All other costs are mainly fixed costs.

Depreciation, wage, financing, supplier, contractor, equipment and material expenses are mostly fixed costs that the Company cannot materially influence in the short term, for the following reasons:

- (A) The costs of fixed assets that the Company has (depreciation).
- (B) Employment agreements with most employees (wages and others).
- (C) A loan that the Company has taken (financing).
- (D) Purchase agreements from suppliers and other inevitable costs (such as municipal rates and guarding).

See Notes 35 and 38 of the Financial Statements for details on the rules and assumptions based on which the division into operation segments was made and further information.

See the explanations in Board of Directors' report sections A3 and A4 for descriptive details provided by the Board of Directors with respect to the developments that occurred in the financial results of the Company as of December 31, 2014 ("**Board of Directors' Report**").

6. The general environment and the impact of external factors on the Company's operations

The assessments of the Company with respect to the trends, events and developments in the macroeconomic environment of the Company that have or may have a material impact on its business results or developments in the Company as a whole and the implications in respect of them on the Company.

6.1 Regulation in the Company's fields of activity

The operations of the Company depend to a great extent on the regulation applying to its operations, including the provisions of the Electricity Sector Law and its regulations, pursuant to which it is given licenses for operations, the policy and resolutions of the Government (including resolutions of the Ministry of National Infrastructures, Energy and Water and the Ministry of Finance), the resolutions of the Electricity Authority (including with respect to the electricity charge rate that is fixed by the Electricity Authority and collected from the customers of the Company), the provisions of the Companies Law and its regulations (*inter alia*, regarding the manner of the Company's conduct as a public company), the provisions of the Government Companies Law and its regulations and resolutions of the Companies Authority (*inter alia*, on the matter of the conduct of the Company as a Governmental Company, the manner of adoption of resolutions by its organs, the manner of preparation of its Financial Statements, appointment of directors and special functionaries and so on), the provisions of the Natural Gas Sector Law – 2002 ("Gas Sector Law") and resolutions of the Natural Gas Authority ("Gas Authority"), provisions of the Antitrust Law and decisions of the Antitrust Authority and the General Director of the Antitrust Authority (pursuant to the Company being a monopoly or pursuant to its execution of agreements that require the receipt of approval from the antitrust control mechanism), the provisions of section 29 of the Budget Foundations Law, 1985 ("Budget Foundations Law") that requires the Company to receive the approval of the Director of Wages and Labor Agreements in the Ministry of Finance ("Director of Wages") in matters of wages and benefits for its employees, the provisions of the Securities law and its regulations, and the regulations and directives of the Securities Authority, the provisions of the Law of Promotion of Competition and Reduction of Centralization - 2013 ("Centralization Law"), and regulation pertaining to business licensing, planning and construction and environmental protection (see Sections 7.12, 8.8 and 9.10), and additional legislation, as also detailed in section 21.6 of this report. See Section 21 for details on restrictions to and regulation of the activity of the Company. See Section 1.3 and section 28.3.7 for details on the main points of the provisions of the Electricity Sector Law pertaining to a structural change.

6.2 The security and geo-political situation in Israel and in the region

The economic, political and security situation in the State of Israel directly affects the Company, whose assets and operations are located in Israel. The emergence of major hostilities in the Middle East against Israel, lack of stability in the political situation in Israel or neighboring countries, or deterioration in Israel's international trade relations may materially impair the operations of the Company.

In view of the geopolitical situation in the State of Israel and its relations with its neighbors, in the case of a disaster or other disruptions, the State of Israel has no backup to the electrical grid of the Company, and in effect the electricity grid in the State of Israel is isolated in all matters relating to the generation of electricity and its supply to residents, without an ability to purchase electricity or to secure a backup from other suppliers within and outside of Israel.

The High Emergency Power Authority (for the Electricity Field), whose members are the CEO of the Company (the Head of the Authority), Vice Presidents in the Company, the Emergency Economy Manager of the Company, the Director of the Electricity Administration and the Director of the Electricity Affairs Administration at the Ministry of National Infrastructures, Energy and Water holds discussions whose aim is to make resolutions on all matters related to the preparations required for ensuring the preparedness of the power supply layout in an emergency.

Due to the essential services that the Company provides to the State of Israel and its residents, the Company may be at risk and constitute a target for hostile actions that are directed against its facilities, including cyber actions. The Company makes sure to maintain extensive guarding of its facilities and receives directions from authorized

parties on various security issues, including the National Emergency Authority, the Ministry of Defense, the police, the Home Front Command and others. With respect to the generation of electricity, the Company has assessed this threat and takes preventive steps relating to staff at its facilities. The Company cannot anticipate with certainty whether or not attacks of this kind against its facilities will occur in the future or if its facilities will be damaged in wartime and what the effect of such damage, if any, will be.

6.3 Natural gas

For the purpose of the generation of electricity, the Company depends to a great extent on the supply of natural gas, including on the supply of liquid natural gas ("LNG"). As a result of this, the Company is affected by risks related to the limited number of gas suppliers and disruptions in the supply of natural gas. These risks are compounded by the fact that the Company has no facilities for the storage of natural gas. Disruptions in the supply of natural gas, the depletion of or malfunctions in natural gas deposits in Israel and violations of the purchase contracts by the gas suppliers, have compelled in the past and will compel the Company, insofar as they will occur, to generate electricity using more expensive alternative fuels in the future that increase the cost of electricity generation significantly. It is noted that in general, the charge rate coverage mechanism gives the Company coverage for the fuels costs, but because the charge rate coverage is not immediate, a cash flow burden may be created for the Company as a result of disruption of the supply of gas. For details of the draft of recommendations of the Steering Team with regard to trade in natural gas and with respect to the position of the Company regarding the recommendations draft of the Steering Team, as stated, see Note 1 e to the Financial Statements.

6.4 The effect of market data

6.4.1 Changes in the exchange rates

Because almost all of the revenues of the Company are quoted in NIS and approximately 59% of the long term financial liabilities of the Company, including permanent bonds and before executing hedging transactions were, as of December 31, 2014 quoted in foreign currencies (dollars, euros and Japanese yen), the Company is exposed to changes in the exchange rates of these currencies. The weighted devaluation rate of the shekel against the currencies in which the financial liabilities of the Company are quoted (except for a loan to finance the gas transmission project which is not intended for unique use by the Company and includes deposits) in 2014 is 9.6% compared with the weighted revaluation rate in 2013 of approximately 10.8%. The fluctuations in the exchange rates affect the expenses of the Company (financial and others) and the outcomes of its operation. However, most of these liabilities are covered in hedging transactions using a hedging mechanism that is built into the electricity charge rate. See Section b 2) of the Report of the Board of Directors for additional details on the exposure of the Company to changes in exchange rates. See Sections 7.11.2.1, 8.9.1 and 9.11.2 for details on the electricity charge rate.

6.4.2 Index changes

The majority of the capital costs and part of the operation costs recognized in the electricity rate are linked to the Consumer Price Index (the "**Index**"). The Financial Statements of the Company are also adjusted to the Index with respect to the reporting periods until December 31, 2014. Additionally, the Company has expenses that are linked to the Index, and these expenses are relatively stable and therefore create a negligible accounting exposure for the Company.

With respect to the reporting periods beginning on January 1, 2015, the Company is implementing the IFRS in full. Therefore, the adjustment of the Financial Statements of the Company to the Index will be terminated, a fact that may cause erosion to the profitability of the Company in case of an increase in the Index, insofar as a suitable rate or accounting solution will not be found.

For additional details regarding the transition to full implementation of the IFRS and its implications on the Company, see Note 36 to the Financial Statements.

Furthermore, the Company is exposed to a real increase of the input prices the Company purchases regarding the rate recognition of input as linked to the Index.

In addition, the Company has expenses that are linked to the Consumer Price Index; however these expenses are relatively stable and as a result pose a lower accounting exposure for the Company than the fluctuations in the currency exchange rates.

6.5 The policy of the Israeli Government with respect to increasing competition in the Electricity Sector and savings in electricity consumption

As of the date of the report, the Company generates, transmits and supplies, in accordance with that which has been stated above, most of the electricity in the State of Israel. The policy of the Government, as reflected, *inter alia*, in their resolutions and in the provisions of the Electricity Sector Law, is to allow competition in the Electricity Sector. Therefore, the Government has established an objective of increasing the generation of electricity by private producers from approximately 4% to 20% of the total installed electricity generating capacity in the State of Israel through to 2020⁸ and an increase in the share of private electricity producers that generate electricity using renewable energies to 10% of the total electricity generation in the State of Israel through to 2020⁹.

As of the date of the report, the total potential generation capacity of the facilities according to provisional licenses that have been given to entrepreneurs for construction of an electricity generating facility (including from renewable energy) as well as future producers that are to operate under the State tender¹⁰ that was published, stands at 5,644 megawatts. If all of the project for which provisional licenses have been issued and that have won the State tender (except renewable energy projects whose energy availability depends on sunlight, water, etc.) materialize, they will constitute approximately 20% of the total installed generation capacity of the State of Israel and approximately 19% of the total installed generation capacity of the State of Israel, assuming that the Company will build all of the substations in its approved Development Plan (including Alon Tavor combined cycle and Project "D" (see section 7.7.7 for details on project "D").

See Section 7.4 for details on the licenses that have been given to private electricity producers and entrepreneurs and their generation capacity as of the date of the report. To the best of the Company's knowledge, as of the date of the report, Dalia Power Energies Ltd. is at the final stages of construction of a power station (with an output of 870 megawatts) and is expected to complete the construction of the power station by May 2015. The Ashdod Energy Company Ltd. and the Ramat Negev Energy Ltd. are expected to complete the construction of the power stations by July 2015 (with an output of 52 and 124 megawatts, respectively). Additionally, IPM Beer Tuvia Ltd. received a conditional license for construction of a power station (with an output of 428 megawatts) and is expected to complete the construction of the power station by the beginning of 2018. Other private electricity producers that intend to construct power stations with a lower output are in various stages toward licensing, construction and operation of private power stations. In addition, increasing activity is evident in the market in relation to the production of electricity using renewable energies, *inter alia*, as a result of the preferential charge rates that producers received. See Section 7.4 for details.

In addition to this, the policy of an increase in competition in the Electricity Sector is reflected in the provisions of the Electricity Sector Law, whereby the ownership of the various activities in the Electricity Sector shall be decentralized. For example, in the field of generation it was determined that no generation license would be given to a person holding 30% or more of the generation capacity of the Electricity Sector, which in effect would require, insofar as the provisions of the Electricity Sector Law regarding this matter will not be changed, the generation field to have at least four companies operating in it. See Note 1e in the Financial Statements of the Company for further information.

⁸ Decision of the Ministerial Committee for Social and Economic Affairs (the Socio-Economic Cabinet) No. SE/43 of November 4, 2002.

⁹ Government Resolution number 3484: Government policy in the field of energy production from renewable sources, of July 17, 2011.

¹⁰

In addition, the State is operating to save consumption (reduce demand). Thus, among other things, the Ministry of National Infrastructures, Energy and Water is taking steps to increase the awareness of energy savings (for example by a campaign for the replacement of light bulbs to energy saving light bulbs, legislation that prohibits the use of incandescent bulbs, replacement of refrigerators or air conditioners that consume too much electricity and so on). The Company is also acting in accordance with this policy and is encouraging “intelligent consumption” of electricity¹¹.

For details of the letter received by the Company from the Antitrust Authority, under which the General Director of the Antitrust Authority is considering to order the Company to refrain from a future increase of its electricity production capacity, see section 7.1.3.

For additional details of the entry of private electricity producers into the field of electricity generation, including implications it may have on the Company, see section 7.4 and Note 34 a 4) to the Financial Statements.

6.6 Raising finances

Beyond the income from rate, the Company finances its operations, *inter alia*, using bank credit and/or non-bank credit in Israel and overseas. It should be noted that the Company’s ability to raise the debt it requires depends on many factors, some of whom are not under the control of the Company, and there is therefore no certainty as to its ability to raise, at any time, all the sums it requires. See Section 28.2.2 below for details.

6.7 Prevailing weather conditions in Israel

Periods of “extreme” weather (a particularly harsh winter or hot summer) may affect the scope of demand for electricity, as well as the reliability of supply of electricity, and the Company’s capability to supply electricity to all households in Israel.

The Company constantly makes arrangements to deal with extreme situations that are characterized by, *inter alia*, peak demands for electricity. Additionally, an increase in the installed production scope in the electricity sector has occurred in recent years, mainly as a result of the entry of private electricity producers into generation activity in the electricity sector and operation of the steam additions at Ramat Hovav, Hagit and Eshkol, in a manner that reduces the risk of the Company’s inability to meet the demand required from it, even in circumstances of extreme weather conditions, and, therefore, the Company estimates that the risk of the Company’s inability to supply all the electricity demand required from it as a result of shortage of installed production scope is reduced.

The estimations of the Company with respect to its ability to meet the expected demand constitutes forward looking information, as it is defined in the Securities Law. These estimations may not be realized or may be realized in a different manner, and this in light of the fact that these estimations are based on future data, whose realization is uncertain, but is mainly dependent on climate changes and third factors, including the rate of entry of private electricity producers into the electricity sector, that are not under the control of the Company.

¹¹ See the website of the Company: www.iec.co.il.

Part 3: Description of the Business Affairs of the Company by Fields of Activity

A separate breakdown of each field of activity of the Company follows. See Part 4 for a description of matters relating to the operations of the Company as a whole.

7. The generation segment

7.1 General information on the generation segment

7.1.1 The structure of the competition in the field and the changes that have occurred

The electricity generating system of the Company in Israel includes five steam driven power stations, which are powered by steam force that turns the blades of turbines, and which are spread along the country's shores, located in Haifa, Hadera (hereinafter: "**Orot Rabin**"), Tel Aviv (hereinafter: "**Reading**"), Ashdod (hereinafter: "**Eshkol**") and Ashkelon (hereinafter: "**Rothenberg**"). The steam driven power stations are powered by coal or natural gas, or fuel oil. In addition to the steam driven power stations, another generation array of gas turbine generation units operates, which are powered by diesel or natural gas.

As of December 31, 2014, the Company possesses and operates seventeen sites of power stations (of which five are steam driven power stations sites as mentioned above) with a total installed generation capacity of approximately 13,617 megawatts. The sites, which are located, in accordance with that which has been stated above, throughout the territory of the State of Israel, are located on land that is owned by the Company or leased to it by the State. Each of the sites of the power stations of the Company has a single unit or a number of separate units for electricity generation. As of December 31, 2014, the Company had sixty three generation units, of which eighteen are steam generation units; fourteen are combined cycle gas turbine units; sixteen are jet gas turbine units¹²; fifteen are industrial gas turbine units¹³, with an additional unit ("**Eshkol**") initially operated in combined cycle form in March 2014. See Section 7.1.1.1 for a table containing a breakdown of all of the generating units of the Company, their locations and generation capacities. See Section 7.6.3 for details on the land used by the sites. See Section 7.10 for details on the raw materials that are used by the Company in the generation of electricity.

As of the date of the report, the order of the costs of generation per kilowatt hour, from the least costly to the most expensive, from among all the electricity generating options of the Company according to the terms of the contracts that it executed to purchase raw materials for electricity generation, is as follows: (A) generation by coal; (B) generation by natural gas in combined cycle units; (C) lower efficiency¹⁴ natural gas powered units; (D) generation by liquid natural gas; and (E) generation by fuel oil and diesel oil.

With the rise of the demand curve¹⁵, the Company runs the generation units in accordance with the criterion of cost of fuels per generated kWh¹⁶ and considering operational constraints. Therefore, the Company runs the units in accordance with the following priorities: coal powered steam generation units, natural gas powered combined cycle units, gas converted steam generation units, natural gas powered open gas turbine units, LNG and diesel oil. If need be, primarily in peak demand periods, the Company runs the diesel oil powered units: industrial gas turbines and jet gas turbines, whose operation may be initiated and stopped in a short time relative to the steam generation units, albeit at a higher cost of operation. The entity that decides on the mix of

¹² A turbine consists of a diesel powered aviation jet engine connected to a generator for generating electric energy. The costs of generation of these units are especially high due to the high cost of diesel fuel and the use made in stressful situations and at peak demand only. See Section 7.1.1.2 (B) for further details.

¹³ A turbine that is run by industrial jet engines, which are diesel powered, with an option for conversion to natural gas operation.

¹⁴ This term expresses the ratio between the amount of energy extracted and the amount of energy invested and is expressed in%.

¹⁵ The demand curve expresses the demand for electricity during the hours of the day.

¹⁶ Kilowatt hour (kWh). A "**kilowatt**" (kW) is a unit for measuring output. One kilowatt equals a thousand watts. A "**kWh**" is an energy unit that is equal to continuous consumption of a kilowatt for one hour.

the operating stations at any time is the system management unit, which is located in the Company as of the date of the report, subject to the regulation that applies to the Company, which is regulated, inter alia, by the criteria and decisions of the Electricity Authority.

The electricity generation volumes and timing are dictated by the figures of electricity consumption by the end consumers at any given moment. See Section 11 for details on seasonality in the consumption of electricity. See Sections 7.5 and 7.7.3 for details on developments in electricity consumption, recorded peak demands and trends in demands.

The use of natural gas for the generation of electricity reduces air pollution and greenhouse gas emissions that form during the process of generation of electricity and reduces the cost of generation.

Despite the transition process to the use of natural gas for producing electricity and the conversion of the steam generation units to natural gas power, which started in February 2004 in accordance with what is stated below, the Company decided to maintain the ability of the steam driven power stations to be “dual-fuel”¹⁷ (except for the Reading Power Station, which is powered by natural gas only), and they will be able to generate electricity using both natural gas and liquid fuel (this is in addition to “dual-fuel” stations that can be operated both by coal (as a main fuel) and by crude as detailed in section 7.1.1.2). This is in order to preserve their ability to generate electricity even during time of shortage in natural gas or because of a disruption in its supply.

As of December 31, 2014, the Company generates most of the electricity in the State of Israel, approximately 84% (compared with approximately 93% as of December 31, 2013), while the remaining electricity is generated by private electricity producers and small photo voltaic installations from which the Company purchases electricity at low rates. A few of them sell all of their output to the Company while others generate electricity for their own consumption and sell only their surplus generation to the Company. In accordance with that which has been stated above, it is the policy of the Government to increase competition in the Electricity Sector. For additional details see section 6.5. In addition, in accordance with the Electricity Sector Law, as an essential service supplier, the Company is committed to purchasing electricity that is generated by private electricity producers. See Section 7.4 for further information on private producers of electricity and the competition in the field of activity of electricity generation. For details of the draft of recommendations of the Steering Committee and the Yogev Letter with regard to the generation segment and the position of the Company with regard to the recommendations of the Steering Team as stated, see Note 1e to the Financial Statements.

¹⁷ A generation unit that can be powered by at least two types of fuel.

A table follows that lists the generation units of all types, and the generation capacity in megawatts as of December 31, 2014, which is included in the Company's load monitoring and control system:

<u>Type of unit</u>	<u>Site</u>	<u>Number of units</u>	<u>Installed generation capacity (in MW)</u>
<u>Steam driven power station generation units</u>			
Coal powered units			
Coal primary fuel, fuel oil secondary fuel	Orot Rabin (Maor David A, B)	6	2,590
Coal primary fuel, fuel oil secondary fuel	Rothenberg	4	2,250
Total coal units		10	4,840
Natural gas converted units			
Natural gas primary fuel, fuel oil secondary fuel	Eshkol	4	912
Natural gas primary fuel, fuel oil secondary fuel	Haifa	2	282
Natural gas only	Reading	2	428
Total gas converted steam units		8	1,622
Total steam driven power station generation units		18	6,462
<u>Gas turbines</u>			
Industrial gas turbine			
	Ramat Hovav	4	436
	Tzafit	2	220
	Alon Tavor	2	220
	Eilat	1	34
	Atarot	2	68
	Gezer	4	592
Total industrial gas turbines		15	1,570
Jet gas turbines			
	Hartov	1	40
	Eitan	1	40
	Ra'anana	1	11
	Caesarea	3	130
	Haifa	2	80
	Kinarot	2	80
	Orot Rabin	1	15
	Rothenberg	2	40
	Eshkol	1	10
	Eilat	2	58
Total jet gas turbine		16	504
Total gas turbines		31	2,074
<u>Combined cycle gas turbines</u>			
	Ramat Hovav	2	701
	Hagit	4	1,394
	Eshkol	2	771
	Gezer 3, 4	2	744
	Tzafit	1	360
	Alon Tavor	1	363
	Haifa	2	748
Total combined cycle units		14	5,081
Total generation units in the Company		63	13,617

7.1.1.1 A breakdown of the generation units of the Company follows:

(A) Steam generation units

The steam generation units of the Company, which generate electricity using gas turbines, are powered, in accordance with what has been stated above, using coal as their primary fuel, or fuel oil or natural gas. Some of the generation units, in accordance with that which has been depicted in the table above, are “dual fuel”, that is can be powered both by coal (as a primary fuel) and fuel oil, or may be powered both by natural gas (as a primary fuel) and fuel oil.

As of the time of the report, their total installed generation capacity is approximately 6,462 megawatts. The dual fuel power stations, which are powered, as of the date of this report, by coal, involve a high investment and a long construction time, but when they are coal powered, the cost per generated kWh is low. After commencement of the flow of natural gas from the Tamar Reservoir, another part of the fuel oil generation units that have been converted to natural gas power has been run by natural gas. See Section 7.9.9.2 (B) for details on the Tamar reserve; see Section 7.1.1.2 for details with respect to the procedures for conversion to use of natural gas for electricity generation.

(B) Gas turbines

Gas turbines are divided into two (2) types: jet gas turbines and industrial gas turbines.

As of December 31, 2014, the Company has sixteen jet gas turbines with a combined installed generation capacity of 504 megawatts, and fifteen industrial gas turbines with a combined installed generation capacity of 1,570 megawatts.

The construction of industrial and jet gas turbines entails relatively low investments and their construction time is short. However, the generation of electricity using jet gas turbine units is more expensive than its generation using steam generation units or industrial gas turbines, but the operation of gas turbines may be initialized and shut down in a relatively shorter time than the startup and shutdown of steam generation units. Because of this, the Company usually runs its gas turbine units primarily in periods of peak demand.

(C) Combined cycle generation units

The combined cycle is a combination of an industrial gas turbine and a steam turbine. Using combined cycle technology, the residual heat that is emitted from industrial gas turbines is exploited and used to run an additional steam turbine with no addition of fuel, meaning that instead of the gases being emitted into the air, they are used for additional generation of electricity. This action contributes to considerable saving in the utilization of fuel and protection of the environment, because production capacity increases without an increase of emission of pollutants into the air.

As of December 31, 2014, the Company had fourteen combined cycle units, all of which are natural gas and diesel powered and whose (combined) generation capacity is approximately 5,081 megawatts. It is commented that the two steam addition units (unit 9 at the Ramat Hovav combined cycle and unit 4 at the Eshkol combined cycle) have not yet been granted a generation license by the Electricity Authority, because the license has not yet been signed by the Minister and because transfer of all the information required by the Electricity Authority as a condition for granting a license has not been completed, respectively.

7.1.1.2 Generation with natural gas

As of December 31, 2014, approximately 57% of the total installed generation capacity of the Company is by units that may be powered by natural gas.

7.1.1.3 Duration of use of the generation units

The Company periodically estimates the lifetime of its assets, based on international information and the past experience of the Company. The useful lifetime of a power station is approximately thirty years at least. The useful lifetime of gas turbines is approximately twenty five years for industrial gas turbines and approximately fifteen years for jet gas turbines. The Company maintains and invests in its generation units on a regular basis, including beyond their useful lifetime, in accordance with techno-economic viability and engineering considerations. Based on the information available to the Company with respect to the energy sector industry, the Company believes that the shutdown rates applicable to its units are similar relative to comparable electricity generators. See Note 2h to the Financial Statements for details.

7.1.2 Restrictions, legislation, regulation and special constraints applying to the field of activity

The operations of the Company in the generation segment, like its other fields of operation, are contingent upon the receipt of licenses pursuant to the Electricity Sector Law and is subject to various restrictions and laws. See Section 21 for details.

As of the date of the report, the Company has 63 generation licenses that have been granted separately for each generation unit (hereinafter: the “**Generation Licenses**”). The validity of the Generation Licenses has been extended until January 1, 2016.

In the decision of the Electricity Authority of May 12, 2014, it was decided to amend the generation licenses of the Company in the generation units at the Ramat Hovav site (unit number 8) and at the Eshkol site (unit number 3), such that the output was increased and the configuration in the generation licenses of these units was amended. After the amendment, the unit at Ramat Hovav was marked as unit 9 and the unit at Eshkol was marked as unit 20.

In a later decision of the Electricity Authority, of December 1, 2014, the Electricity Authority decided to delay its decision of May 12, 2014, until the transfer of the results of the acceptance tests of the units to the Electricity Authority, as required, is completed. In view of this decision, the Electric Company transferred the required acceptance tests to for the Ramat Hovav unit 9 to the Electricity Authority, but as of this date the decision of the Electricity Authority regarding the conversion of the license has not yet been received. Regarding unit 20 at the Eshkol site, the complete acceptance tests have not yet been transferred due to a malfunction in the unit which continues to this date.

After receiving the approval of the Electricity Authority and the approval of the Minister of National Infrastructures, Energy and Water, the licenses will enter into effect.

The revenues of the Company in the generation segment are affected by the electricity rate which is determined by the Electricity Authority in accordance with the Electricity Sector Law. For details regarding the electricity rate and the manner of its determination, see section 7.11.1 below.

7.1.3 Changes in the volume of operation in the field of electricity generation and in its profitability

The Company estimates that there are various factors that may affect the volume of operation in and the profitability of the field, including changes in the volume of electricity consumption, changes in the electricity charge rates that are established by the Electricity Authority, changes in the supply and/or prices of the raw materials that are required for the generation of electricity and the entry of competitors (including private electricity producers) into the electricity generating field.

The installed generation capacity of the Company has increased from approximately 13,483 megawatts as of December 31, 2013 to approximately 13,617 as of December 31, 2014, expressing an annual increase of 1%. The increase results from the synchronization of a steam addition at combined cycle unit 4 at the Eshkol site in March 2014.

For details of the production volume of the private electricity producers as of the date of the report see section 7.4.3.

On January 1, 2014, the Company received a letter from the Antitrust Authority, according to which the General Director of the Antitrust Authority is considering to make use of the authority vested in him and instruct the Company to refrain from increasing, directly or indirectly, its electricity production capacity beyond 13,307 megawatt, and this as long as the electricity production capacity of the Company exceeds 50% of the total sectorial production capacity in the electricity sector. In the letter, it was noted that the above mentioned does not prevent the Company from executing works to improve the efficiency in the electricity production stations it owns, but if these works can increase the electricity production capacity beyond the maximal production capacity mentioned above, it will have to receive the approval of the General Director of the Antitrust Authority for this in advance. On March 4, 2014, the Company submitted its position to the General Director of the Antitrust Authority within a written hearing held for the Company, and presented legal and economic arguments against issuing an order as stated. On March 17, 2014, an oral hearing was held for the Company. On May 26, 2014 the Company delivered to the General Director of the Antitrust Authority its complementary comments to the position that was presented to the General Director. As of the date of the report, the final decision of the General Director of the Antitrust Authority on the issue has not yet been published.

7.1.4 Critical success factors in the field of activity and the changes that have occurred therein

The Company assesses that the business success of the generation segment, as well as the Company's compliance with the rate outline of the generation segment, depends, *inter alia*, on the costs of raw materials for the generation of electricity, primarily natural gas, the availability of the gas from the suppliers of the Company, and in the case of unavailability, on the cost of alternative fuels, on the implementation of the generation segment Development Plan, including the Emergency Plan, on the recognition of the total costs required for the generation of electricity in the electricity charge rate, on the level of demand for electricity, on the pace of the entry of private producers into the generation segment and on the decisions of the relevant regulatory entities with respect to the operation of the Company in the generation segment, the possibility of the Company establishing and operating additional power stations and the effectiveness of their establishment.

7.1.5 Changes in the array of suppliers and raw materials for the field of activity

The suppliers and the raw materials for this field of operation are suppliers of coal, fuel oil, natural gas, liquid gas (LNG) and diesel oil, which are used for the generation of electricity. See Section 7.9 for details with respect to the array of suppliers and raw materials.

7.1.6 The main barriers to entry and to exit for the field of operation and the changes that have occurred therein

7.1.6.1 Entry barriers

By the Company's assessment, entities that operate with a significant production volume in the field of electricity generation are required primarily to make an initial investment of significant amounts of capital, whether by way of investment in shareholders' equity or by way of banking or other financing, for the purpose of the construction of generation facilities, and are later required to have the financial strength for the purpose of their regular maintenance. In addition, the field has complicated regulation, owing to which an entity that wishes to generate electricity is required to undergo a procedure for receiving an electricity generation license from the Electricity Authority (which is performed in a number of stages over a long period), to comply with strict quality requirements and standards, to receive permits with respect to environmental protection, the location of sites and the receipt of construction permits, to ensure the availability of raw materials and their costs. In addition, professional knowledge and experience in the field of electricity generation, a good reputation in the industry and availability of land for constructing the electricity generating facilities are important.

7.1.6.2 Exit barriers

The regulations regulating the operations of the Company and the fact that it is an "essential service supplier license" holder, in accordance with the Electricity Sector Law and the provisions of its licenses, requiring it to

generate electricity for the public as of whole, reliably and efficiently, in accordance with the terms of its license, are the primary exit barriers of the field of operation.

7.1.7 Alternatives to the products in the field of operation and the changes that have occurred

Electric energy has alternative energy sources, such as natural gas, solar energy and fuels for heating buildings and water. However, as of the date of the report, there is no practical alternative to electricity for industrial machines, lighting, office equipment, air conditioning and home maintenance.

7.1.8 The structure of the competition in the field and the changes that have occurred

As of the date of the report, the field of electricity generation in Israel features a significant growth in the market share of private electricity producers. The Company generates most of the electricity in Israel and its competitors are the private electricity producers, whose installed production capacity as of December 31, 2014 is approximately 15.8% of the total installed production capacity in the State of Israel and is expected to reach approximately 24.8% during 2015.

For additional details regarding the structure of the competition in the field and the continuing increase in the volume of activity of the private electricity producers in the generation segment, see section 7.4. For details regarding the possible impact of the structural change on the structure of the competition in the generation segment see Note 1 e to the Financial Statements.

7.2 Products and services

In accordance with what has been stated above, the Company operates for the supply of electricity to consumers, from the generation of electricity at the generation sites, continuing through its transmission and transformation, to its distribution and supply to the end points of all consumers. The electricity that is generated at the generation sites of the Company is not sold to outside parties but is moved to the end consumers via the transmission and transformation segment, and is supplied to them through the distribution segment as well as serving as backup for the private electricity producers.

7.3 The distribution of revenues and profits from products and services:

7.3.1 Revenues

The net revenues from sales of electricity that were assigned to the generation segment in 2014 (based on the assumptions stated in Note 38 to the Financial Statements) for sales of approximately 49,658 million kWh came to a total of approximately NIS 18,939 million, compared with approximately NIS 21,246 million, adjusted to New Israeli Shekels of December 2014, for sales of approximately 53,506 million kWh in 2013, compared with approximately NIS 22,442 million, adjusted to New Israeli Shekels of December 2014, for sales of approximately 57,085 million kWh in 2012. The decrease in revenues of the Company from the generation segment derives from a decrease in the volume of electricity sales by the Company mainly as a result of the entry of private electricity producers into the field of activity and as a result of a decrease in electricity demand which, inter alia, derives from relatively temperate summer seasons in 2013-2014 compared to the summer season of 2012, which featured peak demands. It is noted that the decrease in demand is partially setoff due to a real increase in the electricity rates.

7.3.2 Profit from ordinary operations – the generation segment

The profit from ordinary operations in the generation segment in 2014 amounted to approximately NIS 2,699 million, compared to approximately NIS 373 million adjusted to New Israeli Shekels of December 2014, in 2013, an increase of approximately NIS 2,326 million compared to NIS 1,405 million adjusted to New Israeli Shekels of December 2014, in 2012. The increase in profit in 2014 mainly derives from a decrease in the fuels consumption expenses following a decrease in the scope of sales.

7.4 Competition

7.4.1 General; the Company as a monopoly; private electricity generation – the Government policy and the resolutions of the Electricity Authority

7.4.1.1 General

In accordance with what has been stated, as of the date of the report, the Company generates, transmits, distributes and supplies most of the electricity consumption in the State of Israel and it was declared in January 1999 by the Antitrust Commissioner as a monopoly in the Electricity Sector, *inter alia*, in the following fields: supply of electricity – generation of electricity and its sale, transmission and distribution of electricity and provision of backup services for electricity consumers and producers. See Section 21.10 for further information on the declaration of the Company as a monopoly and the consequences of this declaration. For details regarding a letter from the Antitrust Authority regarding the electricity production capacity of the Company, see section 7.1.3.

Since the enactment of the Electricity Sector Law, it has been the policy of the Government of Israel to encourage competition in the Electricity Sector while increasing the electricity generation capacity by private electricity producers¹⁸. Accordingly, the Government of Israel and the Electricity Authority have been taking steps, including legislative changes, promulgation of resolutions, adoption of resolutions and other arrangements (including published tenders) whose aim is to encourage the entry of private electricity producers into the Electricity Sector, thus encouraging competition in the generation segment.

In accordance with what will be stated below, as of the date of the report, the objective determined by the Government of Israel for increasing the generation capacity of private electricity producers is 20% of the installed generation capacity in the State of Israel by 2020 (not including renewable energies).

Today, the total installed generation capacity of private electricity producers stands at approximately 15.8% (including renewable energies. Without the generation capacity of private electricity producers with renewable energies at 3.7%, this datum is 12.1%) of the total installed generation capacity in the sector, and following the commencement of operation by three additional large power plants, which are being built by private electricity producers (Dalia Power Energies Ltd., Ashdod Energy Ltd. and Ramat Negev Energy Ltd.) in 2015, it is expected to stand at approximately 24.8% (including renewable energies. Without the generation capacity of private electricity producers with renewable energies at 6.5%, this datum is expected to be 18.3%). In addition to this objective, in later resolutions a guiding objective for generation of electricity from renewable energy was set at 10% of the electric energy needs of the State for 2020. In accordance with the Government resolution on this subject, this objective is expected to be achieved by generating electricity to an installed output of approximately 2,760 megawatts. In addition, there is a guiding intermediate objective of generation of 5% of electricity in Israel at the end of 2014 by renewable energies. As of December 31, 2014, this objective has not been achieved. This objective may be achieved by generation of electricity by generation units of an installed output of approximately 1,550 megawatts. The Government further decided to regulate the encouragement of the construction of facilities for energy production from renewable sources, in accordance with the objectives of the Government. With the intent of realizing this policy, it has been decided to direct the Electricity Authority to act within the framework of its authority in accordance with the Law, including by completing the update of charge rates and criteria to the extent required, by division into quotas in accordance with what was stipulated in the resolution.

As part of the steps described above, in 2005 the Electricity Authority added Chapters E and F to the Book of Criteria (which is updated from time to time)¹⁹, which regulate, *inter alia*, the provision of infrastructure services by which private electricity producers may sell energy either to the system administrator or to

¹⁸ In accordance with the Electricity Sector Law, a private electricity producer holds a generation license or licenses. In this report the term is also used to describe an entrepreneur or a party that takes actions to establish a private generation facility.

¹⁹ The Book of Criteria is publicized for the public at the site of the Electric Company: <http://www.pua.gov.il/31-339-he/Electricity.aspx>

suppliers, in order to supply electricity to end users through the Company's transmission grid, the manner of operation of private electricity producers in the Electricity Sector and the charge rate that the Company will charge for transmission of electricity in accordance with the charge rate that will be determined from time to time by the Electricity Authority (hereafter: the "**Criteria**").

In accordance with the provisions and regulations of the Electricity Sector Law, a private electricity producer may sell electricity to an essential service supplier license holder, in accordance with the terms of its license (and in accordance with the restrictions prescribed in the Electricity Sector Law and in the relevant regulations). In addition, a private electricity producer can obtain a license to supply electricity and to sell electricity directly to end consumers.

7.4.1.2 Pursuant to the arrangements mentioned above, the Company is required, as an essential service supplier and as a transmission license holder²⁰, as follows:

- (A) To purchase electricity from private electricity producers in accordance with the regulations pursuant to the Electricity Sector Law and the license conditions of private electricity producers, at charge rates and in proceedings that are regulated in the regulations and rules²¹ that were promulgated pursuant to the Electricity Sector Law and the Criteria prescribed by the Electricity Authority and which apply to the Company and to private electricity producers.
- (B) To connect the private electricity producers to its distribution and transmission grid, and to provide the infrastructure services in order to allow the private electricity producers, *inter alia*, to transact with suppliers²² or to supply electricity by themselves to end consumers.
- (C) To provide backup services for the supply of electricity to the consumers of the private electricity producers (hereafter: "**Backup Services**") in accordance with the charge rates of ancillary services and backup (it is noted that as of the date of the report, a proposal for a decision for a hearing regarding system rates that also include the charge rates of ancillary services and backup has been published but a final decision has not yet been reached).

7.4.1.3 **Private electricity producers**

The private electricity producers operate pursuant to generation licenses that they have received as part of the undertaking of the State of Israel under tenders for the generation of electricity that have been published

²⁰ The Electricity Sector Regulations (Conventional Private Electricity Producer) 2005 and the Electricity Sector Regulations (Cogeneration) 2004 state that transactions for purchasing electricity from producers shall be done by the system administrator (and not by a transmission license holder). The system administrator is defined in accordance with the Electricity Sector Regulations (Conventional Private Electricity Producer) 2005 and the Electricity Sector Regulations (Cogeneration) 2004, as follows: "The director of the supervision, control and command of loads center at the Electricity Authority, of the transmission license holder, or of a party that has received a license for system administration". The transmission license holder has been defined within the said regulations as follows: "An essential service provider license holder that has received a license to convey electricity, from a generation facility using electricity grid lines of high voltage and extra high voltage to a substation and that concentrates more than half of the transmission capacity in the electricity sector". As of the date of this report, the State has founded a system administration company that to the best of the Company's knowledge is inactive. Therefore the Company, as the transmission license holder, bears the duties that apply to a system administrator in accordance with the Electricity Sector Law and the relevant regulations, in accordance with the decision of the Ministers dated February 2009. Upon the commencement of the activity of the system administration company, the rights and liabilities of the Company in accordance with the agreements with these private electricity producers shall be converted.

²¹ The Electricity Sector Rules (Transactions with Essential Service Provider) - 2000, state that if a tender has been published, a contract will be signed for purchasing electricity in accordance with the terms of the tender, and that in such a case the consideration that the essential service provider must pay the producer for electricity will be in accordance with the prices that the winner of the tender has offered and in accordance with the conditions of the contract.

²² "Supplier" – a holder of a license to sell electricity to consumers (supply license).

by the State of Israel or pursuant to generation licenses or provisional generation licenses that have been given to them in accordance with the Electricity Sector Law and the relevant regulations.

For each type of private electricity producer, in accordance with the classification provided below, the Electricity Authority has prescribed a different charge rate arrangement as described below.

In addition, as part of the policy to encourage the entry of private electricity producers, in July 2009, the Electricity Authority published an update²³ to its resolution on the issue of the charge rate arrangements supporting financing for private electricity producers. The resolution was intended to provide an infant industry protection to private electricity producers and serves as an additional link in the government operation to create conditions to promote private entrepreneurship in the Electricity Sector. Within the framework of this resolution, the Electricity Authority has established as follows:

- (A) A private producer will be entitled to remedies detailed in the stated decision, from the essential service supplier, with respect to an act or omission by the essential service supplier, that prevents the private electricity producer from fulfilling its obligations, fully or partially, under the purchase transaction or the private transaction (hereinafter - the act or omission), provided that the private producer could have fulfilled its obligations were it not for the act or omission of the essential service supplier. Additionally, a consumer or a private producer, possessing an instrument that was damaged due to failure in the electricity supply, or a consumer that damaged due to failure to supply electricity, including in circumstances in which this damage was caused due to an act or omission of another producer, will apply to the essential service supplier for compensation as set in the stated decision.
- (B) A private producer wishing to rely on the rate arrangement in case of the occurrence of a force majeure event (as defined in the stated decision) against the supplier will inform the supplier without delay of the occurrence of an event envisaged as force majeure and of the termination of this event. The Electricity Authority will determine if a certain event constitutes force majeure, the date of the beginning of the period of the force majeure event, the period of the event's duration, its classification as a delaying event or as such that enables completion of the purchase transaction, including the sum of payment due to the supplying producer, as determined in the decision.

In its decision of June 3, 2013²⁴, the Electricity Authority set the maximal quotas for various production technologies on which the above mentioned financing supportive arrangements will apply.

In accordance with the Electricity Authority's resolutions regarding principles for recognition of costs incurred by the Company as a results of contracting with private producers²⁵. The costs incurred by the Company in respect of the purchasing of electricity and in respect of finance-supporting arrangements will be recognized as part of the rate.

Costs with respect to purchase of electricity from private electricity producers (including renewable energies) are recognized in advance as advances on the basis of forecasts. On the consecutive annual update date, the recognized rates are retrospectively updated in accordance with the electricity costs that existed in practice in that year.

²³ Electricity Authority Resolution No. 1 of Meeting No. 268, which was held on July 19, 2009 on the matter of: "Charge rate arrangements that support financing for private electricity producers".

²⁴ Electricity Authority Resolution No. 9 of Meeting No. 403, which was held on June 3, 2013 on the matter of: "Update of Authority resolutions pertaining to rate arrangements that support financing for private electricity producers".

²⁵ The Electricity Authority's resolution no. 1 from meeting 383, dated September 5, 2012 regarding: "amendment to the authority's resolution from meeting 375 dated June 4, 2012 regarding finance-supporting price arrangement for private electricity producers". The Electricity Authority's resolution no. 2 from meeting 375, dated June 4, 2012 regarding: "amendment to the authority's resolution from meeting 268 dated July 19, 2012 regarding finance-supporting price arrangement for private electricity producers".

Prior to the entry of private producers on a large scale, the Electricity Authority reached a decision on May 13, 2014, regarding the establishment of a temporary rate for the system's management services²⁶, while, in addition, a decision on the subject of back-up prices and related services is expected to be published. According to this decision, within the Notes to its Financial Statements, the Company has to report on the revenues and expenses from the services that were determined in the decision, and this is a condition for recognition of the system management costs. In its letter of December 11, 2013, the Electricity Authority made it clear that according to its position, the Company cannot execute collection with respect to the temporary rate for system management services, as long as the Company does not report the revenues and expenses as detailed above. The Company does not collect the temporary rate for system management services from the private producers as of March 2014. None the less, it is the position of the Company that the temporary rate cannot be limited or conditioned by publication of the report on the revenues and expenses as detailed above, and accordingly the Electricity Authority was presented with a letter explaining this position of the Company.

On July 9, 2014, the private producer Dorad Energy Ltd. submitted a petition against the Electricity Authority, requesting the Authority to refrain from reaching a decision and conduct a hearing pertaining to the system costs rate "(1) as long as it does not have complete, detailed and full information regarding the types of services provided by the Electric Company and regarding the sums of the cost of those services being provided by the Electric Company, (2) as long as it does not have the ability and possibility to examine and audit the stated services and sums and inter alia, in order to determine if the sums are reasonable and required to provide the services, and (3) without the stated information being made available for review and professional examination by the private electricity producers, and at least as long as the Electric Company does not prepare audited financial statements according to the provisions of the law, including with separation into activity segments and profit centers". The Company and the State submitted their response to the petition and a hearing of the petition at the Supreme Court is scheduled for October 22, 2015.

On January 21, 2015, the Electricity Authority reached a decision regarding the system administrator, under which recognition of cost depends on the Company reporting by July 1, 2015, within the Notes to its Financial Statements, on the revenues and expenses in accordance with the decision of the Electricity Authority of May 13, 2013. For additional details see Note 3.e and Note 34.c to the Financial Statements.

Following the instruction of the employees' union not to cooperate with this move, an action was submitted to the Haifa Regional Court of Labor on March 2, 2015. In its decision of March 5, 2015, the Court rejected the Company's request to oblige the employees to enable publication of the Note required by the Electricity Authority in the Financial Statements.

On March 11, 2015, an appeal against the decision was submitted to the National Court of Labor, and on March 12, 2015 the Court instructed the respondents to respond to the Company's appeal by March 19, 2015. In addition, the Electricity Authority was added as a party to the case.

7.4.2 Types of private electricity producers

7.4.2.1 General

The legislative and regulatory arrangements that apply to the private electricity producers have been established with a distinction between the various generation technologies that the private electricity producers use, and between the different voltage levels to which they will be connected (according to the facility output). Accordingly, the relevant arrangements vary in accordance with the main private electricity producer types, as follows:

²⁶ The Electricity Authority's decision no. 4 of meeting no. 401 from May 13, 2013, regarding: "Determining a temporary rate for the system management service"

- (A) Conventional private electricity producer – a producer of electricity facilities that do not operate by cogeneration or by a renewable energy source (and that is not pumped energy), which is usually connected to the “high voltage”²⁷ transmission system.

In accordance with the Electricity Sector Regulations (Conventional Private Electricity Producer) - 2005, (in this Section: “**Conventional Producer Regulations**”) and the Criteria, a purchase transaction will be performed in accordance with one of the following two methods:

- (1) The sale of available capacity and energy – whereby a private electricity producer will extend to the system administrator available supply capacity in accordance with a generation plan whose form will be determined by the Electricity Authority, and sell it electrical energy or part of it upon a demand on the part of the system administrator; or
- (2) The sale of energy – under this method, a private electricity producer sells electric energy or part of it to the system administrator in accordance with the terms of the Conventional Producer Regulations and in accordance with a generation plan whose form will be prescribed by the Electricity Authority.

According to the Criteria, a conventional private electricity producer must choose in advance from two tracks and notify of this: the first, reservation of 10% of the facility power for sale to suppliers, with allowance to increase this quantity to 30%. The remaining output will be available to the system administrator (this part is known in the Criteria as “fixed available capacity”). The other is reserving all installed output for sale to suppliers.

In the cases in which within the framework of the quota that is intended for sale to the supplier that the producer has announced in advance there is no potential buyer, the producer must offer the energy that it has been unable to sell to the system administrator.

On December 10, 2014, the Electricity Authority published a decision on the subject of “Rate regulation continuation for private conventional electricity producers exceeding 16 megawatts and for private suppliers”, in order to formulate continuing format and contents for the rate regulation for additional existing private producers, that do not meet the incidence of the Authority’s decision of 2008 which regulated the availability and energy rates for private conventional producers (namely, potential producers who had not yet received rate approval on the date of the decision and who will be eligible for rate approval no later than January 1, 2019). This decision enables a producer to choose between two rate regulations set in this decision, one of them is a constant availability transaction with an essential service provider which is characterized by a high level of certainty for the producer and an appropriate expected profitability, and the other is a bilateral transaction with a private supplier in which the producer will operate in a framework of demand risks in the electricity sector alongside a potential for a higher profit. Nonetheless, for combined cycles, at least 15% of the output will be supplied by agreements with private consumers and at the most 85% of the output will be made available to the system administrator.

- B) Private electricity producers that generate using cogeneration facilities – facilities that produce from one energy source, simultaneously, electrical energy and useful thermal energy (that is mostly used for industrial and private purposes). Usually connected to the “high voltage” transmission system: facilities that are located on the premises of consumers and that supply steam and energy to them. In May 2008, the Electricity Authority published a resolution²⁸ on the matter of charge rates for the purchase of energy from cogeneration facilities whereby the charge rates for producers were determined based on the technology of the facility and the annual energy quantity sold to the essential service provider. These charge rates were revised as part of the resolution of the Electricity Authority dated January 21, 2013. With respect to cogeneration producers that are connected to the grid by high voltage, there is a restriction as to the sold quantity, according to the length of the transaction period with the system

²⁷ The regulation applying to a private electricity producer OPC Rotem Ltd. (“**O.P.C**”), although the facility is conventional, because it won a tender that was published by the State, the provisions that apply to it are the provisions of the tender.

²⁸ Resolution No. 1 of Meeting No. 211 of the Electricity Authority dated May 1, 2008, in the matter of “charge rates for purchase of energy from cogeneration facilities”.

administrator. With respect to producers that are sold by medium or low voltage lines there is no restriction and they are allowed to sell all of the energy generated at the facility. On January 11, 2015, the decision of the Authority was published, extending the validity of the previous decision until December 31, 2015. Additionally, this decision determined a new and unique arrangement for the cogeneration producers that are at risk of a situation in which the demand for steam decreases.

- (C) Pumped energy (hereafter: “Stored Energy”) private electricity producers - a producer that generates electricity by exploiting height differences between two water reservoirs. The water descending from the top to the bottom reservoir via pipes runs a turbine for generating electricity. The water pumping from the lower reservoir to the top reservoir is performed by the same turbine, which is run as an electric pump. The facilities will be connected to a “high voltage” transmission system.
- (D) Renewable energy private electricity producers – a producer whose energy source is, *inter alia*: the sun, wind, water, waste, biomass, except fossil fuel. The timing of the electricity generation by these producers depends on the availability of the energy source on which they base their work (thus, for example, it is not possible to generate electricity by wind if no wind is blowing). Because the availability is partial, these producers sell their energy to the system administrator only. Some of these producer facilities will be connected to the transmission system and some to the distribution system. In a Government Resolution dated July 17, 2011, on the subject of the Government policy in the field of energy production from renewable sources (Decision No. 3484), quotas were set for production using various renewable energies, which constituted a continuation of a previous resolution on the subject dated January 29, 2009, and was based on a policy document of the Ministry of Energy for combining renewable energies in the electricity generation array in Israel. In the Government Resolution of October 22, 2014²⁹, additional quotas were added for electricity installations with photovoltaic technology by way of shifting from the quotas of renewable energy production technologies that are not photovoltaic. Additionally, and in accordance with this resolution, the decision of the Electricity Authority was published on January 11, 2015, dealing with “Regulating transition to criteria and rates for decentralized electricity production for self-consumption and transferring surplus to the grid through small installations with photovoltaic technology, in an output not exceeding 50 KW”, and which determines transition regulation aimed at bridging the existing gaps between the installed scope of photovoltaic electricity producing installations for self-consumption and the Government’s targets as defined in the above detailed Government decisions, by regulating the “surplus” not used during the regulation by the Electricity Authority of photovoltaic installations for self-consumption during the years 2008-2014.

As a rule, the charge rates that the renewable energy producers receive are significantly higher than the charge rates that other private electricity producers or the Company receive. The charge rates that are given to owners of renewable energy electricity facilities range from approximately 230 agorot per kWh to approximately 45 agorot per kWh, compared with the weighted generation component of the Company which, as of the date of the report and in accordance with the decision of the Electricity Authority of January 21, 2015, is approximately 30.15 agorot per kWh alone. As part of the hearing conducted by the Electricity Authority regarding the system administration rates (as detailed in section 7.4.4 (C)), it is proposed that the surplus costs deriving from renewable energy will be imposed on all the producers of the sector.

- (E) There is an additional category of major plants that built their own power stations for which they have received an independent generation license. The electricity generated by these power stations is used by the plant only.

²⁹ Government Resolution number 2117 of October 22, 2014, in the matter of “Implementing the Government targets for electricity production by renewable sources - discussion of the appeals regarding the decision of the Ministerial Committee for Promotion, Development and Implementation of Renewable Energies”.

7.4.3 **Private electricity producers – the actual situation**

7.4.3.1 **General**

In accordance with the Electricity Sector Law, the Company, as an essential service supplier, is required to purchase electricity from a private electricity producer. As has been elaborated above, in accordance with the Electricity Sector Law, a private electricity producer is a party that has received a generation license (*that is*, has started to run the generation facility)³⁰. To receive a generation license, the entrepreneur is required to submit a request in accordance with the Electricity Sector Regulations (Terms and Procedures for Granting Licenses and Obligations of the License Holder), 1997 and meet minimal conditions. To the extent that these have been fulfilled, in accordance with the resolution of the Electricity Authority, with the approval of the Minister, a provisional license is given to it³¹. The provisional license holder must satisfy the milestones for building the facility as elaborated in the provisional license. Only after they are all fulfilled and the facility has been built is it given a generation license by the Electricity Authority, which is given effect by the approval of the Minister.

7.4.3.2 **Entrepreneurs with provisional licenses (that have yet to generate electricity)**

As of the date of the report, the total output of entrepreneurs with provisional licenses that have been issued to them by the Electricity Authority and approved by the Minister with producers that have won a tender stands at approximately 5,644 megawatts using various electricity generation technologies, divided as follows:

- (A) The volume within the framework of provisional licenses of conventional producers – approximately 2,318 megawatts.
- (B) The volume within the framework of provisional licenses of cogeneration producers – approximately 1,036 megawatts.
- (C) The volume within the framework of provisional licenses of pumped storage producers – approximately 640 megawatts.
- (D) The volume within the framework of provisional licenses of renewable energy producers – approximately 1,650 megawatts.

The Company cannot anticipate how many projects will be completed by the date set for them.

7.4.3.3 **Producers with generation licenses (namely, producing electricity in practice)**

A significant entry of private electricity producers into the electricity generation field began from the second half of 2013. The installed generation capacity volume of private electricity producers (except photovoltaic facility owners of up to 50 kilowatts without a generation license) that sell electricity to the Company constitutes, as of the date of the report, approximately 2,046 megawatts, constituting approximately 15% of the total installed generation capacity of the Company which, as set forth, is approximately 13,617 megawatts.

In the year ended on December 31, 2014, the Company purchased approximately 1,833 million kWh from private electricity producers, compared with approximately 1,048 million kWh purchased in the year ended December 31, 2013. The average price that the Company paid to owners of private production facilities in

³⁰ In this chapter, the use of the term “private electricity producer” was made broadly, including both an entrepreneur and a producer with a provisional license.

³¹ Section 4 of the Electricity Sector Law grants the Electricity Authority power to issue licenses for activities in the electricity sector and to establish their conditions. The Rules of the Electricity Sector (Transactions with Essential service Provider) 2000 and following them also Conventional Generator Regulations and the Cogeneration Regulations, have stated that a provisional generation license is a temporary licenses that is given for the purpose of construction of a generation facility, while, upon the fulfillment of the prescribed conditions (including fulfillment of milestones as stipulated in the provisional license and in the regulations) and the provisions of the law, that person shall be issued a generation license.

2014 (including small photovoltaic facilities whose generation in 2014 came to a total of approximately 784 million kWh) was 93 agorot per kWh compared with 94 agorot per kWh in 2013. This decrease is accounted for mainly by an increase in the quantity of energy sold by private producers (whose rates are significantly lower compared to the rate paid to photovoltaic installations) and a trend of decrease in the rate paid to photovoltaic installations. The electricity that is purchased from private producers and from small photovoltaic facility owners in 2014 constitutes approximately 3.7% of the electricity that the Company supplied in 2014, as compared to 1.9% of the electricity that the Company supplied in 2013.

The Company estimates that the production rate of the private electricity producers out of the installed production capacity (installed output) in the sector, including with renewable energy, is expected to be as follows: approximately 24.8% in 2015 and approximately 26.1% in 2016. Notwithstanding the aforesaid, there is uncertainty as to the activation dates of the new private electricity producers, which are dependent, among others, on entities that are not connected to the Company.

Accordingly, as of 2013 and until the end of 2014, approximately 180 big customers, purchasing electricity from approximately 1,800 consumer locations³², transferred to private producers. The Company estimates that the total production the Company is expected to lose as a result of the transfer of customers as detailed above is approximately 8 billion kWh in a complete year.

Included among the big customers lost by the Company in 2013-2014 are customers defined by the Company as strategic customers.

Furthermore, the Company estimates that these trends are expected to continue in 2015 and onwards, although the Company has no certainty at this stage as to the number of customers, kilowatts and revenues it will lose in the coming years.

As of the date of the report, two private electricity producers, whose maximum output is 1,326 megawatts, have begun their commercial activation, as well as an additional number of private electricity producers whose maximum output is smaller, and numerous medium and small sized photovoltaic facility owners that will be connected to the distribution grid (high or low voltage). Following are details regarding four of the private electricity producers whose maximum output is the largest among all the private electricity producers the Company has contracted with as of the date of the report:

- (A) On July 6, 2013, OPC started its commercial activity, with a combined cycle maximum output of 466 megawatt. As of the date of the report, the combined cycle can operate on natural gas and can also operate on diesel oil for 200 continuous hours. To the best of the Company's knowledge, the commercial outline of OPC is to sell most of the electricity to end consumers (private consumers) and selling the surplus electricity on the basis of competition of normative price³³.
- (B) In August 2010, the Company executed an agreement with Dorad Energy Ltd. regarding the purchase of available production capacity and energy of approximately 860 megawatts, and supply of infrastructure services, and it began its commercial activity on May 19, 2014. Its commercial outline is selling most of the electricity to end consumers and to sell the surplus electricity on the basis of price bids to the system manager.
- (C) In May, 2012, the Company executed an agreement with Dalia Power Energies Ltd. regarding the purchase of available production capacity and energy of approximately 870 megawatts and the provision of infrastructure services, and its commercial activation is expected to begin in 2015.

³² Consumption location - an area of land, or a number of areas of land, with respect to which a connection to the electricity grid is provided, and a certain consumer is registered for them in the books of the essential service provider, including his registration on a meter if one is installed at the location (the number of consumption locations stated here is those that transferred or are expected to transfer to private producers. There are locations in which not all of the their consumption locations are transferring to the private producers).

³³ See immediate report from July 5, 2013 (Ref No: 2013-01-084672).

(D) In August, 2013, the Company entered into an agreement with P.S.P Investments Ltd. with respect to purchase of pumped energy in the availability and energy method (300 megawatts output), and its commercial activation is expected to begin in 2019.

(E) A number of power stations of private electricity producers are expected to begin commercial activity during 2015, with a total output of approximately 1,200 megawatts.

7.4.4 **Repercussions of the competition in the generation segment for the Company**

The Company assesses that in the upcoming years a significant increase can be expected in the installed generation volume of the private electricity producers, including generation using renewable energies. The Company assesses that such an increase may have a number of repercussions, including the following:

(A) The Company estimates that part of the electricity consumption currently supplied by it and the increase in electricity consumption at the national scale will be supplied in the future by the private electricity producers. As a result of this, and despite the expected increase in the electricity consumption in the economy, there is a reduction in the actual generation of electricity by the Company, and accordingly a decrease in the revenues of the Company in the generation segments and thus an existing and a potential loss of strategic consumers.

(B) Following the entry of the private electricity producers, a decrease in the volume of actual production of electricity by the Company has begun, and according to the estimate of the Company, is expected to continue. A decrease in the volume of production will cause a decrease mainly in the fuels costs and marginally in the variable operation expenses in the generation segment (as most of the operation costs are fixed costs).

According to the decision of the Electricity Authority on the subject of the rate update that was published on January 21, 2015, it was determined that 88% of the operating expenses are fixed, and will therefore continue to be recognized in the rate. Therefore, the damage to the profitability of the Company in the short term is minor and the risk of damaging the operating expenses component has materially decreased. Despite this, in view of the fact that the amortization coefficient is still applied to the fixed expenses component, insofar as the decrease in the Company's production volume will continue, it may have an impact on the profitability of the Company in the long run.

(C) Insofar as the Company is required to serve as a backup electricity source in the case of the failure of private electricity producers to supply electricity to consumers, it is required to maintain high levels of generation capacity as a reserve; in accordance with the explanatory remarks of the decision of the Electricity Authority of May 6, 2013³⁴, the Electricity Authority is expected in future to set backup rates that will apply retroactively from June 1, 2013, as well as to examine the issue of the decline of the energy produced by the Company as a result of the entry of private electricity producers. The Company applied to the Electricity Authority regarding the subject of the backup rates as stated above and demanded that the capital and operational costs with respect to the production units that serve as backup will apply to all the consumers in the economy, such that a cross subsidization will not be created between the Company's consumers and the consumers of the private producers, and in order that the revenues of the Company with respect to fixed capital and operational expenses will not be harmed due to the decrease in the production volumes in light of the entry of the private electricity producers into the electricity generation field. Additionally, the Company demanded that a rate will be set with respect to the provision of backup services for the grid's segments.

On July 28, 2014, the Electricity Authority published a proposal of a decision for a hearing regarding the rates of the electricity system management services (system rates), and it included the publication of the recognized costs and the system rates that include administrative costs of for system balance services, backup services, pan-system costs and services that are provided to power stations on an individual basis,

³⁴ Electricity Authority decision no. 3 of meeting no. 400 of May 6, 2013, with respect to "Setting an Application Date for Backup Rates and Related Services".

that will retroactively apply from June 1, 2013, and according to the decision proposal, beginning from June 1, 2013 and until December 31, 2014 this period will be defined as an adaptation period in which the system rates will apply at 60% of their cost. As of January 1, 2015, the rates are applying at their full cost. The Authority determined this decision in light of the entry of private electricity producers into the electricity sector and its duty to minimize, subject to the balances of the law, cross subsidization between consumers of the private electricity producers and the consumers of the Electric Company. As of the date of publication of this report, the Company has delivered its comments to the Electricity Authority, and until publication of the final decision, the Company is exposed due to lack of full cover of the system costs. To the best of the Company's knowledge, the private electricity producers submitted their position to the Electricity Authority and have also petitioned on this matter to the High Court of Justice. To the best of the Company's knowledge, a final decision has not yet been reached in the matter. For details of the recommendations of the Steering Team with respect to the objective in the production reserve see Note 1 e to the Financial Statements.

- (D) Within the framework of implementation of the provisions of the law and of Government Resolutions, the Electricity Authority encourages the entry of private electricity producers into the Electricity Sector. Within this context, a safety net and preferential conditions have been extended to the private electricity producers, covering, *inter alia*, the use of the transmission and distribution system of the Company and a commitment of the Company to serve as a backup source in the case of failure of private electricity producers to supply electricity to consumers. In view of these preferential conditions and the policy of the Government, there is real uncertainty regarding the scope of competition the Company can expect in future from the private electricity producers and regarding its ability to compete with the private electricity producers in the generation segment. Notwithstanding the above, the Company assesses that the entry of private electricity producers into the Electricity Sector in Israel will not change the monopolistic status of the Company in the field of generation in the Electricity Sector in the coming years either.

Furthermore, at this stage, the Company cannot estimate the implications of incorporation of the generating units within separate subsidiaries, all or most of which might not be incorporated as subsidiaries of the Company, in accordance with the provisions of the Electricity Sector Law on the issue of the structural change, if and insofar as it will be implemented in practice, on the scope and conditions of the competition in future.

- (E) Further to the aforesaid, in order to comply with the policy of the Government, the Electricity Authority has established arrangements that allow renewable energy generation facility owners to be compensated by higher electricity charge rates than those that are paid to the Company. However, any increase in the costs for the Company as a result of payments to the owners of renewable electricity facilities will be recognized by the Electricity Authority within the framework of the charge rate. Accordingly, the expenses that will ensue from the transition of the Electricity Sector to "greener" electricity generation will be included within the framework of the charge rate so that the consumers bear the surplus costs. Notwithstanding that which has been set forth above, a time gap may form until the Company expenses are covered by the charge rate.
- (F) For details of reducing costs with respect to non-compliance with normative operation dates ("Fines") see Note 3b 2)b) to the Financial Statements

This information in this report and within the Financial Statements with respect to the estimations of the Company with respect to the expected increase in the installed volume of generation of private electricity producers as well as with respect to the expected volume of electricity consumption by private electricity producers, the consequences for the Company including the effect of the transition of Company customers to consumption from private electricity producers and the effect on the amount of revenues of the Company and its profitability, and in particular the Company's expectations of an update in the charge rates is forward looking information, as per its definition in the Securities Law, which is based on information that is in the possession of the Company as of the date of the report and on forecasts of the Company whose materialization depends on factors over some of which the Company has no control, such as: the methodology of definition of operation regimes for the various generation technologies, an estimate of possible times for commencing the generation at

the power stations of the various private electricity producers, and a change that may occur in them, agreements in which the private electricity producers will enter into with customers of the Company, and an estimate of the odds for implementation of each private electricity project, the existing charge base and past experience. Therefore, the Company has no certainty that its estimates and expectations will indeed actually materialize in view of the existing uncertainty with respect to the future regulation, including new charge rate arrangements, to the extent that they are formed, the economic and political reality, including the consequences for the volume of electricity consumption on the national economy.

7.5 **Generating capacity**

The table below shows the installed generation capacity of the Company (including Etgal Ashdod Ltd., which is a private electricity producer that has negligible generation capacity of approximately 26 megawatts that is included in the load monitoring and control system of the Company) and the peak demand, in megawatts in 2014 and in 2013:

	For the year ended on December 31	
	2014	2013
Company's installed generation capacity	13,617	13,483
Peak demand throughout the sector	(*) 11,335	(**) 11,640
Of which: generation by the Company	9,440	10,365
Generation capacity available in the sector at peak demand times	13,255	11,700
(*) This peak demand was measured on June 29, 2014.		
(**) This peak demand was measured on December 15, 2013.		

As of December 31, 2014, the installed generation capacity of the Company increased by approximately 134 megawatts, compared with December 31, 2013. This difference arises from the synchronization of a steam addition at the Eshkol unit 34 with an output of approximately 134 megawatts.

7.6 **Fixed assets, land and facilities**

7.6.1 **General**

All assets of the Company are divided into five (5) main types:

Power station – a generation facility that is used for the generation of electricity at an output exceeding 5 megawatts, including structures, machines, conductors, transformation facilities, cooling facilities and systems used for this purpose.

Substations and switching stations – facilities that are used in the transmission segment and connect the various electricity grids and have a process of transformation of electricity voltage from extra high voltage (400 kilovolts) to high voltage (161 kilovolts) or from high voltage (161 kilovolts) to medium voltage (33 or 24 kilovolts).

Transformation rooms – enclosed rooms that are used in the distribution segment and are in the street or in part of a residential building, containing transformers whose function is to adjust the voltage conveyed in medium voltage lines to a voltage that is usable by electricity consumers (low voltage).

Utility lines – overhead or underground power lines that are used in the transmission segment (up to the transformation station) or distribution segment (from the transformation station) of electricity and that include pylons.

Administrative logistic sites – warehouses, offices and other such properties that are used by the three activity segments of the Company, that is, generation, transmission and transformation and distribution.

The number of sites mentioned above that are used for all of the activity of the Company is extensive, including approximately 17 power stations; approximately 140 substations and switching stations; approximately 13,000 transformer rooms; approximately 900 pylons for which the Company is required by law to pay municipal tax as

well as thousands of additional pylons on real estate regarding which the Company has no rights in the land and approximately 150 administrative logistic sites, and in total approximately 13,500 properties with rights in the land, which include dozens to hundreds of facilities and properties of various kinds.

7.6.2 The breakdown of the fixed assets and facilities described below relates to the property and assets that are held by the Company and/or that are used by it in the field of electricity generation operation, disregarding the differences of opinion between the Company and the State with respect to the rights of the Company to such property and assets, which it possessed at the time of expiry of the concession (see Section 14.3 and Note 1 f to the Financial Statements with respect to the “property settlement” and its consequences for the Company).

7.6.3 A breakdown of the power stations used by the generation segment at the different sites follows:

	Name of site	Location	Type	Area of the site in m ²	Land rights
1	Rothenberg Power Station	Ashkelon	Power station	1,442,600	Most of the area is leased from the Israel Land Administration (ILA) by three (3) lease contracts, two (2) of which are ending in 2032, and one in 2054. The three (3) contracts have an option for extension of the lease by 49 years more; Some of the area is by authorization from EAPC until 2017
2	Reading Power Station	Tel Aviv	Power station	227,861	Most of the area is being leased from the State of Israel and its other part was expropriated by the Company. With respect to this property, there is an outline plan under advanced proceedings, whereby large areas of the land are scheduled for expropriation, which if approved will require the Company to relocate facilities from the areas scheduled for expropriation, which will require the Company to make significant investments. The Company has filed its objections to this plan.
3	Haifa Power Station	Shemen Beach, Haifa	Power station	355,964	Owned by the Company, except a certain plot being leased from ILA until 2016
** 4	Hagit Power Station	Next to Elyakim Interchange	Power station	735,844	About half of the area is being leased from ILA until 2051; the rest is owned by the Company (some of the ownership rights have not yet been registered to the title of the Company)
5	Gezer Power Station	Next to Nesher plant in Ramla	Power station	451,200	The rights of the Company to this property have yet to be regulated. The Company is conducting negotiations to sign a lease agreement with the ILA.
6	Eshkol Power Station	Ashdod	Power station	470,055	Owned by the Company
7	Orot Rabin Power Station	Hadera	Power station	2,024,940	About half of the area is owned by the Company (ownership rights have not yet been registered to the title of the Company; about a fifth is being leased from ILA until 2040; the rest is being leased from the Caesarea Development Fund under two contracts, one until 2042 and the other until 2048. There is a cautionary remark to the benefit of the Company in the Land Registration Bureau for all of these lease agreements. An area of approximately 71,000 m ² of land is used by H2DI Ltd. for seawater desalination

	Name of site	Location	Type	Area of the site in m ²	Land rights
					purposes.
* 8	Substation ³⁵ and gas turbine Raanana	Raanana Industrial Zone	Power station	27,631	Owned by the Company
** 9	Ramat Hovav Gas Turbine	Ramat Hovav Industrial Zone	Power / switching station	251,960	Lease from ILA by two contracts until 2028 and 2029 (there is an option for the Company to extend the lease by 49 years more); the Company has a right to obtain a lease contract (pursuant to a transaction approved at ILA) for approximately 50,000 m ² of the area until 2058 plus an option for 49 years more.
* 10	Atarot substation and gas turbine	Atarot Industrial Zone	Power station	38,194	Leased from ILA until 2022 (there is an option for the Company to extend the lease by 49 years more). The lease rights are registered at the ILA only.
* 11	Kinarot substation and gas turbine	North of Tiberias	Power station	29,870	About half of the area is being leased from Mekorot ³⁶ . The rest is under authorization from Mekorot.
* 12	Hartov substation and gas turbine	Beit Shemesh Industrial Zone	Power station	28,470	Leased from ILA in three agreements until 2018, 2020 and 2021 (there is an option for the Company to extend the lease by 49 years more).
13	Alon Tavor Gas Turbine	Alon Tavor	Power station	142,660	Leased from ILA until 2039 (there is an option for the Company to extend the lease by 49 years more). There is a cautionary remark to the benefit of the Company at the land registration bureau.
* 14	Eitan substation and gas turbine	Moshav Eitan	Power station	41,704	The lease rights to this property are from the ILA and were valid until 1996. The lease is registered in the Land Registration Bureau until 2295.
* 15	Eilat substation and gas turbine	Eilat	Power station	67,600	Leased from ILA until 2028 (there is an option for the Company to extend the lease by 49 years more). Lease rights registered
* 16	Tzafit substation and gas turbine	Tzafit	Power station	232,970	Most of the area is leased from ILA until 2034 (there is an option for the Company to extend the lease by 49 years more); the rest is by authorization from Moshav Mevo Beitar
* 17	Caesarea substation and gas turbine	Caesarea	Power station	228,500	Subleased from the Caesarea Development Fund until 2048. The rights of the Company are registered with the Caesarea Development Fund. For part of the lease contracts a cautionary remark to the benefit of the Company has been registered at the Land Registration Bureau.
Total area:				<u>6,798,023</u>	

* This station also has sub-stations.

** This station has both sub-stations and switching stations.

³⁵ Substation.

³⁶ In accordance with an agreement with Mekorot dated March 1979, the Company has a right to possess and use "for a defined period under the condition that it does not exceed the primary lease period that will be registered to the benefit of Mekorot at the Land Registration Bureau". As of the time of this report, no primary lease has been registered to the benefit of Mekorot for the land.

See Section 8.5 with respect to fixed assets and facilities in the transmission and transformation segment.

All of these properties and rights have floating charges applied to them, which the Company created as collateral for some of its liabilities. For details of floating and fixed charges created by the Company as collateral for its liabilities see Note 20g to the Financial Statements.

For details of Alon Tavor land betterment tax of November 28, 2013, and the Tzafit land betterment tax of July 30, 2014, see Note 34 b9)c).

7.7 The development of the Electricity Sector – the generation segment

7.7.1 General

In accordance with Section 19(A) of the Electricity Sector Law, the Minister, after consultation with the Electricity Authority, is entitled to demand of a holder of an essential service supplier license to submit for his approval, in the manner and time that he demands, a Development Plan, complete or in parts, for the purpose of operations of the essential service supplier in accordance with the provisions of the License; if the Minister has approved the plan after consulting the Electricity Authority, a vital service provider license holder shall not act other than in accordance with the approved plan. And in the event that no such plan is submitted, the Minister is entitled, following consultation with the Electricity Authority, to prescribe to such a license holder a Development Plan that it must act by. The Company is committed to full observance of the Development Plan as part of its duties as an essential service supplier, *inter alia* in accordance with Section 17(A)(4) of the Electricity Sector Law, Section 19 of the Electricity Sector Law and the terms of its license. The Company must execute the Development Plan as the Minister prescribes, from time to time, and meet the schedules prescribed therein.

In accordance with the Electricity Sector Regulations (Terms and Procedures for Granting Licenses and Obligations of the License Holder) - 1997, an essential service supplier license holder will submit an annual work plan and a multi-annual work plan to the Electricity Authority. Additionally, in accordance with the stated regulations, a transmission or distribution license holder will submit to the Minister once every five years a Development Plan with respect to its operation in accordance with the License. The Company is complying with the stated provision with respect to the submission of a development plan.

In accordance with what which has been stated above, the supply of electricity is divided into three primary segments: generation, transmission and distribution. The reliability of each of these segments determines the reliability of the entire system. To ensure the reliability of the supply, the Development Plan for each of the segments is made to conform to the projected demand for electricity in the market and primarily the projected peak demand, while ensuring the existence of an appropriate reserve in each of the segments.

The Company makes out long term Development Plans that will expand its generation, transmission, distribution and supply capacity, in order to satisfy the needs of the Electricity Sector in Israel. The purpose of the Development Plans that are made out by the Company is to achieve optimal stability and economic efficiency in the supply of electricity, in the long term and short term. Provisions are set within the framework of the Development Plans for the generation segment, regarding the addition of generation units, including their type, location, generation ability, date of commencement of operation and the type of fuel that powers them for generating electricity, including additional measures that are required in the distribution and transmission segments. The Company is only allowed to execute development plans that were approved by the Minister.

7.7.2 Manner of the determination of the Development Plan for the generation segment

The main goal of the planning of the generation system in the long term is to constitute a basis for making practical decisions with respect to the addition of the generation units that are required in the system, their type, output, date of operation and location, while determining an optimal mix of fuels that is required for powering them. Most of the planning includes coping with the uncertainty relating to the following technological and economic parameters: the future demand for electricity, the anticipated prices of fuel, techno-economic data of candidates for development of the generation system, competitive factors and more. Therefore, planning is commonly carried out for various future scenarios and includes a comprehensive risk

analysis as part of the system development optimization process. In view of what was stated above, there is a constant need for periodical updates of the Development Plan and for a sensitivity analysis of the changes that occur in assessments in relation to the input data, and may be subject to changes, possibly material in nature. Usually the Company shows the minister a Development Plan for the generation system for twenty (20) years and more. The Minister approves updates and additions to the Development Plan from time to time.

By the end of 2008, the development plans for the generation segment of the electricity sector included the construction of power stations, by the Company or by other entities (private producers). In accordance with a Government resolution of June 2008³⁷, as adopted in Section 60(D5) of the Electricity Sector Law, the Electricity Authority may, with the Minister's approval, grant production licenses regarding power stations that are included in the development plan that was approved by January 1, 2009.

7.7.3 **Electricity demand forecast:**

The future demand for electricity is the most significant factor that affects the required capacity in the generation segment, as it defines the future needs of the system and serves as the basis for determining the required capacity of the electricity generation system.

Because the planning range of the generation system is particularly long and involves a high level of uncertainty with respect to the future economic situation of the State of Israel and with respect to climatic conditions, the risk analysis of the generation system development needs to take into consideration a variety of electricity demand forecasts³⁸.

The development of electricity consumption is affected by economic, climate and demographic factors. The long term updated forecast was constructed on the basis of three economic scenarios and two weather scenarios, and the demand for electricity derived from them is based on the factor of the relation between the per capita GDP and the per capita electricity consumption.

The demand forecast serving the long term planning of the generation system is based on the scenario assuming a mean annual increase of 2% in per capita GDP, which is different from the assumption of growth of 1.9% in per capita GDP according to the forecast of the Ministry of National Infrastructure, Energy and Water, as well as on extreme weather conditions (reflected in a heat load of up to 47°C in summer). The annual increase at peak demand that is obtained in this forecast for the years 2015 to 2020 is at a rate of between 2.7% to 3%. The improvement in the energetic efficiency over the years has been taken into account in projecting future demands and consequently also in the development of the generation system.

The installed and available generation ability of the Company is expected to be lower than the peak demand for electricity according to the forecasts of the Company. However, the Company estimates that considering the integration of the private electricity producers in the electricity sector, the total installed production capacity of the electricity sector is expected to meet the peak demands of the electricity sector and even create a situation of overcapacity in the electricity sector.

The estimate of the Company, according to which the total installed production capacity in the sector is expected to meet the peak demands of the electricity sector, is forward looking information as this term is defined in the Securities law. This information is based on forecasts and estimates that exist in the Company as of the date of the report, and that may not be realized or may be realized partially or in a different manner than expected, inter alia in light of the fact that their realization depends on various factors, some of which are not under the control of the Company, including electricity demand at given times and actual production capacity by the private electricity producers.

³⁷ Government Resolution No. 3705: draft of the Electricity Sector Law (Amendment No. 8) - 2008 – approval of the resolution of the Ministerial committee for Legislation and Law Enforcement Affairs, dated June 30, 2008.

³⁸ The demand is affected primarily by: increase in the population and its geographic dispersal, the weather, living standards and consumption habits, economic activity, electricity charge rates and technological developments.

7.7.4 **The expected development of additional generation capacity**

In accordance with the current Development Plan for generation capacity, the operation of the Project D coal power station is being planned, for the purpose of the diversification of the energy sources and maintaining the option of generation using coal in order to avoid too much dependence on natural gas, which may endanger the reliability of the supply of electricity to the national economy. This station, which was included in the Development Plan by the Minister as a coal powered station back in 2001, includes two (2) generation units with an output of approximately 630 megawatts output each and its location has been set to the Rothenberg site in Ashkelon. In light of the discovery of new natural gas deposits off Israel's shores, and based on a decision of the Minister³⁹, the previous planning proceeding of Project D as a coal power station has been stopped (that took place at the Committee for National Infrastructures), and Project D is planned to be built as a dual fuel power station, combining a steam part and a gas turbine, that will be powered by natural gas and that may also be coal powered (a planning proceeding at the National Planning and Construction Council). The review of the dual fuel power station of "Project D" was presented for examination by the Ministry of Environmental Protection on December 25, 2013, and presented to the staff of the Ministry and representatives of the Ministries of Energy and Interior on January 15, 2014. Following the request of the Chairman of the Board of Directors of the Company, a discussion was held on March 2, 2015, at the Minister's, regarding the future of the project, in which the Company presented the importance of the project on the one hand and its financial difficulties on the other hand. A decision as to how to advance the project has not yet been made.

For details of the decision of the Board of Directors to freeze Project D see section 7.7.7. For details of the implications that may apply to the Company and its managers in case of breach of the development plan, see section 21.1.5. For additional details of Project D see Note 34b9)b).

For details of the letter from the Antitrust Authority of January 1, 2014, according to which the General Director of the Antitrust Authority is considering to use the authority vested in him and order the Company to refrain from increasing, directly or indirectly, its electricity generation capability beyond 13,307 megawatts, as long as the electricity generation capability of the Company exceeds 50% from the total generation capacity in the electricity sector, see section 7.1.3.

For details of the draft of recommendations of the Steering Team and the Yogev Letter with respect to future development of additional generation capacity see Note 1e to the Financial Statements.

7.7.5 **The Emergency Plan**

In August 2008, the Minister approved an addition to the Development Plan of the Company ("**the Emergency Plan**"), considering the low reserves in the electricity generation system that endangered the reliability of the electricity supply in the years following the approval of the Emergency Plan. The Emergency Plan stated that it would be performed in two stages in order to prevent an "electricity drought" and lead the installed electricity generation capacity to a level that would ensure the supply of electricity at reasonable reliability and availability.

In accordance with the Emergency Plan, the Company was required to develop the generation segment at an expedited rate and special arrangements were established for the plan in order to provide for the financing and construction of the generation units by the Company.

As part of the first stage of the Emergency Plan, in 2009 and 2010, gas turbine units were run at the "Eshkol", "Hagit" and "Ramat Hovav" sites (units 6, 7 and 8).

At the second stage, and after a decision was reached by the Board of Directors of the Company in March 2011, granting the Management of the Company approval to start the construction of the three (3) steam additions included in Stage B of the Emergency Plan, steam additions were built at the Ramat Hovav and Hagit sites that allowed for the operation of the units in a combined cycle starting from July 2013 and August 2013, respectively. The steam addition for the turbine at the Eshkol site was activated during March 2014.

³⁹ Approval of the Development Plans for the electricity sector dated December 15, 2010.

The estimated expense for Stage B of the Emergency Plan is approximately NIS 3.3 billion, without interest during the construction time. The financing of Stage B in the Emergency Plan is scheduled as follows: approximately NIS 2 billion is to be financed through the spread of the debt of the Company to consumers in the electricity charge rate (for details of the decision of the Electricity Authority on the update of the electricity rate for 2012-2013 and update of the spread of the electricity rate increase see section 7.11.1); approximately NIS 1.1 billion is to be financed through specific loans for financing fixed assets or equipment and for that, on April 15, 2013, the agreement for financing emergency project stage B between the Company and the consortium of banks HSBC Bank plc, Citibank Europe plc, Commerzbank Aktiengesellschaft and Komerční banka was signed. The financing agreement is insured with the South Korean KSURE and Czech EGAP agencies for foreign trade risk insurance. According to the financing agreement, the loan is up to USD 153 million and up to approximately EUR 110 million including insurance premiums for foreign trade risk insurance and interest during the establishment and approximately NIS 0.1 billion from internal sources of the Company. The accruing expense up to the end of December 2014 with respect to Stage B of the Emergency Plan (steam additions at the Ramat Hovav, Hagit and Eshkol sites) adds up to approximately NIS 2.7 billion without interest at the time of construction.

As of December 2014 there was a balance of approximately NIS 385 million in the designated account for the Emergency Plan (as defined in section 7.11.1.5 below). The Company applied several times to the Electricity Authority, and recently on November 19, 2014, requesting to release all the funds that are in the dedicated account for current use by the Company.

The response of the Electricity Authority was received on January 14, 2015, under which a sum of approximately NIS 86 million of the said balance was released to the Company on January 29, 2015. The balance in the account in the amount of NIS 300 million will be converted in favor of a dedicated account for the transmission and distribution segment and will serve as pre-financing to accelerate the investments in this segment. For this purpose, the Company will submit a list of projects in the field of transmission and distribution which will be examined by professional team of the Authority which will determine the projects that will receive the supplement to the recognized cost and afterwards a mechanism for control and release of funds will be operated as determined in the decision of the Electricity Authority of October 30, 2008⁴⁰.

7.7.6 Emission reduction plan

As part of development plan of the Company, and in accordance with a lateral order of the Ministry of Environmental Protection, the Company is required to take action to reduce airborne emissions. Within this framework, in July 2011, the Ministry of Environmental Protection approved a plan submitted by the Company to reduce airborne emissions, under which installations to clean emission gases will be gradually installed in the coal-powered power stations of the Company until the end of 2016. For details of the emission reduction plan of the Company see Note 7.12.2.4.

7.7.7 The development budget of the generation segment

In its meeting of October 2, 2014, the Board of Directors of the Company decided, in light of the lack of progress in the reform process in the electricity sector and the large scope of investments required for "Project D" and the Company's paramount need to take drastic actions to reduce costs, to freeze the entire operations to establish "Project D" (that was planned to end in 2020-2021), not to include the project in the work plan and budget of 2015 and not to include investments in the project in the five-year financial plan of the Company. The Company is examining, inter alia, the possibility that "Project D" will be executed in cooperation with a strategic partner, subject to approval by the Board of Directors of the Company and the relevant State entities as required by law.

Additionally, according to the instruction of the Board of Directors of the Company, the Company approached the Minister and requested to change the development plan in accordance with the above mentioned. As of the

⁴⁰ Decision no. 1 of meeting 238 of the Electricity Authority of October 30, 2008, regarding: "Development plan for the Israel Electric Corporation".

date of the report, his answer has not yet been received. For details of the implications that may apply to the Company and its managers in case of breach of the development plan, see section 21.1.5.

In 2014, a sum of NIS 1.3 billion was invested in the generation segment in December 2014 prices, including investment works in the active power stations and periodic renovations of the power stations. For details of the draft of recommendations of the Steering team with regard to the investments plan see Note 1 e to the Financial Statements.

The development budget for the generation segment for 2015 is approximately NIS 1,721 million (not including remeasurements forecast).

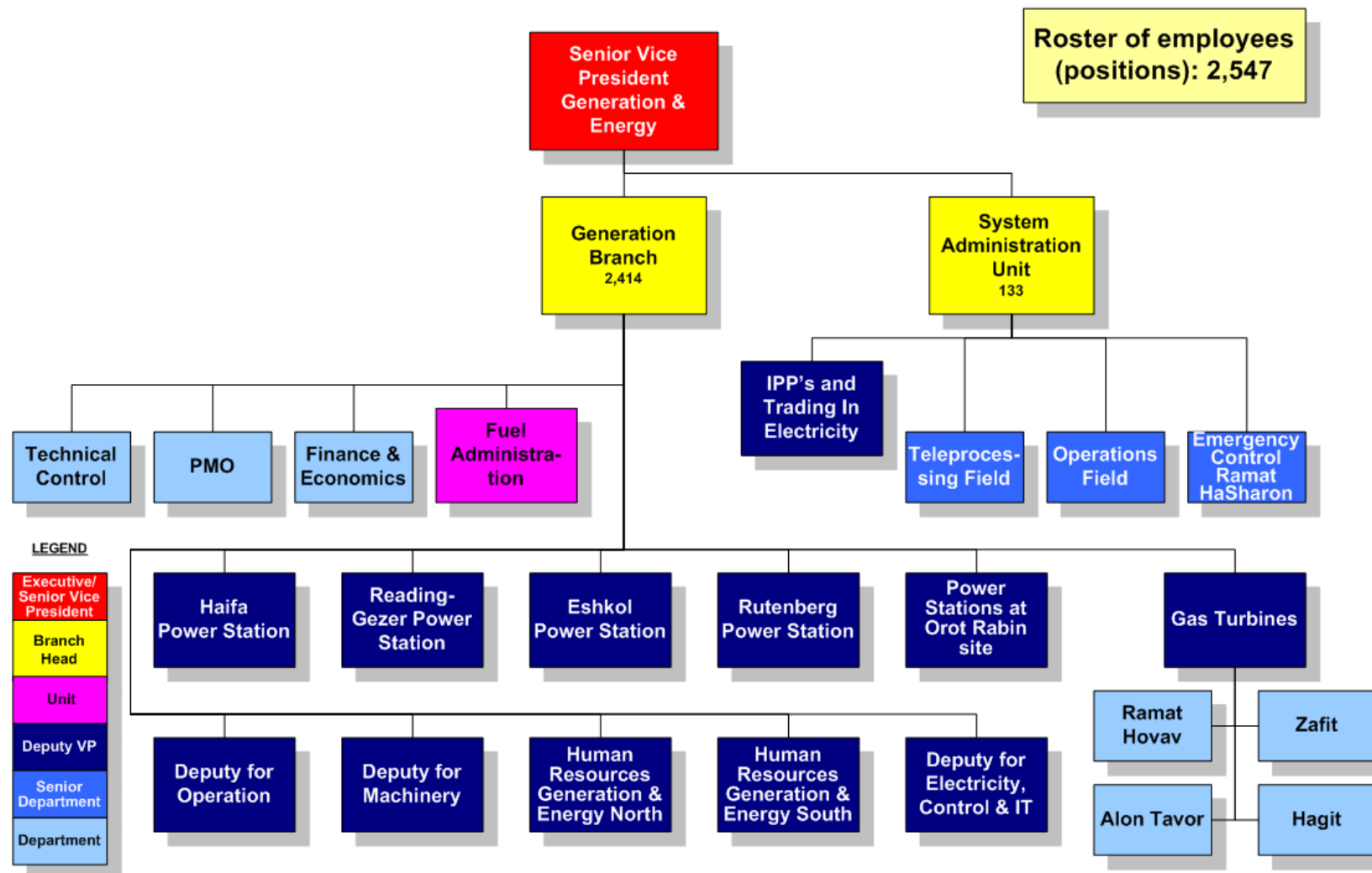
The estimates that have been described above with respect to the Development Plan for the Electricity Sector – generation segment and the expected development budget for 2015, constitute forward looking information, as per its definition in the Securities Law, which is based on the forecasts and assumptions described above, which the Company has as of the date of the report. This information includes forecasts, subjective assessments, estimates and other plans of the Company is based on future figures whose materialization is not certain and that are not under the exclusive control of the Company.

The main factors that may affect the non-materialization of the forward looking information or changes occurring in the estimated schedule for the execution of the Development Plan and the investments for it, as described above, include, inter alia, : failure to receive the Minister's approval for a change in the development plan; a change in the expected rate of increase in the demand for electricity; the implementation of the Structural Change of the Electricity Sector and of the Company (see Section 1.3); the availability of natural gas for the use in the generation system; difficulties in securing licensing or changes in regulations in the field of environmental protection and licensing; ;the absence of appropriate charge rate coverage (see Note 3 B to the Financial Statements) and the ability of the Company to raise the financing required for the execution of the Development Plan.

7.8 Human capital

The organizational structure of the generation segment:

Field of Activity – Generating Segment (including System Administration)



As of December 31, 2014, the generating segment employs 2,342 permanent workers and 205 temporary workers, compared with 2,383 permanent workers and 210 temporary workers as of December 31, 2013. The number of employees relates to the organizational assignment in the generation branch and the division of production and energy, and does not include employees who are assigned to other branches who work for the segment. See Sections 13.4 and 13.6 for details on benefits and the nature of the employment and transaction agreements with workers of various kinds, the investment of the Company in training and instructing and further information.

7.9 Raw materials and suppliers

7.9.1 The raw materials that are used by the Company to generate electricity are fuels of various kinds: coal, fuel oil, natural gas, methanol and diesel oil.

7.9.2 The table below shows the distribution rate of generation (in percent) by the types of fuels that have been used in the generating segment for electricity generation in 2014 and 2013:

	For the period	
	January – December	
	2014	2013
Coal	58.2%	56.2%
Natural gas	41.7%	40.6%
Diesel	0.1%	2.6%
Fuel oil	0%	0.6%
Total	100%	100%

Fuel expenses constitute the biggest operating expense of the Company and constituted approximately 56.1% of the operating expenses of the Company (following the transfer of fuels to regulatory assets) in 2014 compared with approximately 63.7% in 2013.

7.9.3 The table below shows the total costs of fuels (including attributed salary costs) that were used for the generation of electricity in the generating segment in 2014 and 2013:

	Year ended on December 31,	
	2014	2013
	in NIS million	
	(in shekels of December 2014)	
Coal	3,998	4,805
Fuel oil	48	270
Fuel oil impairment	100	0
Natural gas	3,796	4,718
Diesel	92	1,301
Methanol	7	0
Transfer of regulatory asset to fuels	3,435	4,324
Total	11,476	15,418

See the description below for each separate component on explanations on the differences in costs.

7.9.4 The following table shows the average costs of fuels used by the Company for 2014 and 2013:

<u>Power stations powered by:</u>	Year ended on December 31 in agorot of December 2014 per kWh	
	2014	2013
Coal	13.29	14.98
Fuel oil	374.88	81.03
Natural gas	17.59	20.33
Diesel	221.44	87.31
Methanol	150.86	0

A table showing the reductions in prices in 2014 and 2013, follows, for primary raw materials that the Company uses:

<u>Power stations powered by:</u>	Year ended on December 31 Average annual cost per ton in agorot of December 2014	
	2014	2013
Coal	366	407
Fuel oil	10,679	3,209
Natural gas	1,264	1,337
Diesel	5,552	4,229
Methanol	2,366	0

In general all the expenses for fuels are recognized in the rate.

7.9.5 As of the date of the report, all of the types of fuels that are used by the Company in the generation field of activity are purchased, directly or indirectly, from sources outside of Israel, except for natural gas, which is purchased as of the date of this report from the local gas supplier – the “Tamar” partners. As a result of this, the Company and the State of Israel have almost no control over the availability of fuels in general or over any particular type of fuel in particular, and any disturbance in the supply of fuels, of which some are imported as stated, including in the case of a long war and closure of seaports and airports as a result, may have an adverse effect (as of the date of the report or in the future) over the ability of the Company to supply electricity in accordance with the criteria of availability and reliability and over the financial results of the Company. To reduce the adverse effect of such disturbances, the Company maintains limited reserves of all of the fuel types that are used for the generation of electricity, including small amounts of natural gas by storing liquid natural gas (LNG). The Company estimates that its inventory of coal will suffice for 5-7 weeks of consumption. In addition, the Company holds an inventory of diesel oil and fuel oil, while the period of consumption for which this inventory will be sufficient is dependent on the availability of other fuels and the demand curve. For further information on the holding of inventories, see Section 7.10. It is noted that in accordance with the Electricity Sector Law and the licenses of the Company, the Company is required to have a fuels inventory in accordance with the Managing Director of the Fuel Administration in the Ministry of National Infrastructures, Energy and Water.

See Section 7.9.9.2 for details on the agreement for purchasing Tamar natural gas.

See Section 16 for details on the procedure for the Company for work with suppliers outside of Israel.

7.9.6 **Coal**

In each of the twelve (12) month periods ended on December 31, 2014 and 2013, the Company consumed approximately 10.9 and approximately 11.8 million tons of coal, respectively.

The Company purchases all of the coal that it needs through the National Coal Supply Corporation Ltd. (hereafter: the “**Coal Corporation**”), which is a fully owned subsidiary of the Company, in accordance with an agreement that was signed between the parties in July 2004 for the purchase of coal and its supply to the power stations of the Company that consume coal – Orot Rabin in Hadera and Rothenberg in Ashkelon. The agreement is valid from December 31, 2003 and for as long as the Company has generation licenses for these power stations. The Company has a right to cancel the agreement at any time by giving one year’s advance notice. The consideration that is paid by the Company is calculated based on cost plus agreed profit, and is subject to the price of coal approved for the Company by the Electricity Authority.

The average adjusted cost per ton of coal in 2014 stood at approximately NIS 366 per ton, compared with approximately NIS 407 per ton in 2013. The decrease derives from a decrease in the coal prices in the world.

The Coal Corporation purchases coal from a number of sources overseas, the main ones being Africa, Colombia, Russia, and Australia. The Coal Corporation enters into commitments with the coal suppliers based on contracts for a term of at least one year.

The coal purchases are made via the world’s largest and most reliable coal suppliers. The policy of the Coal Corporation is to decentralize coal purchases between countries and within countries to the extent possible, in accordance with the restrictions as to the quality of the coal that can be burned at the power stations.

The Coal Company purchases coal from a number of coal suppliers, none of whom supplies more than 30% of its total annual coal purchases. The Company estimates that the Coal Company is not dependent on any of its coal suppliers.

Most of the purchases of coal in accordance with the documents for the purchase of coal are made by the Coal Corporation on a FOB⁴¹ price basis, with all of the costs involved in the sea transportation and unloading of coal at the generation sites of the Coal Corporation added to the purchase price of the Company, while the rest of the remaining purchases are made by the Coal Corporation on a CIF price basis⁴², while the purchase price includes the costs involved in the sea transport of the coal.

In accordance with the provisions of the outline that applies to the Orot Rabin power station, the Company is required to use low sulfur coal at this site with maximal sulfur content of approximately 0.69%, and by average each year not more than 0.43%. The Company purchases from the Coal Corporation coal with different sulfur content percentages and burns different coal types, which ensure compliance with these instructions. See Sections 7.12, 8.8 and 9.10 for additional details on the impact of the environmental protection laws with respect to the use of coal and additional fuels.

7.9.7 **Fuel oil**

The Company uses fuel oil mainly as a backup fuel for operational purposes at the coal power stations.

In each of the twelve-month (12) periods that ended on December 31, 2014 and December 31, 2013, the Company consumed approximately 4 and approximately 84 thousand tons of fuel oil, respectively. The average adjusted cost per ton of fuel oil as of December 31, 2014 stood at approximately NIS 10,679, compared with approximately NIS 3,209 as of December 31, 2013.

⁴¹ Free On Board – a term from the sea freight or international commerce field that refers to the delivery of the goods to the buyer once the goods cross the rail of the vessel at the port of origin, the rail of the vessel constituting the critical point at which the risks, expenses and responsibility are moved to the buyer.

⁴² Cost insurance and freight – a term from the freight or international commerce field that means that the seller makes sure to transfer the goods to the vessel that will transport the goods to the buyer, insurance and freight and transport costs until the goods reach the port of the buyer.

See Sections 7.12, 8.8 and 9.10 for details on the application of the environmental protection laws to the use of fuel oil and additional oils.

7.9.8 **Diesel oil**

In each of the periods of twelve (12) months that ended on December 31, 2014 and 2013, the Company consumed approximately 17 and approximately 308 thousand tons of diesel oil, respectively. During those years the Company primarily purchased its diesel oil from imports.

In 2013, Vitol supplied approximately 75% of the quantity of diesel oil that was purchased during the year. The rest was supplied by ORL (Haifa Oil Refineries). The Company did not purchase any amount of diesel oil in 2014.

The Company uses diesel oil for generation needs during peak demands, as a backup fuel and for competence tests in the dual fuel generation units.

The assessment of the Company is that it has no dependence on a single diesel supplier because it does not have any impediment to working with additional or other suppliers to the extent required.

The consideration for the quantities of diesel oil that the Company orders for shipment on a particular day are paid by the Company in accordance with the prices of the month of order.

The prices that the Company is paying for diesel oil are based on a CIF LAMERA price quotation, plus a marketing profit, dispensing expenses, excise tax or purchase tax. The prices that the Company pays in exchange for the diesel oil are linked to the global market prices and the margins are determined in competitive tenders that the Company conducts between its suppliers. This way, the Company chooses the diesel supplier in accordance with the cheapest price quoted. The average adjusted cost per ton of diesel oil was approximately NIS 5,552 in 2014, compared with approximately NIS 4,229 in 2013.

7.9.9 **Natural gas**

7.9.9.1 **General**

In 2014, the Company consumed approximately 3 million tons of natural gas at an average adjusted cost of approximately NIS 1,264 per ton, compared with approximately 3.5 million tons of natural gas in 2013 at an average adjusted cost of approximately NIS 1,337 per ton. The decrease in the gas consumption resulted from the continued entry of the private producers to the electricity generation cycle.

As of the date of the report, the Company has two (2) sources (existing or potential) for the supply of natural gas – the “Tamar” field which started to supply gas at the beginning of April, 2013 and an LNG ship with a capability of changing the LNG inside it to natural gas. The “Leviathan” reserve which is situated close to the “Tamar” reserve constitutes a potential gas source for future use. According to public information that the Company has, the estimated quantity of gas in the Leviathan reservoir is double that of the Tamar field⁴³. As of this report, it is still not possible to commercially use the “Leviathan” reserve and there are no contacts between the Company and the owners of the Leviathan reservoir for the purchase of gas.

In 2014, approximately 98.6% of the natural gas that served the Company for the generation of electricity was supplied to the Company from the “Tamar” field and approximately 1.4% was supplied to the Company as liquid gas by the gasification ship that is attached to the marine buoy situated west of the Hadera coast.

For details of the draft of recommendations of the Steering Team with respect to natural gas trading and the position of the Company regarding the draft of recommendations of the Steering Team as stated, see Note 1 e to the Financial Statements.

⁴³ The data on the estimated gas quantities in the Leviathan reserve is external public data published by Delek Drilling Limited Partnership, which is one of the reserve rights owners. The correctness of this data has not been examined or assessed by the Company.

7.9.9.2 Contracts for the purchase of natural gas

(A) The Yam Tethys Group

In June 2002, an agreement for the supply of gas was signed between the Company and the Yam Tethys Group for the supply of natural gas to the Company for approximately 11 years from February 2004, or such time as the consumption of a total quantity of 18 billion cubic meters (BCM) of natural gas, whichever is earlier. Following the depletion of the Yam Thetis reserve, as of December 2013, the supply of gas from the Yam Thetis reserve has ended.

(B) "Tamar" Field

1. In March, 2012, the Company signed an agreement to supply gas with the holders of the rights in the "Tamar" field (Nobel Energy and the limited partnerships Isramco Negev 2, Delek Drillings, Avner Oil Explorations and Dor Gas Explorations (all together in this section: the "**Sellers**" or "**Tamar Partnership**") under which the Company undertook to purchase natural gas at a total minimal volume of approximately 42.5 BCM natural gas and a total maximal volume of approximately 77 BCM (in this section: the "**Agreement**").
2. The Company was given an option to increase the contractual quantity supplied during the period of the agreement to a maximal volume of approximately 99 BCM, after updating the array for supply of gas from the reserve through a system of compressors and/or constructing a second pipeline for gas supply from the Tamar reserve (in this section: the "**Option**").
3. The price of gas in the agreement was determined by a formula that includes a base price and linkage to the U.S. CPI with the addition of 1% in each of the years 2012 to 2019 less 1% each year from 2020 and until the end of the period of the agreement.

The agreement includes a mechanism of take or pay under which the Company is obliged to pay for the right to purchase a minimal amount of natural gas, even if it did not use it, at an amount of 3.5 BCM a year in the first five years and afterwards at an amount of 2.5 BCM a year, and during the option period, if exercised, the annual quantity will increase to 5 BCM a year (subject to adjustments of the sale of the gas of the Tamar Partnership to private electricity producers and volume of electricity production of the Company).

Moreover, two dates were set in the agreement, on which each side will be permitted to demand, in case it thinks the purchase price does not appropriately reflect the gas purchase price in the Israeli market, the adjustment of the price re-opener as follows: after eight years have passed from the date of commencement of supply of gas from the "Tamar" reserve, the parties will discuss (at the request of either of the parties) the adjustment of the purchase price at a rate of up to 25% (addition or reduction), after eleven years have passed from the date of commencement of supply of gas, the parties will discuss (at the request of either of the parties) the adjustment of the purchase price at a rate of up to 10% (addition or reduction). In case of lack of agreement as to the rate of adjustment of the stated purchase price, the issue will be decided in an arbitration proceeding that will be held in accordance with the rules of the Israeli Institute of Arbitration if the amount in dispute is less than the amount set in the agreement, and in accordance with the rules of the London Court of International Arbitration if the amount in dispute exceeds the amount set in the agreement.

The agreement is in effect until the end of fifteen years from the beginning of the supply of gas or until the complete contractual quantity under the agreement is supplied, according to the earlier. In case that by the end of the thirteenth year from the date of signing the agreement the Company will inform the sellers that it expects it will not be able to consume the full contractual quantity during the period of the fifteen years, then the agreement will be extended until the earlier of two additional years beyond the period of fifteen years and consumption of the full contractual quantity.

The parties will be permitted to terminate the agreement under certain circumstances (liquidation, insolvency, assigning rights in favor of creditors, appointing a receiver, etc.) by written notice a hundred and twenty (120) days in advance.

4. The agreement was approved by the Electricity Authority, the General Director of the Antitrust Authority, the Companies Authority and the Socio-Economic Cabinet (the Government).

4.1 On April 19, 2012, the Company submitted an application to the Antitrust Authority, requesting an exemption from an arrangement in restraint of trade due to the agreement (in this section: the "Application"). On June 15, 2012, the Antitrust Authority delivered its decision to the Company, under which it exempted the agreement under section 14 of the Antitrust Law, subject to a series of conditions detailed in its decision, the major of which is splitting the option (whose last date for exercise was postponed from April 2, 2013 to April 15, 2013), according to the following outline:

4.1.1 The option will be split into two stages. The first option exercise date will be in coordination with the Tamar Partnership and will be submitted not later than April 15, 2013. The date of termination of the option period will be December 31, 2019.

4.1.2 At the second stage, the Company can extend the option beyond the month of December, 2019, by notice to the Tamar Partnership until April 15, 2015. The validity of the extension of the second option, if realized, will be until the end of the period of the agreement with the Tamar Partnership.

In accordance with the decision of the Electricity Authority of June 14, 2012⁴⁴, the Company can increase the rate of change of the supply of gas on an hourly basis beyond that stated in the agreement, as long as in terms of the system it is possible to increase the rate of the hourly change in coordination with the system manager. Furthermore, in accordance with the stated decision of the Electricity Authority, for gas quantities that will be supplied within the option, the mechanism under which the increase/decrease of 1% will be executed in the price adjustment formula was cancelled within Amendment no. 1 to the option. In addition, the linkage to the U.S. CPI was reduced to a linkage rate of 30%, as of January 1, 2013, and until the end of the option period, including insofar as the Company will extend the option as stated above.

On April 11, 2013, the Audit Committee and the Board of Directors of the Company, in their separate meetings, approved the exercise of the option and the Company informed the Tamar Partnerships of its decision to exercise the first option that will end on December 31, 2019. If and when the option will be exercised, the Company will be able to increase its hourly quantity of use by 50% and decrease the use of more expensive and more polluting fuels.

At the end of March, 2014, the General Director of the Antitrust Authority (hereinafter the "**General Director**") published a draft for a public hearing under which it is proposed to postpone the date of the notice to continue to exercise the option beyond 2019 from April 2015 to June 2016 (at least) prior to the filing of a consent decree in this matter to the restrictive trade practices court. The General Director is of the opinion that the postponement is required in order to enable the sale of the "Tanin" and "Karish" gas fields and to enable the new owner to prepare for the process of gas sale from these reserves to potential gas consumers.

On April 23, 2014, the Company sent its response in a letter to the General Director, expressing its support with regard to the postponement of the option exercise date, as stated.

At the end of December, 2014, the Antitrust Authority published an update to the public regarding the decision not to submit the above mentioned consent decree for approval by the court.

⁴⁴ Decision of the Electricity Authority of June 14, 2012, regarding "Principles for recognition of costs with respect to natural gas purchase agreements 2012".

On January 14, 2015, the Company announced in a letter to the General Director that in light of the gas sector being at a critical decision crossroads, the Company sees great benefit in postponing the date of the decision regarding the extension of the option by an additional year, as a step that promotes the competition, but if the Company will not receive any other instruction in the matter, the Company regards April 15, 2015 as the binding date for reaching a decision with respect to the extension of the option.

On March 5, 2015, the General Director was approached once again and was requested to postpone the date for the notification of the option extension. On March 9, 2015, in response to the above approach, the General Director sent a request for data. *That stated in this section, regarding the exercise of the option by the Company and increase of the hourly quantity of use by the Company is forward looking information which may or may not materialize or may materialize in a different manner in relation to the expectations of the Company, this inter alia as a result of reasons that are not dependent on the Company including future decisions of the Electricity Authority and the General Director .*

4.2 Regulating the use of the capacity of the gas pipeline from the "Tamar" rig and up to the exit of gas at the reception station in Ashdod.

On December 9, 2012, the Company received from the Ministry of National Infrastructures, Energy and Water Resources the decision of the Committee of the Natural Gas Authority of November 29, 2012, with respect to regulating use of capacity of the natural gas pipe from the "Tamar" rig and up to the exit point of the natural gas from the reception station in Ashdod. This decision was reached due to the limitations and inability of the gas pipeline capacity to supply all the expected hourly demand of the sector in the coming years.

The abovementioned decision determines that:

- (1) The holders of "Tamar" shall not refuse to sign contracts for sale or marketing of natural gas with consumers asking to engage with it under contracts, only due to the fact that the significance of engagement with them is that the total amount of hourly natural gas that is supposed to pass through the gas pipe exceeds the maximum capacity (as defined in the stated decision) in an hour or a certain year.
- (2) A mechanism that will determine the capacity that a marketer in the distribution grid and/or a consumer of the distribution grid will receive in an event of capacity exhaustion (every hour in which the aggregate hourly demand of all the consumers and marketers for conveying natural gas through the pipe is expected to exceed the maximum capacity) ("**Excluded Capacity**"), as well as the total Excluded Capacity that will be allocated to all the consumers and marketers during a capacity exhaustion event. Every hour in which the aggregate hourly demand of all the consumers and marketers for conveying natural gas through the pipe is expected to exceed the maximum capacity (namely, a capacity exhaustion event), the consumers and marketers of natural gas will decrease the volume of their natural gas consumption according to the pro-rata principal, in accordance with the relative share of their capacity in the national transmission system, according to the formula detailed in the decision. In any case, the hourly maximum capacity of each of the consumers will not exceed the hourly maximum capacity the consumer signed for with the holders of the Tamar reserve.

4.3 It is noted that the Company estimates that the decision of the Natural Gas Authority, as stated, will increase the damage to the Company, the electricity consumers and the sector in general, since it will force the Company to increase the use of alternative expensive and polluting fuels. As a result, electricity production costs are expected to rise significantly, starting from 2015, at estimated amounts totaling tens of millions of NIS a year. Furthermore, the Company contends that the resolution makes it significantly difficult to lay a second gas

pipeline, from the Tamar reserve and from additional gas reserves and a further gas entrance into Israel's shores. The Company believes that transmitting natural gas from the Tamar reserve through a single pipeline undermines the reliability of the natural gas supply and as a result, the reliable supply of electricity generated with the use of natural gas, and therefore increases the risk that as a result of any failure or damage to this pipeline, there will be a significant rise in the duration of power failures.

- 4.4 On June 23, 2013, the Government of Israel decided to adopt the main recommendations of the committee for examination of the Government policy on the subject of the natural gas sector in Israel. Within this, the Government determined that in order to increase the reliability of the supply of natural gas and increase the quantity of supply to the local economy, it is necessary to construct a pipe system to transmit natural gas from the "Tamar" reserve to the Ashkelon area including a facility for treating natural gas, and to determine that the Mari B reserve will be an active storage reserve. For this purpose, the Minister was entrusted with the duty to oblige the holding partners of the "Tamar" field to construct a natural gas supply piping to the Ashkelon area, including an installation for treating natural gas, by December 31, 2016. This is in addition to installing compressors by July 1, 2015, in accordance with the approval granted by the Minister. Additionally, it was determined that a storage license should be granted to the Ashkelon holding owners regarding the Mari B reserve for a period that will be determined. Constructing a pipeline as stated will be a condition for the license, as well as termination of the Ashkelon holding with the termination of the license, and transferring the Mari B reserve to the State on the same date as an operating and proper storage reserve.

The "Tamar" partners are acting to establish a compressor array in Ashdod, which will enable to increase the quantity of gas supply to the local sector through the present gas conveying piping. The completion of the compressor array establishment is expected during the second quarter of 2015.

The Company will be able to have an increased supply of gas through this array, insofar as the Company's option will be exercised, as stated above.

The Ministry of National Infrastructures, Energy and Water has not yet approved the use of the Mari B reserve as a storage reserve.

That stated in this section, regarding the expectation of a material increase in the electricity generation costs as a result of increased use of alternative fuels, and regarding the risk of a significant increase in periods of time of failure to supply electricity as a result of the use of only one pipeline for gas supply from the Tamar reserve, is forward looking information as it is defined in the Securities Law, and there is no certainty that it will materialize or materialize in a different manner, and which is based, inter alia, on the maximum present capacity of the gas pipe between the rig in the "Tamar" field and the reception installation at the Ashdod beach, on the terms included in the present agreement with the "Tamar" partnership, on the present installed generation capability for generation through natural gas of the Company, on costs of the alternative fuels as they are known at present, and on the present forecast of the entry of private electricity producers into the electricity sector.

(C) Importation of liquefied natural gas (LNG)

In order to bridge the period of shortage in natural gas through to the beginning of extraction of gas from the Tamar fields, and as an solution for the peak demands and reliability of the gas supply after the extraction begins as well, the Minister gave approval in February 2011 for the Company to advance an infrastructure project for the purchase of liquefied natural gas (**LNG**). In accordance with the resolution of the Minister, Israel Gas Lines Ltd. ("**IGL**"), which is a company that is fully owned by the State of Israel,

deployed a buoy west of the shore of Hadera, which was connected to the national gas transmission system, to which an LNG ship, which has the ability to gasify the liquefied natural gas onboard ship and to pump it into the national transmission system through a buoy, is connected. For this purpose, the Company entered into an agreement to lease a gasification ship from the Hadera Gateway LLC.

In September 2012, the Company signed an agreement with the Hadera Gateway LLC Company to lease and operate an LNG ship with gasification capability. The estimated cost of leasing and operating the gasifying vessel is approximately 100 million dollars per year.

In October 2013, the Company extended the contractual engagement with the Hadera Gateway LLC Company for the lease and operation of the gasification ship, until October 2017 (a total of 5 years), in consideration for a reduction of lease fees at a rate of 23%. The other terms of the agreement remained unchanged.

The supply of liquid natural gas began on January 26, 2013. The maximal gas quantity that can be transmitted from the buoy to the transmission system is 590,000 cubic meters per hour.

The Electricity Authority decided to recognize, for the Company, the costs of leasing the gasification ship, the cost of purchasing the liquid natural gas, as well as other costs, direct and auxiliary, as were expressed in agreements with suppliers, subject to cost control.

As of the commencement of the supply of natural gas from the "Tamar" field, LNG is mainly used during a break or malfunction in the gas supply from the "Tamar" field, when the quantities of gas supplied from "Tamar" are not enough to meet the electricity demands of the Company, and during high gas demands in the sector that may harm the survivability of the electricity system.

On February 5, 2014, the Company entered a contractual engagement with the BP Gas Marketing LTD to supply a cargo of approximately 125 thousand cubic meters of liquid natural gas in the amount of approximately NIS 188 million, which was supplied by loading the gasification ship in the beginning of March, 2014.

On July 9, 2014, the Company entered a contractual engagement to supply a partial cargo of approximately 70 thousand cubic meters of liquid natural gas in a total amount of approximately NIS 78 million that was supplied by loading the gasification ship in the middle of August, 2014.

In order to preserve the survivability of the electricity system and prevent system interruptions in administering the system, the system administration unit's policy is that gas production in the sector does not exceed 60% of the total routine fuels mix.

As of July 2014, with the approval of the electricity administration in the Ministry of Energy and Water, the policy of the routine operation of the LNG ship has changed, and in addition to its operation during faults in the Tamar reserve or during use of all the gas in the Tamar reserve, the ship is operated for survivability of the electricity system when the sectorial gas consumption exceeds 42,500 MMBTU. In such case, the ship is operated at an hourly level at a rate of 2500 MMBTU.

On January 22, 2015, the Company entered a contractual engagement for the supply of liquid natural gas of approximately 58 thousand cubic meters and in the sum of approximately NIS 132 million, which was supplied by loading the gasification ship at the end of January 2015.

(D) EMG

In August 2005, the Company executed an agreement with EMG (a natural gas supplier from Egypt) for the supply of natural gas for the purchase of a total quantity of 25 billion cubic meters, for fifteen years, with an option for the Company for the extension of the agreement by five more years under the same conditions. The agreement included a tripartite agreement between the Company and the Egyptian gas companies EGAS and EGPC and the EMG Company, in which the Egyptian companies undertook to provide the EMG Company with the gas it had committed to supply to the Electric Company.

The contractual gas flow started on July 1, 2008, but since then the EMG Company has not met its full contractual obligations.

In early 2011, disruptions in the gas supply started, which found expression in repeated attacks against the natural gas transmission pipeline from Egypt to Israel, which significantly impaired the Egyptian gas supply until total cessation of the gas supply in April 2012. The Company assesses that the explosions occurred as a result of deliberate action. EMG has alleged, in its notification to the company upon the halting of the pumping of gas from Egypt, that the events were a result of force majeure.

In view of the continuing disruptions in the gas supply, the Board of Directors of the Company decided already in September 2011 that the Company would enter an international arbitration process versus the national Egyptian gas supply companies and EMG, to receive compensation for the heavy damage incurred and that will be incurred in future by the Company by non-delivery of the gas from Egypt as a result of breach of the agreements. The arbitration started in September 2011 and in April 2012, the International Chamber of Commerce in Paris appointed the arbitrators for the arbitration against EMG and the Egyptian companies. The Company claims compensation of more than four billion dollars with respect to the heavy damages incurred and that will be incurred by the Company. At the same time that the claim was filed, the Company announced, after consulting with its international legal consultants in London, that given the unilateral cancellation of the threefold agreement between it and the Egyptian gas companies and EMG, it has no choice but to accept this position and regard the contract as null and void. At the same time, the Company decided to inform EMG that the agreement between EMG and the Company is cancelled.

The first hearing was conducted on May 31, 2012 in Paris, before the arbitrators, attended by the parties. In January, 2014, an evidentiary hearing took place in Paris in the presence of the arbitrators, with the presence of the witnesses and experts on behalf of the parties. After two weeks of hearings, the arbitrators requested from the parties to submit summaries in writing in the beginning of April, 2014, and set a date for a summarizing hearing in the middle of May, 2014. The parties submitted the summaries in writing and the summarizing hearing took place as planned, and an application for reimbursement of legal expenses was also submitted in the middle of June, 2014. The part of the arguments in the arbitration is over and the Company is waiting to receive the arbitration award, which is expected to be received in the coming months.

(E) Project for the construction of a natural gas transmission system (here after: the “Gas Transmission Project”)

In November 2004 an agreement was signed for the construction of part of the natural gas transmission system, between the State of Israel, the Company and IGL and four (4) addenda have been made to this agreement, which constitute an integral part of it (together: “**the Trilateral Agreement**”).

The construction works of the natural gas transmission system were completed in February 2009.

For details of the dispute between the Company on the one side and IGL and the State on the other side pursuant to the tripartite agreement see Note 33 b (1)(a) to the Financial Statements of the Company.

(F) Natural gas transmission agreement

In June 2006, the Company signed an agreement with IGL, for the transmission of natural gas, which regulates the commercial, technical and legal rules pertaining to the transmission of the natural gas.

In January 2009, an agreement was signed, replacing the 2006 agreement, which is valid for fifteen (15) years, *that is*, until 2024, and it will apply to all of the sites of the Company that will be connected to the gas transmission system. Within the framework of the new agreement, the Company has been granted flexibility on the issue of ordering capacity through a right to divert capacity to a volume of up to 15% of the ordered capacity, and through a right to order short term capacity (for at least a full month).

In the summer months of 2013, the Natural Gas Authority determined a special capacity regulation which enabled the Electric Company to increase the transmission capacity ordered by it in accordance with the terms of the regulation that were determined.

(G) Sale and marketing of surplus gas

On November 5, 2014, the Natural Gas Authority of the Ministry of National Infrastructures, Energy and Water (the “**Gas Authority**”) gave its approval for the Company to market and sell surplus natural gas.

The Gas Authority’s approval is contingent on various conditions, including those detailed below:

1. The Company is permitted to sell or market natural gas only to certain consumers who are directly connected to the national transmission system and who have a signed transmission agreement with the Israel Natural Gas Lines Company Ltd. and the natural gas is intended for their own consumption, to entities dealing with the marketing of natural gas to consumers connected to the transmission system as long as they themselves do not consume natural gas, to private electricity producers whose annual consumption exceeds 50 million cubic meters a year or that their installed capacity output exceeds 50 megawatt, and to owners of licenses to supply compressed natural gas.
2. The Company is permitted to sell or market natural gas only according to agreements in which the last date for selling or marketing the gas shall not be later than July 1, 2018. The Company is also permitted to close occasional transactions for selling or marketing natural gas for a short period with private electricity producers, subject to the rest of the conditions of the approval.

The Company expressed reservations with regard to the decision of the Gas Authority, and in a letter of December 25, 2014, requested from the Gas Authority, to be given an appropriate opportunity to present its position in writing and orally within a hearing arranged according to law that will be held regarding this issue.

7.10 Working capital; inventory

As stated, the Company operates as a single combined, coordinated system, and therefore the working capital is examined in the terms of the Company as a whole (see Section 18 for details). However, details will be presented below with respect to policy and duties of the Company with respect to the holding of inventories of fuel that is assigned to the generating segment:

- 7.10.1 Coal – It is the policy of the Company to keep at each of the power stations inventory that is appropriate for seven (7) weeks of average consumption, without falling below an inventory that is sufficient for five weeks. In the event of a break-down in the coal unloading system, coal will be transported from site to site in accordance with an emergency procedure that the Company has in place. See Section 7.9.6 for details.
- 7.10.2 Fuel oil – Following the commencement of use of natural gas from the “Tamar” field, the policy of the Company was updated to maintain a total inventory of at least 165 thousand tons at the following Company sites: “Eshkol” site in Ashdod, where fuel oil can be used in the dual-fuel units, and at the “Orot Rabin” in Hadera and “Rotenberg” in Ashkelon, which serve as storage sites only., In the event of an emergency, fuel oil will be transported from these sites to steam driven power stations. See Section 7.9.7 for details.
- 7.10.3 Diesel oil – Following the commencement of use of natural gas from the “Tamar” field, it is the policy of the Company to hold an inventory of at least 190 thousand tons, and this inventory includes the requirement by the fuels administration of the Ministry of National Infrastructures, Energy and Water, that the Company maintain an emergency inventory of 165 thousand tons. The diesel inventory is stored in tanks that are located at the sites of the Company and at the national storage terminals. For details, see Section 7.9.8.
- 7.10.4 The inventory of liquid fuel has been set quantitatively and the duration of this inventory cannot be determined, as it depends on the actual generation state that varies by use of other fuels, compared with the use of coal that is determined by consumption time, as the coal consumption is predictable and fixed, give or take, over time.

- 7.10.5 The quantity of inventory that is held by the Company is subject to provisional orders of the CEO of the Company, in accordance with the needs of the Company during emergencies, to the effect that while there is a shortage in the supply of natural gas, the Company is acting to increase the inventory of diesel oil that is available to it.

The Company policy for maintaining a fuels inventory is mainly for backup and availability of the electricity system in case of failure in the supply of gas and in time of emergency.

7.11 Restrictions on and supervision of the operations of the Company in the generating segment

The Company has licenses for generating electricity, pursuant to the Electricity Sector Law. See Section 21.1 for details on the validity of the generation licenses of the Company, the manner of their extension, the restrictions that apply to them, and sanctions that will apply due to non-compliance with the conditions of the licenses. For the purpose of the generation of electricity, the Company builds and operates units for the generation of electricity and ancillary facilities that are required for the generation of electricity (mainly through steam turbines, gas turbines and ancillary and peripheral equipment), whose construction and operation are subject to complex, extensive regulations, which include the receipt of licenses, permits and approvals (including pursuant to the Planning and Construction Law, the Business Licensing Law and pursuant to environmental protection laws) with which the Company must comply.

Additionally, the Company is subject to the decisions of the Electricity Authority regarding the electricity rate, inter alia as detailed below:

7.11.1 General

7.11.1.1 The manner of determining the charge rate

The revenues of the Company are based on the electricity charge rate that the Company charges consumers. In accordance with the Electricity Sector Law, the electricity charge rates and their manners of update are determined by the Electricity Authority in accordance with the following rules:

- (a) The charge rates shall be determined based on the principle of cost, considering, inter alia, the type and standard of services. Each price shall reflect the cost of the particular service, without any price decreasing at the expense of increasing another.
- (b) With respect to the cost, an adequate return on capital rate shall be taken into account, considering the rights and duties of an essential service supplier license holder. The law does not define what an adequate return on capital rate is.
- (c) For the purpose of setting the charge rates, the Electricity Authority shall perform cost control actions for the essential service supplier license holder. The Electricity Authority is entitled not to take into account, for setting charge rates, expenses, in part or in full, which in its opinion are not required for fulfillment of the duties of the essential service supplier license holder.
- (d) When determining the rates according to all the consumers, the Electricity Authority will take into account the costs that were not taken into account as a result of the reduced payments.

In accordance with these principles, the electricity charge rate should cover all of the costs sustained by the Company due to the operation of its assets that are required for fulfilling the duties of the Company as an essential service supplier, subject to cost control. These costs consist mainly of the costs of fuels, costs of operation and maintenance, and costs of capital (depreciation, financing and return on capital).

The resolutions of the Electricity Authority with respect to the setting of the charge rate bases state that every few years, the Electricity Authority is supposed to establish a charge rate basis for a certain test period (a period in which the charge rate basis will be valid). The charge rate basis has a number of components, some applying to all activity segments and some relevant to only a certain segment. The electricity charge rates for the various consumers are set in accordance with the type of consumption and the supply voltage. The main charge rate types are: uniform charge rate (domestic, general, street lighting and low voltage and high voltage bulk) and load and

time charge rates (low voltage, high voltage and extra high voltage). The electricity charge rate that is derived from the charge rate basis is updated during the test period through regular updates and annual updates in the manner explained in Subsection (2) below.

In addition, the Electricity Authority adopts, from time to time, various resolutions in which principles that apply to the electricity charge rates are established, some of which pertain to the electricity charge rate in general and some of which pertain to the electricity charge rate for a certain segment of activity.

In accordance with the Electricity Sector Law, for the purpose of the discharge of the duty of the Electricity Authority, the Authority will allow representatives of consumer organizations to bring before it proposals and positions with respect to the setting of the charge rates and criteria, in the manner that the Minister will prescribe (after consultation with the Minister of Finance and according to the proposal of the Electricity Authority).

Prior to the adoption of any final resolution by the Electricity Authority with respect to the charge rates and the Criteria⁴⁵, the Electricity Authority publishes a resolution proposal for public response (hearing), and only after the time that is prescribed for responses does the Electricity Authority publish its financial resolution on the matter of the charge rates.

7.11.1.2 Update of the charge rate

In accordance with the Electricity Sector Law, the electricity charge rates are to be updated according to an update formula that the Electricity Authority will determine. In accordance with the provisions of the Electricity Sector Law, the electricity rate can be updated during the year due to an annual update or a current update, as follows:

- a) Annual update - Every year, in April, the Electricity Authority is supposed to carry out an annual update of various components of the costs recognized for the Company in the rate, according to variability of various components in the Company's input basket.
- b) Current rate update - the following parameters have the following updating formulas:
 - The recognized fuels costs are linked to the changes in the fuels price.
 - The foreign capital costs are linked to the CPI.
 - The operating costs are partially linked to the CPI and partially linked to the average index of a position of an "employee" in the economy.
 - The other components are linked to the CPI.

The update formula may take into account a savings coefficient (coefficient of reduction in the charge rate calculation mechanism), which will be decided upon after consultation with the ministers. In the resolutions of the Electricity Authority with respect to the electricity charge rates, it has been determined that the charge rate will be updated on an ongoing annual basis. For additional details see note 3 of the financial statements.

Because the charge rate for consumers is not updated following each theoretical update, a gap forms between the revenues for the actual charge rate and the theoretical update. This gap may be positive or negative in accordance with the recognized cost for the Company. In accordance with the accounting rules implemented by the Company, this gap is imputed to a regulatory asset (or liability) called "compensation for delay in update" and is included in the charge rate calculation applying from the next annual update date. For details see Note 9d to the Financial Statements.

7.11.1.3 The financial strength of the Company as a consideration within the framework of the setting of the charge rate

In various resolutions of the Electricity Authority, with respect to the electricity charge rate, the Electricity Authority states that its resolutions are adopted while balancing between the need to allow the Company to

⁴⁵ For details of the Criteria see section 7.4.1.1.

execute its activity in the electricity chain segments while maintaining its financial strength, and safeguarding of the interests of the consumers to minimize the costs of the Company that are reflected in the charge rate.

7.11.1.4 **Discounted social charge rates**

For details on discounted social rates, see Note 9 to the Financial Statements.

7.11.1.5 **The current electricity charge rate**

(a) The current electricity charge rate, which entered into force on February 1, 2015, is: the uniform domestic charge rate – (namely, houses serving for residence only, houses of worship and structures that serve for agricultural needs) - 48.60 agorot per kWh (not including Value Added Tax). The general uniform charge rate (namely, structures serving for workshops, industry or commerce, including educational and cultural institutions, absorption centers, structures serving associations and non-profit organizations, clinics, hospitals, hotels, government offices and structures connected with a temporary connection – 50.37 agorot per kWh (not including Value Added Tax).

(b) Annual update –

In accordance with the decision of the Electricity Authority of July 10, 2014, the electricity rates for 2014 will remain unchanged, such that the third increase of the electricity rate which was required by the decision of the Electricity Authority of March 22, 2012 was not executed. This decision constituted an update of the Electricity Authority's decision of March 22, 2012, according to which the increase of the electricity rate following the gas crisis during 2011-2012 will be spread over three years.

On January 21, 2015, the Electricity Authority published decisions regarding an annual update for 2014. The decision determined, inter alia, that the electricity rate will be decreased by 11.8% on average as of February 1, 2015, relating to the rate that entered into force on May 16, 2013. For additional details see Note 3 a to the Financial Statements.

(c) Regular update –

In the decision of the Electricity Authority of January 21, 2015, it was determined that a regular update will be executed when one of the following conditions are fulfilled, according to the earliest

1. Change in the cost of the recognized input basket of all the system at a rate of at least 3.5%, provided that four months have passed since the last update date.
2. The annual update date, beginning from 2016.

Special purpose account for financing the emergency plan - as an outline for financing Stage B of the emergency plan, on March 7, 2011⁴⁶, the Electricity Authority decided to spread the Company's debt to consumers, of NIS 2 billion, until the end of 2025 (the Authority updated this decision such that the repayment period of the Company's debt to consumers will be shortened to 7 years instead of 15 years as was determined in the original decision). In accordance with this decision, the Company opened in the past a separate and special purpose account for administering the money with regard to the financing of Stage B of the Emergency Plan ("**Special Purpose Emergency Plan Account**"). During this period, the complete sum required, in the amount of NIS 2 billion, has been deposited. After the Company withdrew approximately NIS 1636 million from the account, as of December 2014 it had a balance of approximately NIS 385 million (of which NIS 21 million interest accrued in the account).

For additional details regarding the Special Purpose Emergency Plan Account see section 7.7.5 above.

⁴⁶ Decision 1 of Meeting 328 of March 7, 2011: "Spreading the debt of the Electric Company to prevent electricity distress".

7.11.1.6 Reporting to the Electricity Authority

On February 9, 2015, after conducting a public hearing proceeding, the Authority published a decision under which the Company will be required to annually report to the public regarding the gaps between the actual expenses in that year and the Company's income from the electricity rate, according to activity segments, in accordance with the format presented in the decision. This decision should enter into force as of the date of publication of the Financial Statements for 2014, and additionally, under the decision, such reports for 2010-2013 should be presented in the Company's website within three months from the date of receiving the decision.

7.11.2 The generation segment charge rate

7.11.2.1 General

On February 1, 2010, the resolution of the Electricity Authority was adopted with respect to the update of the charge rate basis for the generation segment for 2010-2014 (the Test Period) ⁴⁷ in accordance with the "charge rate basis book – recognized costs for the generation segment for 2010-2014" ("the **New Generation Charge Rate Basis Book**" and "the **New Generation Charge Rate Basis**", respectively). This resolution and the charge rates derived from it took effect on February 15, 2010.

According to the remarks of the Chairman of the Electricity Authority in Appendix A to the resolution of the Electricity Authority on the update of the charge rate basis (Charge Rate Basis Book) it is stated that the resolutions of the plenum of the Electricity Authority were determined while balancing between the need of the Company to establish and operate its generation array in the upcoming years while maintaining its financial strength on the one hand, a policy that has been expressed by increasing the recognition of the capital and operating costs, and the right of the electricity consumers to a decrease in charge rates due to a reduction in the costs of the fuels as a result of the increased use of natural gas on the other hand. The Electricity Authority noted that within the framework of some of its resolutions that are cited in the New Generation Charge Rate Basis Book, the use of financial incentives for improving the performance and saving of the Company was increased and that the charge rate signals pose for the Company norms for the cost of constructing power stations while keeping to schedules, norms for capital raising based on quotes from the financial markets and charge rate signals for the operation and maintenance of the power stations – during a proceeding for saving and minimization of costs. In addition, it was made clear that the setting of the charge rate basis for the generation segment would be valid until December 31, 2014, but would remain in effect after this date, as long as the Electricity Authority did not decide otherwise. As of the date of the report, an updated charge rate basis for the generation segment has not been published.

The new generation charge rate basis states the cost basket recognized for the Company in the generation segment for 2010-2014, including costs of capital, costs of operation, the fuels mix and more. The recognized costs were determined after audit of the costs of the Company that were carried out by the Electricity Authority, as they were listed in the books of the Company for the period from 2002 to 2009 with respect to the capital costs and for the period from 2002 to 2006 with respect to the operational costs. According to the preliminary estimates of the Company, the new generation charge rate basis is not expected to cover all the costs of the Company with respect to its operations in the generation field for the years 2010-2014. For additional details with respect to the position of the Company regarding the charge rate basis for the generation segment see note 3.b.3) in the Financial Statements. For details of the decision of the Electricity Authority, under which the Company will be required to annually report to the public regarding the gaps between the actual expenses and the Company's income from the electricity rate, according to activity segments, see Note 3 i to the Financial Statements.

⁴⁷ Resolution No. 1 of Meeting No. 289, dated February 1, 2010: "Charge rate base for the generation sector for 2010-2014 and updates to the transmission and distribution segment" and updates in the "charge rate structure" book.

7.11.2.2 Components of the generation charge rate base

Details on the main components of the generation charge rate base follow:

7.11.2.2.1 Calculation of the fuels mix

The recognized fuels mix for a certain year is calculated twice – once at the beginning of the year on the basis of forecasts and a second time at the beginning of the following year while updating the actual demand curve and updating parameters due to new professional information. Within the framework of the annual update of the subsequent year, an account will be made according to the difference between the revenues of the Company from the fuels mix in retrospect (ex post) and the revenues of the Company from the fuels mix that was calculated in advance. The difference will be returned to consumers or to the Company with the addition of interest and linkage through a compensation mechanism due to the late update. In addition, the fuels mix will apply in calendar terms to January through December.

7.11.2.2.2 Recognized assets and depreciation

The assets that were recognized in the new charge rate basis in the generation segment were established according to a normative outline for 2010-2014. The Electricity Authority has determined that the recognized cost for active assets will relate to two generation categories: (1) “old” generation units – generation units that were activated before December 31, 2002; and (2) “new” generation units – generation units that were activated after December 31, 2002. The recognition of the costs of the “old” generation units is based mainly on the costs listed in the books, whereas the recognition of the costs of the “new” generation units is in accordance with normative parameters such as operation dates, construction times and normative interest rates – as prescribed by the Electricity Authority.

The Electricity Authority has determined that in the case of the actual costs for the construction of the units being excessive in the opinion of the Company and not being included in the normative cost basis, the Company would be entitled to ask for the Electricity Authority to recognize these excessive costs after the unit operation date.

See Note 3B to the Financial Statements for details on the manner of recognition of recognized assets and depreciation, including with respect to the manner of recognition of the equipment costs and the development and assembly costs, and with respect to depreciation made in the Financial Statements.

7.11.2.2.3 Normative operation dates of the new generation units and their consequences for the charge rate

The Electricity Authority has established normative operation dates for the operation of the generation units that are expected to operate in the test period (2010-2014). These dates are relevant for recognition of the charge rate of the costs of assets and depreciation, financing costs and the fuels basket with respect to these generation units.

According to the charge rate base book, it was determined that if the Company does not meet the normative schedules that were established for the operation of the new generation units of the Company, the recognized costs for the Company in the charge rate will be decreased by the decrease model that the Electricity Authority has prescribed. The decrease model forms an affinity between the duration of the delay and the amount of the decrease to the effect that the greater the delay time, the greater the decrease rate accordingly.

On March 24, 2011⁴⁸, the Electricity Authority issued a resolution in which it updated the normative operation times of the generation units that were prescribed in its resolution based on the charge rate for the generation segment, whose operation date deferral had been approved by the Minister.

In view of this, the exposure of the Company for the fines has decreased compared to the estimate from the time of the publication of the charge rate base book for the generation segment in February 2010.

In addition, within the framework of a resolution of the Electricity Authority dated March 7, 2011⁴⁹, on the subject of spreading the debt of the Company to consumers (see details on this matter in Section 7.11.1.5 (b)), the

⁴⁸ Resolution No. 1 of meeting 331 dated March 24, 2011, on the matter of “Generation licenses for Israel Electric Corporation Ltd.”.

⁴⁹ Resolution No. 1 of Meeting No. 328 dated March 9, 2011, on the matter of “Spread of the debt of Israel Electric Corporation for prevention of electricity shortage”.

Electricity Authority stated that the Company would be given a "grace" period prior to the activation of the reduction mechanism for a delay in the schedules for the construction of 3 steam additions included in Stage B of the Emergency Plan (for which the debt was spread), which would be for forty five (45) days after the operation dates specified in the resolution. In addition it was determined that in the case of a delay of more than a year in the time of synchronization of each of the steam additions, the amount would be decreased by 2% per year out of the debt spread amount for each steam addition.

According to the decision of the Electricity Authority of May 6, 2013⁵⁰, and in accordance with the Company's request, the emergency Alon Tavor combined cycle has been derecognized from the recognized assets inventory of the Company, such that with respect to it the Company has no exposure to a fine due to not meeting the normative operation date.

The normative operating date of Eshkol emergency steam addition ("S.A.") was set to December 1, 2013. However, since a generator at Ramat Hovav S.A. was damaged in September 2012, a generator intended for Eshkol S.A. was transferred to Ramat Hovav in order not to affect the date of synchronization of Ramat Hovav S.A. which was set for the summer months. As a result, the operation date of Eshkol S.A. was postponed to March, 2014. As a result of the aforesaid, the Company is exposed to a fine of NIS 30 million and this while taking into account a period of grace of 45 days beyond the normative operating dates, as aforesaid. In May, 2013, the Company applied to the Head of the Electricity Administration, requesting to approve the update of the development plan. In response to this application, the Head of the Electricity Administration approved that the postponement of the operation date of Eshkol S.A. seems reasonable. However, there is no mention of the update of the development plan. In July 2014, explanations and arguments for postponing the activation date of this unit were submitted to the Electricity Authority. In view of the fact that it is an exogenous event and in light of past experience, the Company estimates at a level of likelihood of more likely than not that the Authority will refrain from applying these fines to the Company.

The information included in this report, and within the framework of the Financial Statements of the Company, with respect to the estimation of the Company regarding the decrease of the recognized cost in the charge rate as a result of this, is forward looking information as it is defined in the Securities Law, which is based on information held by the Company as of the date of the report, and its realization is dependent on various factors, some of which are not under exclusive control of the Company, such as obtaining the financing required to establish the combined cycle, receiving the licenses and permits required to establish the combined cycle, decisions of the Electricity Authority concerning the decrease of the recognized cost, and so forth. Therefore, the Company has no certainty that its estimations and expectations will indeed be realized in practice.

7.11.2.2.4 Financing costs (recognized return rate)

The return rate recognized in the charge rate for assets is intended for the purpose of the calculation of the financing component of the capital services that are derived from the value of the recognized values of the Company's assets in the charge rate. The recognized return rate is used starting from the resolution of the Electricity Authority with respect to the generation charge rate base as a basis for recognition of capitalization of financing costs of assets at the time of their construction. The rate of return recognized in the charge rate is derived from three (3) variables: (1) the financial leverage level; (2) the return on equity capital rate (gross); and (3) interest on foreign capital.

(a) The hedging mechanism

The purpose of the hedging mechanism in the charge rate is to prevent acute fluctuations in the profitability of the Company in periods of major differences between the rate of change in the Consumer Price Index and the rate of change in the exchange rate, because the assets of the Company are adjusted to the Index while a major portion of them is financed by foreign currency loans. In the view of the Electricity Authority, in recent years, there has been a development in the local financial markets for capital raising and for financial markets for derived financial

⁵⁰ Resolution No. 4 of meeting 400 dated May 6, 2013, on the matter of "Annual Update for 2012-2013".

instruments for hedging of exchange rate risks, and therefore it has been decided to cancel the hedging mechanism. Accordingly, according to the new charge rate base book for the generation segment, the previous hedging mechanism has been cancelled, but a new hedging mechanism has been established, which was supposed to be gradually cancelled within three (3) years, until 2013.

In the decision of the Electricity Authority of September 16, 2013⁵¹, it was determined that the outline of cancellation of the hedging mechanism that was determined in the decision of the Authority detailed above, of February 1, 2010, regarding the generation rate base, is frozen, and therefore the rate hedging rate is frozen at a rate of 9% of the foreign capital that was determined at the rate base, until the 2014 annual update date. Following the delay in publication of the annual update, on May 13, 2014, the Company approached the Authority with a request to freeze the hedging mechanism until the date of publication of the 2014 annual update.

According to the decision with respect to the 2014 annual update that was received on January 21, 2015, the present hedging mechanism is supposed to be frozen up to the date of the 2015 annual update or until the determination of a rate base for the grid's segments, according to the earliest of the two.

The main points of the hedging mechanism follow:

1. The amount of the hedge fund will be updated on the annual update date in accordance with the recognized assets and the decreasing outline that the Electricity Authority published (until the absolute cancellation of the mechanism).
2. The interest differentials between the foreign currency interest and the real shekel interest will also be part of the hedged amount and will be spread until the end of the hedging mechanism period.
3. The exchange rate of the effective basket and the foreign currency interest will be linked to the dollar and the euro, at rates of 75% and 25%.
4. It was determined that the amounts that will accumulate to the credit or debit of the Company shall be spread until the end of the hedging mechanism in April 2013. However, the mechanism was frozen in the decision of the Electricity Authority of September 16, 2013 up to the date of publication of the 2014 annual update, and afterwards as well, as detailed above.
5. No depreciation coefficients shall apply to the hedged amount.

In accordance with the resolution of the Electricity Authority in the charge rate basis book for the generation segment, the debt that has accrued for consumers for the cancellation of the hedging mechanism in its former format will be spread over a period of five years. See Note 3B.2 (D) to the Financial Statements for further information. The Electricity Authority, in its decision of January 21, 2015, increased the collection rate of the debt, in order to end the collection by February 2015. The differences that accumulated will be expressed within a compensation mechanism with respect to consecutive non-updating.

7.11.2.2.5 The operational costs

In the past, the operational costs that were recognized for the test period were derived from the average operation costs according to the financial statements of the Company for 2002-2006 while separating labor costs and other costs and after performing certain adjustments, in accordance with the increase in sales, and a depreciation coefficient of 2% per year was applied to these recognized costs. According to the decision of the Electricity Authority of January 21, 2015, a change has occurred in the manner of recognition of the operating costs, such that they were divided into fixed costs (at a rate of 88% of the total operating costs) and variable costs (at a rate of 12% of the total operating costs). It was also determined in the stated Authority's decision that the fixed cost will be advanced according to installed megawatts and the variable cost will be advanced according to net generation. The manner of recognition as detailed above will apply from June 1, 2013, until a new rate base is determined for the generation segment.

⁵¹ Decision no. 4 from meeting no. 413, of September 16, 2013, with regard to "continuation of freezing of the rate hedging mechanism of the Electric Company".

7.11.2.2.6 Pension costs

Through to the date of publication of the final resolutions of the Electricity Authority, the recognized costs of operation for the generation segment shall include the pension costs in accordance with the amendment published in 2009 and the recognized asset cost in the generation segment of the combined cycle generation units whose operation commenced after 2002 ("the New Units") shall only include costs of accumulating pensions of third generation employees. The costs shall not include actuarial pension costs of first generation employees, second generation employees or third generation employees (relating to free electricity, gift for holidays and bonuses). The recognized costs of the assets of the generation units that commenced operation through 2002 (hereafter: the "Old Units") was taken off the books of the Company and included in the pension costs of the employees of the Company.

The examination of the pension costs has not yet been completed by the Electricity Authority in accordance with what was stated above, and this issue is still being discussed between the Company and the Electricity Authority. Upon the adoption of a final resolution on the matter of recognized pension costs of first and second generation employees and pension costs for free electricity, gift for holidays and bonuses of third generation employees, this component shall be updated accordingly.

For details of the recommendations of the Steering Team with regard to free electricity see Note 1e j) to the Financial Statements.

7.11.2.2.7 Development and assembly costs

The normative development and assembly costs have been divided into two (2) groups: (A) the costs of Company employees that are linked to changes in the average monthly wage for an Israeli employee's position. (B) Costs of contractors, which are linked to the residential construction input index.

7.11.2.2.8 Special and one-time additions to the charge rate

In addition to the general framework for setting and updating the charge rate, as described above, and following requests of the Company, the Electricity Authority has included in certain cases additional components in the charge rate for financing of construction costs. See Section 7.7.5 for details with respect to recognition of costs of the Emergency Plan of the Company.

7.12 Environmental risks and the ways in which they are managed – the generating segment

7.12.1 Environmental hazards and environmental regulation – general

The activity of the Company in the generating segment is exposed to various environmental hazards, which include the emission of pollutants into the air that include fuel combustion products, the storage and use of hazardous materials and fuels, the pollution of soil and water sources, use of seawater for cooling, industrial effluents, asbestos, coal ash, noise, non-ionizing radiation and more.

Therefore, the generation activity is subject to extensive regulation in the environmental protection field. Over the course of recent years, the applicable environmental requirements (or those pending legislation) for the operations of the Company and the supervision and enforcement of those requirements have become stricter. The Company estimates that this trend is likely to continue and even intensify in the coming years, in accordance with the awareness and international requirements and, *inter alia*, in accordance with the common practice in western countries.

Among the laws from the field of quality of the environment that apply to the generating operations of the Company include, *inter alia*, the Hazard Prevention Law 1961 (hereinafter: the “**Hazard Prevention Law**”), including relevant personal orders that have been issued ; the Planning and Construction Law - 1965; the Business Licensing Law - 1968 (“**Business Licensing Law**”); the Water Law - 1959; the Prevention of Water Pollution from Land Sources Law - 1988 (hereafter: the “**Prevention of Water Pollution from Land Sources Law**”); the Hazardous Materials Law - 1993 (hereafter: the “**Hazardous Materials Law**”); the Coastal Environment Protection Law - 2004 (hereafter: the “**Coastal Environment Protection Law**”); the Clean Air Law - 2008 (hereafter: the “**Clean Air Law**”); the Prevention of Hazards from Asbestos and Harmful Dust Law - 2011, (hereafter: the “**Prevention of Hazards from Asbestos and Harmful Dust Law**”); the Freedom of Information Law - 1998; the Non-Ionizing Radiation Law - 2006 (hereafter: the “**Non-Ionizing Radiation Law**”); the Energy Sources Law – 1989 (“**Energy Sources Law**”) and the relevant regulations; Environmental Protection Law (Emissions and transmissions to the Environment - Reporting and Registering Duties) – 2012 (“**Register of Emissions to the Environment Law**”); the Pharmacists Regulations (Radioactive Elements and their Products) – 1980; and various bylaws (jointly hereafter: the “**Environmental Laws**”).

The Company is studying the ramifications of the Environmental Laws, is acting to prevent or minimize the environmental risks that may occur during the course of its operations, is preparing for the financial, legal and operational consequences of the laws and is allocating money in its budgets for the purpose of fulfilling the provisions of the Environmental Laws applying to it and those that are expected to apply to it.

However, there is no confidence that the costs and commitments within the existing and anticipated Environmental Laws will not exceed the amounts that have been allocated by the Company for these purposes, particularly in view of the trend of stricter environmental regulation in recent years and the volume of investments that is required in order to comply with it. The Company estimates, as of the time of this report, and based on the provisions of the Electricity Sector Law, that the material costs that will be imposed on it as a result of new regulatory requirements in the field of environmental protection will be covered within the framework of the electricity charge rate. However, the resolution with respect to the recognition of costs is under the authority of the Electricity Authority.

The aforesaid with respect to the assessments of the Company regarding the stricter environmental requirements that apply to the Company's activity, as well as the estimations of the Company regarding the cover of the material costs that will be imposed on the Company as a result of these regulatory requirements within the framework of the electricity rate, therefore constitute forward looking information, as per its definition in the Securities Law, and their realization depends on various factors, and they are not under the control of the Company and whose realization is not certain.

The Company assesses, as of the date of this report, that it is materially in compliance with the material provisions of the Environmental Laws. The Company possesses the environmental licenses required for its activity and where missing it is acting to obtain them. Non-compliance with the provisions of the Environmental Laws and the conditions of the permits and licenses provided to the Company by virtue of them may expose the

Company and its managers to criminal and administrative exposure, including imposing fines and sanctions and issuing closing injunctions for installations, and exposure to expenses for cleaning and rehabilitation of environmental damage.

7.12.2 **Air**

7.12.2.1 **The Clean Air Law**

Under the provisions of the Clean Air Law, the Company is required to hold emission permits for emission sources it operates that require permits, including power stations. The application for an emission permit must include details of the best optimal technique available that will cause the maximal reduction of emission of pollutants into the air, from all the possible optimal techniques.

In accordance with the transitional provisions in the Clean Air Law, an emissions source that has been duly operated by the Company prior to the commencement of the law will be allowed to continue to operate without an emissions permit through to September 30, 2016, or until a resolution is reached with respect to an emissions permit, as long as the Company submits an application for an emissions permit with respect to it by March 1, 2015. For new facilities or significant changes in existing facilities that will be activated until that time, the Company will have to receive an emissions permit as a condition for their operation. As of the date of this report, the Company completed the submission of applications for emission permits for all the generation sites.

In January, 2014, an emission permit was received for units 1-4 at the Orot Rabin station. Most of the provisions of the permit will enter into effect only after the conversion of the units to natural gas.

During the months of September and October the Company received additional conditions in business licenses for the Tzafit, Ramat Hovav and Haifa sites, under which the Company must, on the date of submitting the application for a permit for emissions into the air for these sites, submit additional documents for a combined (integrative) environmental regulation. For details see section 7.12.12 below.

This estimate is forward looking information, as is defined in the Securities Law, which may not materialize or may materialize in a manner other than that anticipated by the Company and this, inter alia, in accordance with the decision of the Ministry for Environmental Protection, as stated above.

The Clean Air Regulations (Fees), 2010 requires the payment of a fee for the submission of an application for an emissions permit or an application for a significant change in operation at an emissions source. The Company's assessment is that the total fees that it will be required to pay do not constitute a material expense. Additionally, the law authorizes the Minister of Environmental Protection to set a levy with respect to emission of pollutants into the air, which will be levied on the emission permit holders. As of the date of the report, this levy has yet to be set.

The Clean Air Regulations (Air Quality Values) (Temporary Order), 2011 prescribe values for the presence of airborne pollutants. An update of these regulations was published in May 2013. The regulations may affect the planning of future projects of the Company and the operation of existing facilities, but the Company does not have the ability to presently estimate the extent of the stated impacts and whether they will have a material impact on it.

As far as the Company knows, the Ministry of Environmental Protection intends to exercise its authority under the Clean Air Law to declare a number of areas in Israel as air pollution stricken areas (the areas under examination are the Haifa Bay, Gush Dan and Jerusalem areas). In view of the first stage of this examination, the Company cannot assess its consequences at the time of this report.

In September 2014, the Ministry of Health announced the classification of exposure to air pollution, including particulate matter (PM) air pollution, as carcinogenic to man. This followed a similar classification by the World Health Organization. At this stage, the Company is not required to take additional actions or means

beyond those already taken by it to reduce airborne emissions. The Company is monitoring developments in this matter.

7.12.2.2 **Conditions with respect to air pollution in personal orders pursuant to the Hazard Prevention Law**

Conditions with respect to airborne emissions from the facilities of the Company are being imposed on the Company *inter alia* within the framework of personal orders that have been issued under the Hazard Prevention Law (which were given prior to the effect of the Clean Air Law) and within conditions in a business license.

At the Haifa, Reading and Eshkol sites, individual personal orders that include various instructions with respect to the reduction and prevention of airborne pollutant emissions, monitoring and sampling, manners of operation and more, apply.

Furthermore, a lateral personal order signed in December 2010 applies to the Company and applies to all the power stations of the Company (the “**Lateral Order**”).

The Lateral Order prescribes, *inter alia*, a duty to reduce emissions at the coal power stations of the Company in a gradual manner, updated airborne emission values, a duty of continuous monitoring and installation of monitoring instruments, duties of tracking, recording and reporting, restrictions with respect to the use of fuels and more.

The order obliges the Company, *inter alia*, to produce electricity using only coal and natural gas, whereas the natural gas is defined as a major fuel and diesel oil/fuel oil as a backup fuel. The order also determines that in dual fuel generating units that are permanently operated with natural gas, in certain cases when it is impossible to supply the demand for electricity by operating them with gas, the Company has to use a cleaner, but also more expensive fuel mix, and this means in practice exhausting the operation of all the generating units with diesel oil before transferring to the use of fuel oil.

For details of the emission reduction projects see section 7.12.2.4 below.

7.12.2.3 **Directives with respect to the use of backup fuel in stations operating with natural gas**

The Lateral Order prescribes various provisions for circumstances in which the Company will be allowed to burn backup fuel (fuel oil and diesel oil) in the natural gas powered generation array, which include a fault in the natural gas extraction, conduction or supply system.

During March 2013, the supply of natural gas from the Tamar reserve to the national electricity system began, and the Company also began purchasing liquid natural gas (LNG). In November, 2014, the Ministry for Environmental Protection issued provisional instructions that, subject to certain conditions, enable the use of liquid fuel, in a situation in which it is required in view of the limitations in the gas supply and transmission, and in order to maintain the survivability of the system.

7.12.2.4 **Emission abatement plan**

Within the framework of the lateral order, the Company is required, *inter alia*, to work towards the reduction of emissions into the air. Within this framework, in July 2011, the Ministry of Environmental Protection approved, an airborne emission abatement plan that the Company submitted whereby devices for cleaning emission gases would be installed at the Company’s coal power stations gradually until the end of 2016. The emission abatement plan also includes conversion of units 1-4 at the Orot Rabin site will be to natural gas. A directive regarding the conversion of these units to operation by natural gas was also issued by the former Minister of National Infrastructures. The Company began to advance the national outline plan required for the Orot Rabin site in order to enable operation by natural gas at the site. The Company has applied to the Electricity Authority to receive rate recognition for the project before it is launched. In January 2015, a meeting was held by the Electric Company and the Electricity Authority, regarding rate recognition for this project. As part of this, the proposed rate model was presented to the Authority and it was agreed to hold another meeting in March 2015 for presentation of the project’s contents and cost.

In February, 2014, following requests by the Company to postpone the dates of the projects due to events that are not controlled by the Company, the approval of the Ministry for Environmental Protection was received, subject to conditions, for postponing the termination dates of the project so that the last project will end by June 30, 2018.

As of March 2014, the Company notified the Ministry of Environmental Protection that in the absence of a clear and suitable outline for the rate recognition for the project, it will be difficult for the Company to finish the emission reduction project on their current dates. Additionally, the Company applied to the Deputy Attorney General of the Government and other relevant entities and requested their intervention in order to bring about coordination between the demands of the various Government entities with regard to the projects, and to have the date of rate recognition and manner of spreading that are suitable for projects of this kind. Furthermore, as of May 2014, the Company notified the Ministry of additional events that are beyond its control and that may result in the Company's inability to meet the updated objectives of the project, inter alia Operation Zuk Eitan, limitations from the field of labor laws that prevent the intake of new employees instead of those that ended their period of work in the Company, and the impasse of the negotiations regarding the structural change.

In October 2014, the Electricity Authority clarified that it recognizes the project in principle but the rate recognition will in any case be subject to principles that will be determined, cost control and additional data provided by the Company.

In December 2014, a letter was received from the Ministry for Environmental Protection, under which the Ministry intends to assimilate obliging interim dates for executing the airborne emission reduction project in the conditions of the business license and the emission permits of the Orot Rabin and Rutenberg power stations in order to comply with the schedules that were approved in the past. A draft of an amendment to the conditions of the business license of the Orot Rabin site was attached to the letter for comments by the Company. The draft of conditions anchors obliging interim dates for the project's progress. In February 2015, the Ministry sent a draft of an emission permit for the Rutenberg site which included, inter alia, anchored milestones for implementing an emission abatement project at this site. The Company applied to the Ministry of Environmental Protection and the Ministry of National Infrastructures, Energy and Water, and also held meetings with the relevant Ministries, in which the Company presented its position and requested that the target dates of the project will be postponed and interim dates will not be anchored, and that a reexamination will be conducted of the format of emission reduction from units 1-4 at Orot Rabin in view of the events mentioned above.

The Ministry of Environmental Protection replied to these applications, noting, inter alia, that the Ministry does not intend to refrain from noting the milestones in the updated terms of the business license and the emission permit and the Company is provided with the possibility of relating to the proposed milestones themselves. In February, the Company sent its response to the Ministry of Environmental Protection, requesting an extension for the delivery of a detailed response to the terms of the Orot Rabin business license and the Rutenberg emission permit, after exhausting the negotiations presently conducted between the Government entities regarding the integration of milestones in projects and the suitable outline for emission abatement at the Orot Rabin units 1-4. The Company continues to hold meetings with the relevant ministries in this matter.

Insofar as the Company will not be granted an extension of the schedules, operating the coal units without means to reduce emissions after the dates set in the provisions will be against the law.

The Company estimates that although the Company is making an effort and is investing many resources in order to advance the emission reduction project, the Company might not meet the schedules set for it. Insofar as an extension will not be granted to the Company, a pause or postponement of the emission reduction project may be contrary to some of the environmental laws that apply to the Company, and may lead to criminal or administrative legal proceedings against the Company and its managers, and may even cause the continued operation of the coal power units by the Company without means to reduce emissions to be contrary to the law.

The estimate of the Company, according to which the Company may not meet the schedules set for it with regard to the emission reduction project at the Orot Rabin and Rutenberg sites, is forward looking information, as is defined in the Securities Law. This information is based on forecasts and estimates existing in the Company as of the date of the report, which may not materialize or may materialize partially or in a manner other than that anticipated, and this, inter alia, in view of the fact that their materialization depends on various factors that in part are not under the control of the Company.

7.12.2.5 Airborne emissions of coal dust and fly ash

During 2012, the Company received additional conditions to the business license of the Orot Rabin Power Station with respect to the prevention of diffuse emissions of coal dust and fly ash from the power station.

In October 2014, the Company initiated a meeting in order to update the Ministry for Environmental protection about the status of the handling of the various issues, and noted, inter alia, that in light of technical and technological difficulties met with by the supplier of cameras for visual monitoring and a series of difficulties related to the installation of the telescopic funnels, it cannot meet the project dates. The Company is taking a series of steps to advance the projects and is in touch with the Ministry of Environmental Protection.

7.12.2.6 Prevention and reduction of air pollution from vehicle fleet

In September 2014, the Company received instructions under the Clean Air Law for Prevention and Reduction of Air Pollution from its heavy vehicle fleet (10 tons and above). The instructions determine, inter alia, an average particle emission target for the vehicle fleet, instructions for a gradual increase of the percentage of vehicles that use alternate means of propulsion, recording of greenhouse gas emissions and training drivers to drive economically. In December 2014, the Company delivered an initial report of data about the vehicles to the Ministry for Environmental Protection as required by the instructions.

7.12.3 Land and water

The facilities of the Company store and contain hazardous materials, infrastructures and facilities that contain fuels and hazardous materials. The Company is working on the prevention and treatment of soil and water pollution from these materials, infrastructures and facilities.

The Company is required, at various sites, within the framework of various requirements, to seal spill containment pallets of fuel tanks in order to prevent fuel leakage that may cause pollution of earth and water sources. These requirements may impose costs on the Company, which may even be material costs, in accordance with the conditions of the site and the infrastructures installed in it.

This estimate is forward looking information, as defined in the Securities Law, based on future data whose realization is not certain and not under the control of the Company, but depends on the manner of interpretation of these requirements by the Ministry of Environmental Protection, and their implementation, if and as far as will be required, as stated above.

During closure of a site, as well as under the instructions of the Ministry of Environmental Protection, the Company is sometimes required to dismantle old fuel infrastructures. During the dismantlement of fuel infrastructures, a need may arise to perform polluted soil and water sources rehabilitation works. These works may involve material costs for the Company.

This assessment constitutes forward looking information, as per its definition in the Securities Law, as the treatment of contaminated soils varies, depending on the contaminated soil volume and the contamination type, the cost per treatment per cubic meter of contaminated soil being at estimated at hundreds to a few thousand shekels and the magnitude possibly reaching tens of thousands of cubic meters per site.

As part of the Company's activities to fulfill the conditions required in its business licenses, the Company has prepared a multi-annual plan for executing tests of the intactness of the fuel tanks it possesses at a cost of

approximately NIS 150 million spread multi-annually. The plan was approved for implementation within the current work plans of the Company.

In May 2012, during a routine filling of the tank at the Haifa power station with diesel oil, a spillover of diesel oil from the tank to the spill containment pallet was identified. The Company delivered an immediate notification of the event to the Ministry of Environmental Protection and acted to pump the diesel oil from the spill containment pallet. Most of the fuel was pumped and cleared and the Company is continuing the pumping, rehabilitation and periodic monitoring operations. All the operations are executed in accordance with the instructions of the Ministry of Environmental Protection. In May, 2013, the Company received a notice of an intention to debit with financial sanction of approximately NIS 2.6 million, under a claim of breach of the Hazardous Materials Law, 1993, with respect to this event. In June, 2013, the company presented its arguments in the matter to the Ministry for Environmental Protection. The response of the Ministry for Environmental Protection was received in December 2014, stating that in light of the arguments of the Company, it is retracting its intention to place a financial sanction on the Company with respect to this event.

Following the immediate report of March 2014 regarding the leakage of diesel oil at the Hagit site⁵², the Company took action to stop the leakage upon its discovery. The Company is regularly acting to treat the results of the leakage, including the pumping of water mixed with diesel oil and removing soil from various areas of the site. The Company is in constant contact with the relevant authorities and is acting in accordance with their instructions in this matter. The Ministry of Environmental protection has begun to examine the incident, including the summons of employees for questioning by the green police. According to the instructions of the Ministry of Environmental Protection, in March 2015, a summarizing report was delivered for approval by the Ministry of Environmental Protection that included results of soil test performed in the site and recommendations for rehabilitation.

7.12.4 **Instructions of the Ministry for Environmental Protection for treating polluted soil**

In January 2015, the Ministry for Environmental Protection published the principles of the policy in the field of prevention of soil pollution and treatment of pollutants in the soil, and at the same time published professional instructions (existing ones and those being formulated). These documents deal with, inter alia, the subject of preventing the cause of soil pollution, instructions to report on soil pollution being caused, immediate treatment of leakage of pollutant material to the soil and instructions for reviewing and rehabilitating polluted soil. The policy and guiding documents are expected to be integrated within binding documents (business licenses, toxic material permits or planning procedures). Insofar as the instructions will be integrated in binding permits or documents that will be received by the Company, this may have material implications for the Company.

The estimates of the Company with regard to the possible costs of the policy principles and professional guidelines of the Ministry of Environmental Protection for the Company is forward looking information which may not materialize, or materialize in a different manner than expected by the Company, and this is, inter alia, in light of the manner of integrating the principles and guidelines in binding documents.

7.12.5 **Effluents**

During the course of the generation of electricity, industrial effluents are formed in the generating segment facilities. The industrial effluents at coastal power stations are mainly exploited, after treatment, for reuse for the purposes of the station and other treated wastewater is dumped into the sea in accordance with the offshore discharge permits that are given to each site pursuant to the Prevention of Sea Pollution from Land Sources Law.

Following that stated in section 7.12.2.1, as part of a combined (integrated) environmental regulation for all the sites of the Company, it is possible that the Company will be required to improve the existing means in the effluents treatment facilities in the various sites. This may involve costs that may be significant.

⁵²See immediate report of March 3, 2014 (ref. no.: 2014-01-004494).

This estimate is forward looking information as is defined in the Securities Law, which may not materialize or may materialize in a different manner than expected by the Company, and it is, inter alia, according to the decision of the Ministry for Environmental Protection, as stated in section 7.12.12.

7.12.6 **Hazardous materials**

The Company holds, uses and stores hazardous materials at the power station sites. The Company holds poison permits as required by law for the purpose of dealing with hazardous materials and takes the actions for the purpose of compliance with the conditions of the permits.

7.12.7 **Asbestos**

According to the provisions of the Asbestos Hazard Prevention Law, the Company is required, inter alia, to remove and bury all brittle asbestos that has been installed for the purpose of thermal insulation in its facilities until 2021.

The Company is working to fulfill the provisions of the Law, inter alia for the purpose of removing brittle asbestos from the power stations and obtaining the permits that are required for this under the law.

7.12.8 **Planning and construction**

Within the framework of the generation activity, the Company is subject, inter alia in the environmental aspects of its activity, to the provisions of planning and construction laws. The power stations of the Company are subject to various environmental provisions that are described in outline plans and in construction permits. Within the framework of the planning processes for the design of new power stations or the expansion of current stations, the Company is sometimes required to conduct environmental effect surveys or environmental expert opinions, in accordance with rules and directives that are determined by the planning and environmental protection authorities.

NOP/10/a/3 - Reading Power Station

In 2010, a National (partial) Outline Plan, NOP 10/a/3 that determines, *inter alia*, the termination of operations at the site in 2020, the phases of termination of operation of certain areas, transitional orders, etc. was submitted. Under the submitted plan, the Company will be required, inter alia, to make environmental investments at the site. If the plan will be approved in its submitted version, its provisions will impose material costs on the Company.

The plan was discussed in January 2014 by the National Council for Planning and Building, which decided to transfer the plan that was presented, subject to conditions, to approval by the Government. As of the date of the report, this approval has not yet been received.

In January, 2014, an order was received from National Council for Planning and Construction, to prepare a new National Outline Plan that will enable continued operation of the site under certain conditions after 2020 as well. As of the date of this report, this plan has not yet been prepared.

The aforesaid regarding the material costs that the Company may have to bear insofar as the NOP 3/10/a will be approved, is forward looking information, as it is defined in the Securities Law, which may not be realized or may be realized in a different manner than expected by the Company, and this is, inter alia, as a result of reasons that are not dependent on the Company including that insofar as the NOP 10/a/3 will be approved in a different manner than the manner presented at present.

7.12.9 **Preservation of the coastal environment**

The Coastal Environment Preservation Law prohibits, *inter alia*, harm to the coastal environment as per its definition in the law (a strip of 300 meters from the shoreline), unless a duly issued permit to do so is issued. Within the framework of this law, the Coastal Environment Preservation Committee was established, and is required to approve various plans within the coastal environment. Within the framework of the law, the Company is sometimes charged with requirements with respect to and restrictions relating to Development Plans of coastal power stations.

A significant portion of the manufacturing facilities of the Company are along the coast of the Mediterranean Sea, and therefore the Company is preparing for the prevention of the pollution of the sea with fuel, increasing its preparedness for marine pollution incidents, and for protecting its facilities from sea pollution from an external source.

In June 2014, the Company received a summons to a hearing on an alleged pollution of the coast with coal leachates from the Rutenberg power station. It is a spill of water mixed with a quantity of approximately 1 Kg. of coal powder that reached the sea through the drainage canals. According to the summary of the hearing, the Company carried out a comprehensive examination for finding an engineering solution to prevent the drainage of leachates from the coal quay out of the station. The Company delivered the findings of the examination to the Ministry of Environmental Protection and began work to implement the recommended alternative.

7.12.10 **Fly ash**

Within the framework of the generation of electricity at coal power stations – Orot Rabin and Rothenberg, fly ash is created. Since 1998, the quantity of fly ash formed has been sold by the Company for use in the construction and infrastructure industries and agriculture.

In June 2008, the Director of the Prevention of Noise and Radiation Section at the Ministry of Environmental Protection announced that he considered fly ash to be radioactive waste. In July 2008, the Company submitted an objection to this resolution, *inter alia* claiming that this classification had no scientific basis, and based on directions and regulation of the issue in western countries and the International Atomic Energy Agency (IAEA). The objection of the Company was dismissed, as was a pre-Bagatz (High Court of Justice pre-trial hearing in which a petition is sent to the Petitions Department in the State Attorney's Office) submitted by the Company in this matter. Nonetheless, further to the objection of the Company, the Assistant to the Director General of the Ministry of Environmental Protection announced that the Ministry itself was interested in optimum, maximum use of fly ash, under supervision with respect to the content of radioactive materials in the construction products containing fly ash.

In January 2010, the third version of Standard SI 5098 "Content of Natural Radioactive Elements in Construction Products", which establishes that construction products in Israel, including those containing fly ash may not be manufactured or distributed unless they have been inspected and found to comply with the standard, took effect. As far as the Company knows, construction products containing coal ash from the power stations of the Company are inspected in accordance with the requirements of the standard.

In December 2014, the Director of the Prevention of Noise and Radiation Section at the Ministry of Environmental Protection announced that in accordance with regulation 5 of the Hazardous Materials Regulations (Radioactive Waste Disposal), 2002, he is instructing the Company to remove coal ash from its power stations while giving precedence to cement industry, so that the Company has to transfer to the cement industry all the bottom coal ash with completion of up to 800,000 tons of fly ash and the surplus quantity of coal ash can be transferred to the cement industry (in this section - the "**Instruction**"). The Company delivered its reaction to the Director of the Prevention of Noise and Radiation Section at the Ministry of Environmental Protection and also applied to the General Counsel of the Ministry of Environmental protection. In this framework, the Company detailed, *inter alia*, its position that the use of coal ash in the cement industry as is carried out in Israel and elsewhere in the world does not involve any risks and therefore there is no reason to give such an Instruction. This position of the Company was not accepted. The Company estimates that implementation of the instruction may cause, *inter alia*, a decrease in the flexibility of removing the coal ash from the stations and may lead to accumulation of surplus ash at the Company sites. On March 23, 2015, the Company received a petition by Shafir Structures & Industries Ltd. that was filed against the Supervisor of Environmental Radiation in the Ministry of Environmental Protection and against the Company in this matter.

The estimate of the Company with regard to the implications that may be for the implementation of the Instruction constitute forward looking information, as is defined in the Securities Law, which may not materialize

or may materialize in a different manner than the manner expected by the Company, and this, inter alia, due to the demand for coal ash in the cement industry and the results of the petition.

7.12.11 Business Licensing

Most of the power stations of the Company operate pursuant to business licenses that have been given permanently and ancillary conditions that are updated or renewed from time to time. These were intended to regulate, *inter alia*, the operation of the station with the goal of reducing or preventing environmental risks and hazards. The Company is acting to regulate the business licenses for the remaining generation sites and for other licensable items in accordance with the provisions of the law and the requirements of the authorities, the regulation process for some of them being at advanced approval stages. The operation of the sites of the Company without a business license constitutes a violation of the Business Licensing Law and may lead to the termination of the operations of the business. See Section 21.9 for further information on the Business Licensing Law and the state of licensing of the various licensable items at the Company.

7.12.12 Integrative licensing

The integrative licensing procedure comprehensively examines the environmental effects of the plant on the environment in all aspects (effluents, air, land, etc.), and accordingly determines detailed conditions for each plant, while considering its unique conditions and the integration between its various environmental effects. The Ministry also wishes to assimilate laterally, within the integrative licensing, mechanisms such as the obligation to implement BAT, transparency of the licensing procedure, reorganization and adding information and surveys that are submitted to the Ministry of Environmental Protection for licensing, sharing with the public and Life Cycle Analysis (LCA), requirements for environmental administration, and so forth.

During the months of September and October 2013, the Company received additional conditions in business licenses for a number of sites, according to which the Company has to submit additional documents on the date of submission of the application for air emission permits for these sites, for combined (integrative) environmental regulation, according to the updated instructions that were published on the website of the Ministry for Environmental protection in September 2013. In April 2014, the Ministry for Environmental Protection and the Company agreed that applications for integrative licensing will be submitted for all the generation sites of the Company, according to a gradual and agreed upon schedule. Requirements deriving from the integrative licensing process may impose costs on the Company, which may even be material costs.

The aforesaid with respect to the material costs the Company may have to bear regarding the requirements that will derive from the integrative licensing process is forward looking information, as it is defined in the Securities law, which may not materialize or may materialize in a different manner than expected by the Company, and this, *inter alia*, as a result of reasons not dependent on the Company and taking into account the requirements that will be set in practice.

7.12.13 Material events or matters with respect to environmental protection

As of the date of the report, to the best of the Company's knowledge, it is not exposed to material events or matters with respect to environmental protection in the generating segment unless these have been stated above.

7.12.14 Material legal or administrative proceedings with respect to environmental protection

Various legal proceedings, criminal and civil alike, have been filed against the Company and directors thereof with respect to the generating segment, on grounds of violation of environmental laws.

The criminal prosecutions relate primarily to seawater and air pollution, and those whose adjudication is over did not involve material fines for the Company or its directors. See Note 34 B.2 and 34 B.3 to the Financial Statements.

7.12.15 Company policy in environmental risk management

The Company considers itself to be responsible as being responsible and committed in taking steps to protect the environment and reduce environmental hazards throughout the electricity chain.

The Company is operating in accordance with the an environmental strategic policy and vision to protect the environment out of responsibility for society and the environment, with a long term, prospective sustaining view, for minimization of the environmental consequences that stem from its activity and for leadership in the field of hazard prevention and environmental effect abatement.

The principles of the economic policy of the Company include the integration of environmental considerations throughout its fields of activity, including in decision making processes; design and operation of facilities; adopting the best proven and economical technologies; adoption of proven, advanced environmental criteria; intelligent use of raw materials and natural resources and encouraging economical use of electricity; the reduction and recycling of waste and byproducts; integration of landscape, regional and environmental considerations in the design of new facilities and maintenance of existing ones; the holding of an open, transparent dialog with the public, joint activity with environmentalist, state, public and international entities, including participation in environmental studies, in the development and initiation of advanced technologies and adoption of environmental values in the organizational culture.

7.12.16 **Environmental costs and investments of the Company in environmental protection**

A breakdown of the investments of the Company in environmental protection is as follows:

NIS million, current prices	Twelve months ended on December 31 (adjusted to NIS of December 2014)		
	2012	2013	2014
Total investment in environmental protection facilities	Approx. 864	Approx. 759	Approx. 808
Current costs (without depreciation)	Approx. 91	Approx. 82	Approx. 90

(A) Investments during 2014

In 2014, the Company invested approximately NIS 803 million, in environmental protection aspects in the generating segment (in addition to approximately NIS 5 million in special products), *inter alia*, in the installation of air emission abatement measures at the Orot Rabin Station (including, *inter alia*, “primary devices” and removers).

In addition to the investments that have been described above, the Company spent in 2014 within the framework of costs of operation of the power stations and ancillary expenses to fuels, approximately NIS 89 million for compliance by the production system with environmental protection requirements (in addition, a total of approximately NIS 1 million which are not attributed to the production system). The Company estimates that the environmental costs that the Company bore in 2014 were invested mostly in future prevention and reduction of environmental damage and the rest was invested in environmental repair and restoration.

(B) Budget for 2015

The Company is allocating in its budgets money for compliance with environmental conditions and laws. For 2015, the Company allocated within its current operation and development budgets a total of approximately NIS 1,350 million for compliance with environmental protection requirements including, among others, waste treatment, acts to protect fauna and flora, the air, land, underground water and surface water, effluents treatment, protection from radiation and noise reduction.

(C) Emission abatement budget

Within the framework of the development budget, without interest at the time of construction, in 2011-2018, the Company has allocated an amount of approximately NIS 5.5 billion (in 2015 budget prices) for the emission reduction project (the above mentioned investment does not include the comprehensive investment of the water supply project for the emission reduction installations in the amount of approximately NIS 12 million less costs with respect to remeasurements, and also does not include the investment in the emission reduction projects in Orot Rabin 1-4 in which approximately NIS 22 million were invested so far and the natural gas supply project at Orot Rabin 1-4), *inter alia* for the purpose of

installation of airborne pollutant emission abatement devices from the Orot Rabin and Rothenberg sites ("primary devices", removers and construction of catalytic devices).

As stated in section 7.12.2.4 above, the Company continues to hold meetings with relevant Government entities, inter alia with respect to the appropriate outline for emission reduction at the Orot Rabin units 1-4.

In February 2011, the Company executed an agreement with Babcock Noell GmbH for the purchase of emission abatement systems for some of the generation units at the Rabin and Rothenberg Power Stations. The total amount that the Company committed to pay within the framework of this agreement is substantial. There is disagreement with the same equipment supplier, mainly on the subject of the sum of payment.

The estimates of the management of the Company with respect to the expected scope of investments in the field of environmental protection is forward looking information, as per its definition in the Securities Law, which is based on the Company's budget and work plans. The estimates of the Company with respect to the expected volume of investments in the environmental protection field may fail to materialize or materialize partially or differently than estimated, inter alia due to factors that are not under the control of the Company, including a change in the regulatory requirements applying to the Company, a change in the volume of generating operations of the Company and the fuels with which the Company generates and other events, including those that stem from the lateralization of risk factors of the Company.

7.13 Legal proceedings

With respect to other pending legal proceedings against the Company, including proceedings for the generation segment, see Note 33b.1.a. and Note 34 B to the Financial Statements. For details with respect to legal proceedings in which the Company is the plaintiff in the proceedings see section 23.

8. The transmission and transformation segment

8.1 General information on the transmission and transformation segment

8.1.1 The structure of the field and the changes that have occurred

The electricity transmission and transformation activity is conducted under a license that the Company has received “for transmission, distribution, supply, sale and trade of electricity”. This license, and all activities involved, was extended, as mentioned, along with other licenses that the Company possesses, until January 1, 2016.

The Company has no separate license for activity in the transmission and transformation segment and the activity that is being conducted in accordance with the text of the consolidated license above (which in accordance with that which has been stated above related to a number of activities).

Within the framework of this field of activity, the majority of electricity that is generated, as described by the Company, and partly by private electricity producers, is transferred by the Company via its transmission grid. The transmission grid is deployed throughout the State of Israel and the territories that have been subject to its rule since June 1967 (East Jerusalem and the West Bank) and Gaza (in this section, for the sake of convenience only, “the country”). The transmission grid consists of extra high voltage lines (400 kV) and a high voltage grid (161 kV), through which electrical energy is transmitted from the generation units to the switching stations (stations of 400 kV voltage) and to the major substations (stations of 161 kV voltage) and from the switching stations and the major substations to substations that are built nationwide. At the switching stations and substations of the Company, transformation activity is performed, changing the electricity voltage levels from extra high or high voltage (through connection transformers at switching stations) and from high to medium (through the output transformers at the substations). The electricity transmission at extra high voltage facilitates the transfer of energy between the power stations generating the energy and the switching stations and substations of the transmission segment, at relatively low losses. After transformation to medium voltage (distribution grid), the energy is transferred to high voltage users and through grid transformers to low voltage users. See Section 9 for details on the distribution segment. Some of the customers of the Company are extra high voltage customers that include mainly big consumers such as industrial plants, the Mekorot Company, desalination facilities, and more (see section 10).

Operation, maintenance and handling malfunctions is also included in the execution of activity of the segment of electric energy transmission.

The Company has three types of substations: (1) permanent; (2) temporary, and (3) mobile. The mobile substations are stationed at various sites adjacent to the load center or at existing substation sites, usually until the construction of a permanent substation in the area, for a period of five to ten years. In addition, there are private substations that are divided into 2 types:

- New substations owned by a consumer or producer of high voltage. The operational and maintenance responsibility of the high voltage and extra high voltage in these substations lies with the Electric Company.
- Old substations that are owned by a consumer of high voltage (enable to intake a private producer too after examination and accommodating the private substation to the new conditions).

8.1.2 Restrictions, legislation, regulation and special constraints applying to the field of activity

The activity of the Company in the transmission and transformation segment, like its other fields of activity, is subject to legislative restrictions, such as those which have been stipulated in the provisions of the Electricity Sector Law, in the Government Companies Law and in the Book of Criteria Published by the Electricity Authority and to constraints that are related to licensing issues and requirements for permits from various authorities and government ministries such as the Electricity Authority, the Companies Authority, the Ministry of National Infrastructures, Energy and Water and the Ministry of Environmental Protection and to emergency and Development Plans in the Electricity Sector. The electricity transmission and transformation activity is executed under a license received by the Company for “transmission, distribution, supply, sale and trade of electricity”.

The validity of this license, including all the activities included in it, was extended until January 1, 2016. As stated, the Company was not issued with a separate license for the transmission and transformation activity and the activity is therefore executed under the version of the united license that relates to several activities. See Section 21 for details on restrictions, legislation, regulation and special constraints applying to all of the activity of the Company. See section 8.9 for details regarding the electricity rate in the transmission and distribution segments. See Note 1 e to the Financial Statements for details of the provisions of the Electricity Sector Law regarding the structural change.

8.1.3 **Changes in the scope of activity in and profitability of the field**

The main trends and changes that may affect the volume of transmission and transformation activity are the following:

- (A) Due to the increase in the generating capacity in the national economy, whether by private energy producers or by the Company, and the increase in the reserve⁵³ of the electricity generating ability, the Company anticipates that it will be required to build additional switching stations and high and extra-high voltage lines, as well as upgrading existing power transmission lines to stronger ones.
- (B) In addition the Company expects that due to the constant increase in demand for electricity, it will be required to build additional substations and to increase transformation at existing switching stations and substations.
- (C) The Company is acting consistently in order to reduce the costs of the construction of substations, by building outdoor substations (*that is*, a station in which switching equipment in the high voltage regulator and transformers are external and located on the premises of the station) and reducing the costs of all of the station components. However, due to the strict environmental requirements, the Company is expected to build internal substations (*that is*, a station in which all electrical equipment is enclosed in a building and isolated by gas) of larger scale. In addition, there are demands on the part of outside parties to bury overhead transmission lines underground and divert existing lines within the framework of “intelligent avoidance” policy, which is application of reasonable measures for reducing magnetic field levels where possible.
- (D) The construction of a larger number of private switching stations and substations by private electricity producers and high voltage and extra high voltage customers will lead to a greater investment of working hours of Company staff in introduction of utilization that the Company is required to make in the operating premises under its responsibility for the installations of the private producer or consumer, for tests and maintenance, because the tests that are related to the connection of the substation to the transmission system can only be conducted by the Company by virtue of it being an essential service provider in the transmission field..
- (E) Changes in the Criteria for the level, standard and quality of service provided by a licensed essential service supplier in the field of transmission, which are determined by the Electricity Authority, will require the Company to make greater payments as indemnification to electricity producers and consumers that are connected to high voltage grids. The implementation of a criterion for high voltage will impose on the Company fines due to failure to meet the prescribed schedule for connecting a new consumer or failure to supply electricity for various reasons.
- (F) A demand of the Ministry of the Interior to add high voltage lines to an outline plan (NOP) extends the time of construction of high voltage lines.
- (G) Environmentalist requirements with respect to electromagnetic radiation and the difficulty to obtain expected line corridors will increase the volume of high and extra high voltage cables and regarding oil spill containment pallets for transformers.

⁵³ This refers to the difference between generation ability and the demand for electricity at that time from consumers.

- (H) Requirements stemming from laws, standards and regulations of the various government entities, such as: firefighting authorities, anchoring requirements against earthquakes, information security for substations, protection against firing, protection against electro-magnetic-pulse (EMP) may increase the Company's expenses in this field of activity.
- (I) Security requirements including physical, logistical requirements and information security for substations, switching stations and command centers may increase the Company's expenses in this this field of activity.

What has been stated above with respect to the key trends and changes that may affect the volume of activity in the field and its profitability constitutes forward looking information, as per its definition in the Securities Law, which is based on estimates and forecasts of the Company for the date of the report and for which there is no certainty that it will materialize, in part or in full, in the manner described or in another manner and may materialize in a materially different way, inter alia, because of circumstances that do not depend on the Company only, such as: changes in the regulation applying to the field of activity, changes in the demand for electricity, the entry into activity of private electricity producers and the dependence on external factors.

8.1.4 **Technological changes that may materially affect the field of activity**

The technological changes that may materially affect the field of activity and which the Company has started a process of implementation of follow:

- (A) Short term deployment of high output (75 MVA⁵⁴ instead of 50 MVA) transformers with short current limiters at the substations within metropolises, increasing the volume of capacitor batteries and arrays connected to the distribution grid for increasing the transformation ability at new substation sites and adapting this new equipment to the existing distribution grids. Furthermore, replacements are planned of transformers at existing substations to new transformers including the peripheral equipment, as noted with regard to new stations.
- (B) Deployment of new technologies in the transmission field, such as ACSS wires with high thermal ability compared to a regular wire with the same cross-sectional area, which are used for increasing the transmission capacity of existing transmission lines to avoid the construction of new lines.
- (C) Laying of underground cables of 2,000 mm² cross section.
- (D) Information security equipment in the field of computerization and communications for substations.

8.1.5 **Critical factors for success of the field of activity and changes applying therein**

The Company estimates that the business success of the transmission and conduction segment depends primarily on the update of the electricity charge rate for the transmission and transformation segment and on the level of demand for electricity, the costs of maintenance and operation of the transmission and transformation facilities, recognition of the total costs that are required for electricity transmission and transformation within the electricity charge rate and the ability of the transmission and transformation segment to increase efficiency in structure and technology.

8.1.6 **The key entry and exit barriers of the field of activity and changes occurring therein**

(A) Entry barriers

The Company estimates that the key entry barrier in the field of activity is the need to receive a transmission license in accordance with the Electricity Sector Law.

(B) Exit barriers

The regulation that regulates the activity of the Company and its status as an "essential service supplier license" holder in accordance with the Electricity Sector Law and the provisions of its licenses, requiring it to

⁵⁴ MVA – megavolt ampere. Voltage measurement unit.

transmit electricity to the public at large, reliably and efficiently, in accordance with the terms of its license, are the key barriers preventing exit from the field of activity.

8.1.7 The structure of competition in the field of activity and changes occurring therein

As of the date of the report, the Company is acting as a monopoly in the field of electricity transmission and transformation and has no competitors. In addition, the Company is required to allow private electricity producers to use its transmission system. See Section 7.4.4 for details. Notwithstanding that stated, it is commented that under the Electricity Sector (Cogeneration) Regulations, 2004, the Ministry of National Infrastructures, Energy and Water has the authority to provide approval for cogeneration producers to produce electricity to adjacent consumers without using infrastructure services.

8.1.8 Alternatives to products of the field of activity and changes occurring therein

Technologically speaking, there are places in the world in which the construction of gas turbines in industrial zones and in cities in which there is no existing transmission system and that require alternative means of power supply, without a need to connect to the transmission system, such as via a standalone generator, solar panels and so on.

8.2 Products and services

Services in the transmission field are given to high voltage customers (private producers and 10 major consumers such as Dead Sea Works, desalination installations) and the districts of the Company (the distribution system that sells medium voltage and low voltage electricity to consumers in the State of Israel). The end consumer pays for the transmission component by the general charge rate that is prescribed by the Electricity Authority (see Section 8.9).

8.3 Segmentation of revenues and profitability of products and services

8.3.1 Revenues

The net revenues from the sale of electricity that are assigned to the transmission and transformation segment in 2014 (according to the assumptions detailed in Note 38 to the Financial Statements) came to a total of approximately NIS 2,836 million, compared with approximately NIS 3,076 million in 2013 adjusted to the NIS of December 2014, representing a decrease in revenues of approximately NIS 240 million and compared with approximately NIS 2,642 million in 2012 adjusted to the NIS of December 2014. The change in revenues in 2014 arises from a decrease of approximately NIS 40 million for a real decrease in the electricity charge rate, and additionally a decrease in consumption of approximately NIS 160 million.

8.3.2 Profit from ordinary operations – the transmission and transformation segment

The profit from ordinary operations in the transmission and transformation segment in 2014 came to a total of approximately NIS 216 million, compared with a profit of approximately NIS 771 million in 2013, adjusted to the NIS of December 2014, representing a decrease of approximately NIS 555 million, and compared with a profit of approximately NIS 546 million in 2012, adjusted to the NIS of December 2014.

8.4 **Generation capacity – the transmission and transformation segment**

8.4.1 **The transmission segment (power lines):**

A breakdown the length of the transmission circuits⁵⁵ of the Company follows:

Date	400 kV lines km of circuit	161 kV overhead lines km of circuit	115 kV lines km of circuit	161 kV underground lines ⁵⁶ km of circuit
December 31, 2014	741.2	4,469.5	114.5	109.4
December 31, 2013	741.2	4,441	114.5	109

On December 31, 2014, the installed output of 161/400⁵⁷ MVa connection transformers⁵⁸ stood at 10,300 MVa. On December 31, 2013, the installed output of 161/400 MVa connection transformers stood at 9,650 MVa.

8.4.2 **The transformation system:**

On December 31, 2014, the transformation system consisted of 196 substations (of which 43 substations were owned by high voltage consumers), compared to 193 substations that had transmission systems, it had on December 31, 2013 (of which 42 substations were owned by high voltage consumers).

On December 31, 2014, the installed transformation ability was approximately 19,901 MVa (including approximately 2,915 MVa across substations for high voltage consumers), compared with an installed transformation ability of approximately 19,700 MVa (including approximately 2,855 MVa across substations for high voltage consumers) as of December 31, 2013.

The table below displays a number of switching stations (including also substations) and number of substations of the Company and of consumers, as of December 31, 2014 and 2013:

Substation type Year	Switching station	Substation	Private	Total
December 31, 2014	10	143	43	196
December 31, 2013	10	141	42	193

The material changes in the transformation system that occurred in 2013 and 2014 are: the establishment of future substations and transformation additions at Misgav, Galia, Ofakim and Yoqneam. Additionally, the construction of a 400 kV switching station at Ein Tut was completed.

⁵⁵ In general, there is more than one transmission line between any two pylons, known as a "circuit" and measured in km

⁵⁶ Underground.

⁵⁷ A connection transformer changes voltage levels within the transmission system (from 400kv to 161 kv).

⁵⁸ The transmission system has three voltage levels: (1) extra high voltage- 400 kv; (2) high voltage system of 161 kv and (3) a high voltage system of 115 kv (and old system whose use is decreasing),.

8.5 Fixed assets, land and facilities

See Section 7.6.1 for details on assets that it uses in its fields of activity, including in the field of transmission and transformation.

Details of the fixed assets and facilities described below relate to the property and assets possessed and/or used by the Company in the field of transmission and transformation activity, disregarding the differences of opinion between the Company and the State with respect to the rights of the Company to the property and assets in question, which it possessed, as of the time of expiration of the Concession (see Note 1 f to the Financial Statements and Section 14.3 with respect to the “property settlement” and its consequences for the Company).

A breakdown of the switching stations and the major substations that are used by the transmission and transformation segment at the various sites follows:

Name of site	Location	Type	Site area in m ²	Nature of the rights
Caesarea **	Caesarea	Switching station	-	Sublease, Caesarea Development Company, until 2048
Tzafit *	Next to Kfar Menachem	Switching station	-	Lease till 2034
Petach Tikva *	Next to Morasha Junction	Switching station	65,073	Ownership
Zevulun *	Kfar Hassidim	Switching station	272,045	Development agreement with ILA till 2000 with a right to receive a lease
Gan Sorek *	Rishon le Zion	Switching station	210,136	Development agreement with ILA till 1998 with a right to receive a lease
Even Sapir *	Southwest of Moshav Even Sapir	Switching station	104,000	Lease till 2040
Gezer **	Next to Ramla	Switching station	-	Possession
Ramat Hovav **		Switching station	-	Lease contracts till 2028/2029
Hagit ***		Switching station	-	327,000 m ² leased till 2051. The rest is owned.
Yavneh	Ashdod Junction	Major substation	100,117	17,600 m ² leased until 2023. The rest is owned.
Kishon **	Nesher	Major substation	100,000	Lease till 2058
Alon Tavor **		Major substation	-	Lease till 2039
Yarkon *	Tel Aviv, Ramat Hahayal	Major substation	116,655	100,000 m ² owned. The rest is possessed
Ayalon (Ganot)	Ganot Intersection	Switching stations	39,092	Lease until 2061 (transaction approved in ILA and IEC, site under construction, contract issued, signed in IEC and transferred to be signed by ILA)
		Total area	1,007,118	

* The site includes a substation.

** The area of the switching stations and major substations above includes a substation and is included in the area of the site of the relevant power stations, as indicated in Section 7.6.

*** The areas of these switching stations are included in the areas of the site of the Hagit Power Station, as indicated in Section 7.6.

There are two (2) additional substations that are on the premises of power stations. See Section 7.6 for further information.

The transmission and transformation segment includes 113 permanent substations, 18 temporary substations and 15 active portable substations that are dispersed nationwide. See note 14 c to the Financial Statements for details on the type of rights of the Company to these properties.

8.6 Development of the Electricity Sector – the transmission and transformation segment

8.6.1 Manner of determination of the Development Plans of the transmission and transformation segment

See Section 21.1.3.2 for details on the duty of the Company to submit a Development Plan and comply with its conditions and the relevant schedules.

The Development Plan for the transmission and transformation system is submitted for approval by the Minister once a year. The duration of the Development Plan as stated is for a period of five years. Due to the long time required for advancing projects in the transmission and transformation field, considering the proceeding required for environmental and statutory purposes and receiving construction permits, the Company is preparing a Development Plan for ten years, with a semi-annual update (in view of changes in the demand forecast, a need for accommodating projects of private entrepreneurs, problems in advancing infrastructure projects and more), from which the five year Development Plan that is submitted as mentioned for the approval of the Ministry is derived.

The plan includes, inter alia, the construction of new projects and projects that include expansions and improvements of the existing system, for the purpose of adapting the transmission and transformation system to the needs of the Electricity Sector, while considering the availability of the sites and the ability of the Company to realize projects.

8.6.2 Main assumptions and restrictions underlying the Development Plan

The Development Plan is based on: (A) the geographic layout of the load, which his consistent with the national demand forecast; (B) the generation system Development Plan including private electricity producers; (C) the planning criteria; (D) the implementation of advanced, proven technologies in the transmission and transformation system; and (E) analysis of the odds of materialization of the projects.

The purpose of the Development Plan is to adapt the transmission and transformation system to the needs of the national economy, while reducing costs and minimizing land resources, in accordance with the prescribed in arrangement with the Ministry of National Infrastructures, Energy and Water. The plan is being developed while considering planning, land, environmental and economic uncertainties and constraints and their consequences over the ability to implement the plan.

A test is being made for the projects that have been listed in the Development Plan with respect to the chances of materialization that depend on the availability of the sites and the ability of the Company to implement them. In accordance with these evaluations of odds of materialization, updated operation dates have been established.

The Company is acting to implement a Government resolution dated January 2009⁵⁹ that addresses the transition to the generation of electricity from renewable energy to a volume of 10% before 2020 and in this context it operates to connect each renewable energy entrepreneur that has applied to it for connection, for making a feasibility study or a connection review, in accordance with the criterion “high voltage connection” of December 2012.

Within this framework, in accordance with the resolutions of the Electricity Authority, the Company has published a large number of feasibility studies of the various initiatives for generation of electricity using renewable energy. The Company has incorporated in the outline plans of the entrepreneurs strips for connection to the transmission system and is advancing plans for the construction of a second 400 kV line with a

⁵⁹ Resolution No. 4450.

north - south route whose purpose is to allow for the accommodation of renewable energy generation facilities to large scales in southern Israel.

On the issue of the Government tender for solar power stations at Ashalim, the Company is advancing the construction of a joint switching array and 161 kV line for the reception of the energy that will be generated. The plan provides for the connection to the regulator of a photovoltaic facility with an output of 30 megawatts as well as two thermal solar facilities. Another large-scale photovoltaic project, Ketora, is in advanced statutory stages and has been assigned a position in the transmission system. A 161 kV photovoltaic facility with an output of 37.5 megawatts was recently connected to the system at Neot Hovav.

However, the Company does not have the possibility to connect to the electricity grid all initiatives for the construction of renewable power stations to a significant magnitude without completing the project for connecting Eilat and the southern Arava to the transmission grid via Mitzpe Ramon using a new 161 kV high voltage line towards Eilat, and particularly without completion of the segment of the Makhtesh Ramon region. As of the date of the report, in accordance with the demand of the Ministry of Infrastructures, Energy and Water and with the consent of the Minister for Environmental Protection, and after examining alternatives, the National Committee for National Infrastructures, in its meeting of March 3, 2014, adopted the combined alternative (that includes burying the line at the Ramon Crater area). The Company intends to submit an outline plan for the route that is partly above ground and partly underground in accordance with the decision of the committee as stated.

8.6.3 Development of the transmission system

In accordance with the Company's Development Plan, in 2015-2019, the Company is planning to add to the high voltage (400 kV) transmission system approximately 513 km of circuitry, conditional to the conclusion of statutory proceedings for the approval of the lines. As of the date of the report, the Company is within the schedule that was described in the Development Plan. See Sections 8.6.1 and 21.8 for details on the statutory proceedings.

In 2015-2019, the Company is planning to add approximately 676 km of upper circuitry to the high voltage (161 kV) transmission system. In addition, approximately 832 km of circuitry will be upgraded, rebuilt or relocated, and approximately 74.5 km of underground cable circuits are scheduled to be added.

8.6.4 Development of 400/161 kV transformation system

The Development Plan of the Company for 2015-2019 includes: the construction of the Ayalon Switching Station with 3 connection transformers and a total output of approximately 1,950 MW (in 2015) as well as the construction of the Galil Switching Station with 2 connection transformers and a total output of approximately 1,150 MW and the construction of the Atidim Switching Station with 3 connection transformers and a total output of approximately 1,950 MW in 2019. At the end of 2019, the Company is due to have twelve 400/161 kV switching stations with a total output of approximately 16,045 MVA.

8.6.5 Development of 161 kV transformation ability

The development of the substations of the transmission and transformation segment is being carried out in accordance with the multi-year planning of the Company, while considering the geographical layout of the demand. This forecast is expressed in the construction of new permanent substations, temporary and portable substations and the addition of transformation in existing substations. The Company has fixed, temporary and portable substations.

Within the Development Plan of the Company, approximately 20 permanent substations with a total transformation ability of approximately 2,292 MVA are planned to be added in 2015-2019. At the end of 2019, there are expected to be approximately 161 substations with a total transformation ability of approximately 19,038 MVA (permanent, temporary and portable). In addition, at the Ayalon substation a high voltage capacitor battery with an output of 220 MVar will be installed.

8.6.6 **The development budget of the transmission and transformation segment**

In 2014, a sum of approximately NIS 717 million was invested in the development of the transmission and transformation segment. In accordance with the decision of the Board of Directors, the development budget of the transmission and transformation system for the year 2015 is approximately NIS 620 million.

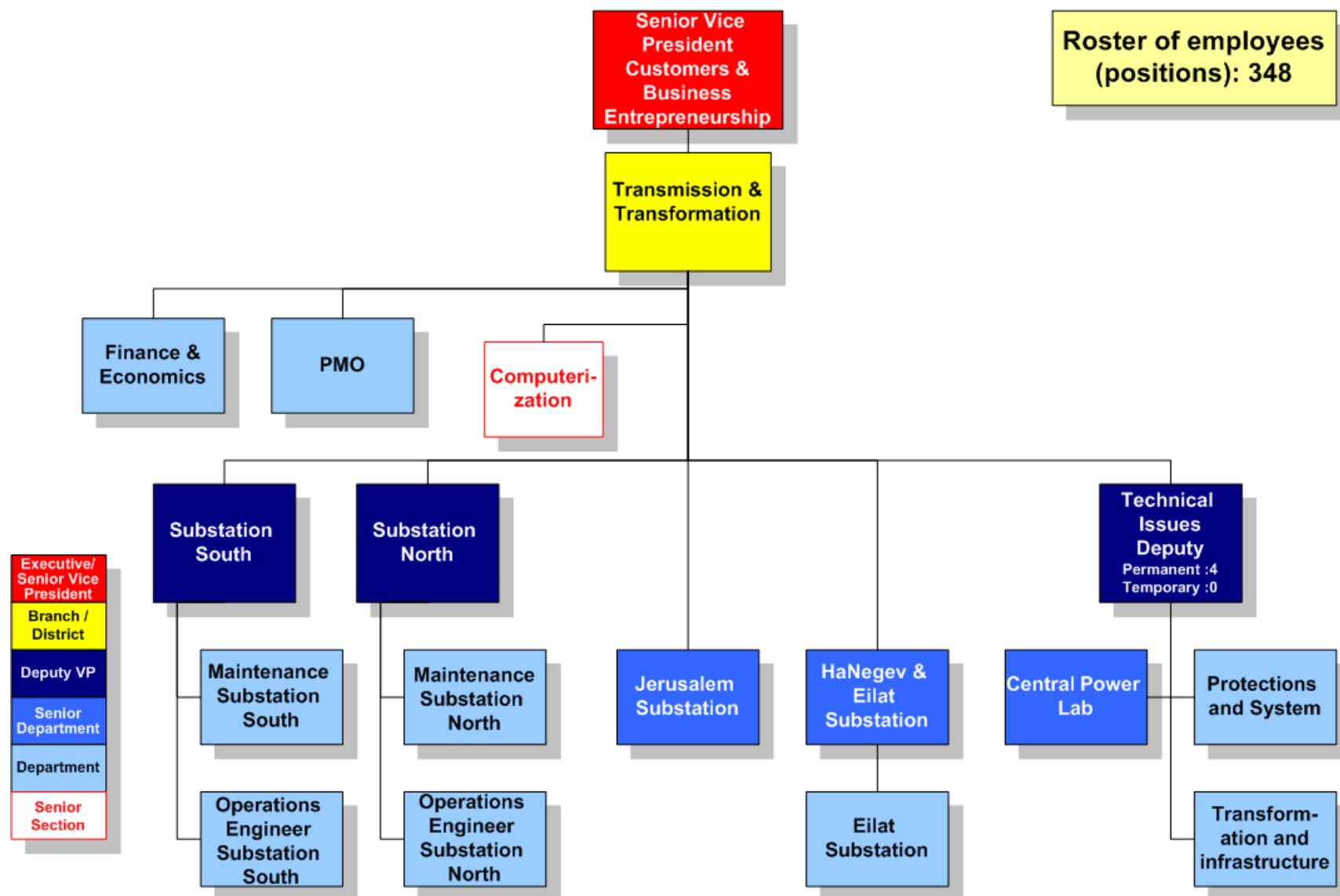
For details of the draft of recommendations of the Steering team with regard to the Company's investments plan see Note 1e to the Financial Statements.

The above mentioned with respect to the Development Plan of the Company for the transmission and transformation segment and with respect to the expected development budget for 2015 is forward looking information, as per its definition in the Securities Law. This information includes forecasts, subjective estimates and other plans of the Company and is based on future data, whose materialization is uncertain and is not under the exclusive control of the Company. The main factors that may affect non-materialization of the forward looking information or changes occurring in the estimated schedule for its execution in accordance with the description above include: a change in the expected growth rate in the demand for electricity, implementation of a change in the future organizational structure of the Electricity Sector and of the Company (see Section 1.3 and Notes 1e and 1f to the Financial Statements); future Development Plans that the Minister will approve for the transmission and transformation segment; difficulties in securing licenses and/or changes in regulation in the environmental protection and licensing field; the absence of appropriate charge rate coverage and the ability of the Company to raise the financing required for executing the Development Plan.

8.7 **Human capital**

The organizational structure in the transmission and transformation segment:

Field of Activity – Transmission Segment



As of December 31, 2014, the transmission and transformation segment has 305 permanent employees and 43 temporary employees in the transmission and transformation section, compared with 304 permanent employees and 46 temporary employees in the transmission and transformation section as of December 31, 2013 (The number of employees relates to organizational assignment and does not include employees assigned to other sections and working for the benefit of the segment, such as transmission grid line operation staff, who are organizationally assigned to the distribution districts and vice versa – see Section 9.8).

See Section 13 for details with respect to benefits and the nature of the employment agreements and additional details.

8.8 Environmental risks and ways of managing them – the transmission and transformation segment

8.8.1 Environmental risks and environmental regulation – general

The activity of the Company in the transmission and transformation segment is exposed to various environmental risks, which include storage and use of hazardous materials and fuels, pollution of soil and water sources, non-ionizing radiation and more. See Sections 7.12 and 9.10 for details on environmental risks and the regulation applicable to the Company in these fields.

8.8.2 Land

The Company is working to seal transformer enclosures and to create oil spill enclosures for transformers that do not have enclosures in accordance with an internal environmental survey which was performed by the Company for the purpose of prioritizing the handling of oil spill enclosures of the transformers. An initial assessment by the Company concerning the financial implications shows that this activity is not expected to impose material expenses on it.

8.8.3 Hazardous materials

The transmission and transformation division has a poison permit that is renewed every three years. See Section 7.12.6 for details on risks from hazardous materials.

8.8.4 Business licensing

See Section 21.9 for details on this subject.

8.8.5 Material events or matters with respect to environmental protection

As of the date of this report, to the best of the Company's knowledge, it is not exposed to material events or matters with respect to environmental protection in the transmission and transformation segment unless specified above.

8.8.6 Material legal or administrative proceedings with respect to environmental protection

See Note 34 B to the Financial Statements on the issue of legal proceedings with respect to the transmission and transformation segment.

See Note 34 b 8 to the Financial Statements with regard to legal proceedings pertaining to the transmission and transformation segment and letters of indemnity that will be given by the Company pursuant to section 197 of the Planning and Construction Law.

8.8.7 The policy of the Company in environmental risk management

See Section 7.12 for details on this subject.

8.8.8 Environmental costs and investments of the Company in environmental protection

See Section 20.8 for details on this subject.

8.9 Restrictions and regulation over the activity of the transmission and transformation segment

See section 8.1 for details of the license of the Company in the field of activity of transmission. See section 21 for details of the regulation that applies to the Company, including the transmission segment.

The electricity rate for the transmission and distribution segments

8.9.1 The current electricity charge rate

The electricity charge rate for the transmission and distribution segments was set in accordance with the resolution of the Electricity Authority dated July 1, 2002 on the issue of “the electricity charge rates and the Criteria for 2002-2005 and their manner of update”⁶⁰ (hereafter: the “**2002 Charge Rate Basis Book**”), which took effect on July 5, 2002. The 2002 Charge Rate Basis Book stated that if until December 31, 2005 no new charge rates would be set with respect to January 1, 2006 onward, then the resolutions of the Electricity Authority would be valid until the date of setting new charge rate bases. As of the date of the report, the Electricity Authority has not yet set new charge rate bases for the transmission and distribution segments, but for the generation segment only, meaning that the charge rate basis for 2002 also applies to the transmission and distribution segments.

8.9.1.1 Manner of determining and updating the charge rate

For details on the manner of determining and updating the electricity charge rate, see Sections 7.11.1 and note 3C of the Financial Statements.

8.9.1.2 Main components

(1) Recognized active assets and depreciation

- (A) The asset basis - the asset basis in the transmission and distribution segments was calculated based on the average net active fixed assets data in 2000.
- (B) Depreciation - the recognized depreciation costs were based on the depreciation costs in the books of the Company in the year 2000.

(2) Financing costs (return on assets)

Like the new charge rate basis for the generation segment, the calculation of the recognized return on its assets is derived from three (3) variables: leverage level, return on equity capital and return on foreign capital. The recognized normative leverage ratio in the charge rate and the rate of return on foreign capital are in accordance with the new generation charge rate basis book.. The rate of return on equity capital is in accordance with the resolution of the Electricity Authority dated July 1, 2002, and stands at 5.5% with respect to the transmission segment and 6.2% with respect to the high voltage and low voltage distribution segment. In accordance with the resolution of the Electricity Authority, the rates of return stated above for equity capital reflect different risk levels that are expected in the various segments of activity, which arise, *inter alia*, from the market risks of each segment.

The preexisting hedging mechanism in accordance with the 2002 charge rate book has been cancelled, and a new hedging mechanism has been applied to all of the activity segments of the Company. See Section 7.11.2.2.4 for details on the rate of return on foreign capital and the hedging mechanism.

(3) Costs of operation

The recognized costs of operation for the transmission and distribution segments were based on the operation costs listed in the books of the Company based on the year 2000, while making certain adjustments.

(4) Pension costs

Within the operational costs in the charge rate, as prescribed in the charge rate bases in 2002, the wage and pension costs of the employees of the Company are recognized. The Electricity Authority has also recognized

⁶⁰ Resolution No. 1 of Meeting No. 110, dated July 1, 2002, on “electricity charge rates and criteria for 2002-2005 and their manner of update”.

changes in the assessment of the actuarial debt for pension for second generation employees. The distribution by segments was made by the wage distribution.

(5) Depreciation coefficients

Depreciation coefficients per sold kWh have been set within the charge rate formulas, which represent the expectation of cost saving in the Company and that are supposed to reflect economy of scale at cumulative annual rates. As of the date of the report, the annual rates of the depreciation coefficients are: 1.3% for transmission and transformation segment inputs⁶¹; 2.5% for the inputs of the high voltage distribution segment⁶²; 3.7% for inputs in the low voltage distribution segment⁶³; and 2% for the inputs of consumer costs that are included in the transmission and distribution segments (at all voltage levels). Notwithstanding, the Electricity Authority decided to freeze the depreciation coefficients in the transmission and distribution segments commencing from April 1, 2012, and until the determination of a new rate base for these segments.

8.9.2 The future electricity charge rates in the transmission and distribution segments

Within the framework of the planned raising of the charge rate⁶⁴ by 8.9%, which took effect on April 1, 2012, following a resolution of the Electricity Authority dated March 22, 2012, on the “spread of increase of electricity charge rates for the years 2012-2014 in a period of problems in the supply of natural gas to the energy sector in Israel”, an addition to the recognized cost was included in the transmission and distribution segment, contributing approximately 1.2% to the electricity charge rate. The addition is in the amount of approximately NIS 300 million in current terms.

The rate increase in 2013 included an additional advance in the amount of approximately NIS 100 million a year (in current terms) as an addition to the recognized cost of the transmission and distribution rates. In its decision of January 21, 2015⁶⁵, the Electricity Authority increased the stated sum for 2015 by an additional approximately NIS 300 million (in current terms) so that at present the supplement to the recognized cost of the distribution and transmission segment is approximately NIS 700 million (in current terms) in total.

These additions shall be valid until a new charge rate basis is determined for the transmission and distribution segments.

In addition, it has been determined that the costs recognized for the transmission and distribution segments, including the supplement under this resolution, shall remain without a depreciation coefficient until a new basis is set for these segments, which will be valid starting from April 1, 2012.

Also, differences that will arise between the recognized cost at the time of setting the new basis and the recognized costs shall be deemed as compensation for the delay in the update. Discussions and correspondence are being carried out since August 2013 between the Company and representatives and advisors of the Electricity Authority regarding the transmission and distribution rates.

In January 2015, the Company received a draft of a paper by a consulting company (“Navigant”) on behalf of the Electricity Authority regarding update of rate bases for transmission and distribution, before publication of a hearing for the public in this matter.

The Company delivered its reaction to this report to the Electricity Authority on January 29, 2015.

⁶¹ Not including high voltage consumer costs: fixed payment in the electricity bill and payment for expanded services that are collected from consumers.

⁶² Not including high voltage consumer costs: fixed payment in the electricity bill and payment for expanded services that are collected from consumers.

⁶³ Not including high voltage consumer costs: fixed payment in the electricity bill and payment for expanded services that are collected from consumers.

⁶⁴ Resolution No. 1 of Meeting No. 367 of the Electricity Authority dated March 22, 2012.

⁶⁵ Resolution No. 4 of Meeting No. 452 of the Electricity Authority dated January 21, 2015, regarding “Summarizing resolution for electricity rates for Electric Company consumers in 2015”.

On March 2, 2015, a letter was received from the Authority, including the response off the Navigant company to the Company's reaction and the Company delivered its reaction on March 16, 2015.

For additional details see Note 3 c to the Financial Statements.

8.9.2.1 Temporary rate for electricity system management services

For details of the temporary rate for electricity system management services see section 7.4.1.3 and Note 3.f to the Financial Statements.

8.10 Legal proceedings

See Note 34 b to the Financial Statements.

8.11 Raw materials and suppliers

The primary suppliers of the Company in the transmission and transformation field are: (Elco) Von-Rol and Siemens Israel Ltd. that supply transformers to substations and connection transformers to switching stations. The General Engineers Ltd., Alstom Grid, ABB Technologies Ltd., Siemens Israel Ltd. and SEL (Schweitzer) manufacturers mainly supply equipment for arrays, including switching equipment (current interrupters and disconnectors), control, monitoring and protection systems.

9. The distribution segment

9.1 General information on the distribution segment

9.1.1 Structure of the field of activity and changes occurring therein

The distribution segment of the Company conveys electric energy from the substations, at which the voltage level drops to the level of the distribution voltage, for consumption purposes. The distribution system consists of distribution lines of 33 kilovolt, 22 kilovolt and 6.3 to 12.6 kilovolt tension levels (all of these are high voltage lines), low voltage lines and a distribution transformer that interconnects them.

The Company delivers to most consumers electricity at low voltage, and to major consumers (*that is*, consumers that consume a large amount of electricity, such as major factories and private producers) electricity at medium voltage.

The distribution segment has the Marketing Division and five districts, which cover the entire country, through which most of the work and service relations between the Company and its companies are held, whose number as of the date of this report is approximately 2.62 million.

9.1.2 Restrictions, legislation, regulation and special constraints applying to the field of activity

The activity of the Company in the distribution segment, like its other fields of activity, is subject to legislative restrictions, such as those prescribed in the provisions of the Electricity Sector Law and the Government Companies Law, and constraints related to the issue of licensing and requirements for permits from various government authorities and offices such as the Electricity Authority, the Companies Authority, the Ministry of National Infrastructures, Energy and Water and the Ministry of Environmental Protection and emergency and Development Plans in the Electricity Sector. The activity of electricity distribution is carried out under a license that the Company has received for “transmission, distribution, supply, sale and trade of electricity”. This license and all of the activities therein have been extended to January 1, 2016. In accordance with the above, the Company has not had a separate license issued for the distribution activity and therefore the activity is carried out in accordance with the text of the consolidated license that relates to a number of activities. See Sections 1.3 and 21 for details on these aspects of the activity of the Company and the various restrictions. See Note 1 e to the Financial Statements for details of the provisions of the Electricity Sector Law regarding the structural change.

9.1.3 Changes in the volume of activity and profitability of the field

The Company estimates that there are various factors that may affect the volume of activity and profitability of the field, such as changes in the volume of electricity consumptions and changes in electricity charge rates. Additionally, the increase of the production capacity of the sector, whether by private electricity producers or by the Company, requires an increase of the distribution and transmission system. For details of the draft of recommendations of the Steering team with respect to the distribution and supply segment see Note 1 e to the Financial Statements.

9.1.4 Technological changes that may materially affect the field of activity

In the short term, the Company does not anticipate material technological changes that may affect the activity field. However, in the long term, the Company is examining operations in the “smart metering” fields. See Section 9.7.4.2 for details on the “smart metering”.

9.1.5 The critical factors for success in the field of activity and changes occurring therein

The Company estimates that the business success of the distribution segment depends, *inter alia*, on the level of demand for electricity, the costs of maintenance and operation of the distribution facilities, recognition of the total revenues required for the distribution of electricity within the electricity charge rate and the ability of the distribution segment to improve its structural and technological efficiency. No change has occurred in these factors in the report period.

9.1.6 **Changes in the layout of suppliers and raw materials to the field of activity**

The Company is increasing the amount of purchase of raw materials in low cost countries for purposes of reducing costs. However, there are fluctuations in the prices of the raw materials in the distribution segment, especially in the main raw materials of the segment (copper, aluminum and steel).

9.1.7 **Key entry and exist barriers of the field of activity and changes occurring therein**

Entry barriers:

The Company estimates that the main entry barriers to the field of activity are receipt of distribution and supply licenses. In this subject, also see details with respect to granting licenses to historical distributors in section 9.4.1.

Exit barriers:

The regulation that regulates the activity of the Company and its status as an “essential service supplier”, in accordance with the Electricity Sector Law and the provisions of its licenses, which requires it to supply electricity to the public at large, reliably and efficiently, in accordance with the terms of its license, are the key exit barriers from the field of activity.

9.2 **Products and services**

In accordance with that which has been described above, the Company operates as a single, combined and coordinated system, for the supply of electricity to consumers, from the generation of electricity at the generation sites, continuing through its transmission and transformation, to its distribution and supply to the end points of all consumers. In addition, the Company makes connections to homes of consumers and expansions to existing connections.

9.3 **Segmentation of revenues and profitability**

9.3.1 **Revenues**

The net revenues from sales of electricity that are assigned to the distribution segment in 2014 (in accordance with the assumptions stated in Note 38 to the Financial Statements) came to a total of approximately NIS 2,891 million, compared with approximately NIS 2,900 million in 2013 adjusted to New Israeli Shekels of December 2014. This represents a decrease in revenue of approximately NIS 9 million and compared with approximately NIS 2,872 million in 2012 adjusted to New Israeli Shekels of December 2014. The change in the revenues in 2014 arises from an increase of approximately NIS 201 million, for a real increase in the electricity charge rate, and against a decrease in consumption of approximately NIS 210 million.

9.3.2 **Profit from ordinary operations – the distribution segment**

The profit from ordinary operations in the distribution segment in 2014 came to a total of approximately NIS102 million, compared with a profit of approximately NIS 216 million in 2013, adjusted to New Israeli Shekels of December 2014, a decrease of approximately NIS 114 million, and compared to a loss of approximately NIS 561 million in 2012, adjusted to New Israeli Shekels of December 2014.

9.4 **Competition**

9.4.1 As of the date of the report, the Company supplies electricity to its customers in substantially all areas of the country and in those areas has no competitors in the distribution line. There are a number of places to which the Company supplies electricity in bulk (concentrated), which is transferred to one point, and the distribution itself is performed independently to end customers through internal distribution systems of these places.

See Note 1.e to the Financial Statements with respect to the provisions of the Electricity Sector Law that state restrictions to possession of licenses in general and for the distribution section in particular. In addition, on the plane of activity of supply and sale of electricity of the Company, there are private electricity producers that

hold a supply license in addition to their generation license that has been given to them and that therefore also serve as suppliers to end consumers that transact with them directly and receive electricity from them rather than the Company. As has been stated above, the electricity that is generated by these private electricity producers is transmitted via the transmission and distribution grid of the Company (a service that is given to the producer against payment, including all of the ancillary services that the Company supplies with respect to the supply of electricity, except billing services). Since most of the private electricity producers use the transmission and/or distribution grid and pay infrastructure services for this, the Company estimates that the Company revenues in the distribution segment are not expected to be significantly harmed due to the entry of the private producers into the electricity sector, and may even increase. However, an increase in the volume of self-producers that do not use the infrastructure of the Company may, to a certain extent, adversely affect the revenues and profitability in the distribution segment.

The Decision of the Electricity Authority of August 11, 2009⁶⁶ determined that if a Historical Distributor chooses not to join the outline of the Historical Distributors to arrange its activity according to law, or will not meet the milestones of the outline ((except if it is defined as a consumer), it will continue to have debts as an essential service supplier towards its customers but will not enjoy the rights deriving from this including towards an essential service supplier, and, subject to the law, will commence a process of ceasing its activity, transferring its license and the area of his license to another entity, that will operate in the area of activity under a lawful license, subject to that stated in the decision. The Decision of the Electricity Authority sets a Mechanism that distinguishes between distributors with a license of an essential service supplier that holds 25% or more of the distribution volume in the electricity sector (a dominant distributor) and other distributors and determines various rules and terms for the transfer of the distribution areas. The decision of the Electricity Authority of January 7, 2013, (in this section - the “**Decision of the Electricity Authority**”) was published on July 15, 2013. It determines arrangements and conditions for transferring distribution areas of historical distributors⁶⁷ to other entities that will be provided with a license to distribute and supply electricity (the “**Mechanism**” and “**Other Distributors**”). Thus, inter alia, it was determined in the Decision of the Electricity Authority that Other Distributors will be permitted to collect from the electricity consumers prices that are lower than the rates of the Electric Company. This distinction limits the ability of the Electric Company to compete with private bodies (who have no such restrictions) over the distribution areas of the Historical Distributors. It should be noted that since the Decision of the Electricity Authority was published without holding a preliminary hearing for it, the Electricity Authority announced its intention to hold a hearing regarding its decision and the Company is preparing to present a response on its behalf. Insofar as the Decision of the Electricity Authority will not change as a result of the hearing, the Company is of the opinion that the decision may have an effect on the Company revenues from the distribution segment. On November 12, 2014, the Electricity Authority republished the document for a hearing.

The estimation of the Company with regard to the effect of the Decision of the Electricity Authority on the distribution segment constitutes forward looking information, as its meaning in the Securities Law, 1968, and there is no certainty that it will materialize, fully or partially, and it may materialize in a materially different manner, and this due to factors that are not controlled by the Company, such as, inter alia, a change in the Decision of the Electricity Authority due to the hearing the Electricity Authority intends to conduct.

- 9.4.2 On January 15, 2015, the Electricity Authority reached a decision which ratified a previous decision of the Electricity Authority of June 25, 2012, for providing electricity distribution and supply licenses to the Shean (Electricity) Development Company Ltd. (“Shean Development Company”), and according to which the Minister

⁶⁶ Decision of the Electricity Authority from meeting 272 of August 11, 2009, regarding: “Outline for Regulating the Legal Operation of Historical Electricity Distributors”.

⁶⁷ According to decision 272 of the Electricity Authority, of August 11, 2009, an “**Historical Distributor**” is: a body such as local councils, villages, kibbutzim, cooperative Israeli settlements, community settlements, or other settlement areas, that fulfill the following conditions: it is the owner of rights in the land that serves it as a consumption location and owner of rights in the electricity infrastructure that serves it for distribution of electricity to its residents. It carries out activity of electricity distribution and supply without licenses (as these activities are defined in the Electricity Sector Law - 1996), to domestic consumers with personal meters in its distribution area. It has received approval from the Head of the Engineering Division that it is a Historical Distributor”.

signed in the past supply and distribution licenses for the Shean Development Company that were in force until January 1, 2015. The Shean Development Company supplies electricity to plants in the industrial area that is close to Beit Shean. The distribution license was granted for a period of one year that begins on the date that the permit is received. The supply license was granted until June 30, 2015. The licenses will enter into force upon receiving the Minister's approval, and to the best of the Company's knowledge it has not yet been received as of the date of the report.

- 9.4.3 In addition, if and to the extent that the Structural Change in accordance with the provisions of the Electricity Sector Law is conducted, including incorporation of holders of distribution licenses within separate companies, the Company cannot assess what the consequences of such incorporation would be in the future or of any outline of structural change that will be determined over the competition in this field of activity, over its activity, profitability and financial status.

For details of the draft of recommendations of the Steering Team and the Yogev Letter with respect to the distribution segment, including with regard to the operation of private entities as sub-distributors, and for details of the position of the Company regarding the recommendations of the Steering Team as stated, see Note 1 e to the Financial Statements.

9.5 **Distribution capacity**

On December 31, 2014, the distribution system consisted of approximately 26,899 km of medium-voltage grid lines (compared with approximately 26,594 km on December 31, 2013); approximately 48,070 distribution transformers with a total output of approximately 23,230 megavolt-amperes (compared with approximately 47,474 distribution transformers with a total output of approximately 22,871 megavolt-amperes as of December 31, 2013) and approximately 22,836 km of low-voltage grid lines (compared with approximately 22,358 km of low-voltage grid lines as of December 31, 2013).

9.6 **Fixed assets, land and facilities**

See Section 7.6.1 for details on assets that serve it in its fields of activity, including in the field of transmission and transformation.

The breakdown of fixed assets, land and facilities described below relates to the property and assets kept by the Company and/or the parties serving the Company in the field of activity of distribution, supply and sale of electricity, disregarding the differences of opinion between the Company and the State with respect to the rights of the Company to such property and assets, which it possessed at the time of expiry of the concession. See Section 14.3 with respect to the "property settlement" and its consequences for the Company.

The Company has approximately 30 district and regional offices, in the total area of approximately 150,000 m².

In addition, there are approximately 13,000 transformation, switching and bulk rooms dispersed nationwide.

See Section 8.5 for details on the type of rights of the Company to these properties. See also Note 14 to the Financial Statements. In addition, the assets of the Company include assets, mainly grids and lines, which are in Judea and Samaria (the West Bank) (including in the territories of the Palestinian Authority) (hereinafter: the "Territories"). The Company estimates that the use of these assets for the supply of electricity will continue, and the assets will continue to be owned by the Company. If the ownership of the remainder or some assets in the Territories will be moved from the Company, the Company cannot assess whether the Company will receive full or partial indemnification, if any, for these assets.

9.7 Development of the Electricity Sector – distribution

9.7.1 Manner of establishing the Development Plans of the distribution and supply segment

See Section 21.1.3.2 for details on the duty of the Company to submit a Development Plan and comply with its prescribed conditions and schedules.

The Development Plan in the distribution segment for 2014-2018, which has not yet been filed for the approval of the Minister pursuant to his authority under Section 19(A) of the Electricity Sector Law, has three (3) key components of the distribution grid: a medium voltage grid, transformers for distribution and a low voltage grid. Each of these components is given attention in the Development Plan with respect to their construction or replacement. In addition, the distribution grid has a component of electricity meters, automation and improvement of the connection to homes. The Development Plan is intended to adapt the distribution system to the needs of the Electricity Sector in view of the introduction of new substations and the development of existing substations, adding of consumers, increase in the predicted load of existing consumers and antiquation of the existing grid, in accordance with techno-economic planning criteria. The Development Plan for the distribution system is being carried out by the districts of the Company that are responsible for planning, executing, operating and maintaining the distribution grid.

9.7.2 Key assumptions and restrictions underlying the Development Plan

The distribution grid Development Plan of the Company, which as stated above still requires the approval of the Minister, is based on the following data and assumptions:

- a. A forecast of the number of new domestic and small business connections and connection expansions, that has been received from the statistics and market research department of the Company.
- b. A forecast of the number of new large business connections based on average performance of previous years, produced from the ordering system of the Company.
- c. High voltage consumer data received from the ordering department of the Company.
- d. Technical directives for planning of the distribution grid given by the national grid.
- e. Directives of the Ministry of National Infrastructures, Energy and Water, the Electricity Authority, local authorities, and statutory authorities for the planning and execution of national infrastructures, such as the directive of the Ministry of Energy and Water of the year 2001 for building an underground grid in urban and industrial areas featuring high population density.
- f. Obsolescence of the distribution grid requires preparation for its renewal in accordance with the plan formulated by the Company.
- g. Forecast of natural increase of the peak demand for electricity.

9.7.3 Anticipated development of additional distribution capacity

The anticipated development of additional distribution capacity is based on long term planning of the Company for 2013, which is submitted to the Board of Directors within the financial planning of the Company, each year.

Within the Development Plan, and subject to the approval of the Development Plan by the Minister and its complete execution, in 2014-2018 approximately 6,404 km of overhead and underground medium voltage lines are expected to be added. In addition, approximately 1,083 km of grid will be replaced.

Additionally, approximately 8,299 km of overhead and underground voltage lines are expected to be added. In addition, approximately 703 km of grids will be replaced and approximately 6,775 new transformers. During these years, approximately 4,674 transformers are scheduled for replacement. During 2014, approximately 596 new transformers were added and approximately 124 transformers were replaced.

9.7.4 Development budget of the distribution segment

In 2014, the development budget for the distribution segment was approximately NIS 1,350 million. According to the decision of the Board of Directors, the development budget of the distribution segment for 2015 is expected to be approximately NIS 1,231 million.

For details of the draft of the recommendations of the Steering Team with regard to the Company's investments plan see Note 1 e to the Financial Statements.

The above mentioned with regard to the Company's development plan for the distribution segment and the expected development budget for 2015 constitutes forward looking information, as per its definition in the Securities Law. This information includes forecasts, subjective estimates and other plans of the Company and is based on future data, whose materialization is uncertain and is not under the exclusive control of the Company. The main factors that may affect the non-materialization of the forward looking information or changes occurring in the estimated schedule of its execution, in accordance with that which has been described above, include, inter alia: non-implementation of special projects, change in the expected growth rate in the number of connections, implementation the structure change in the Electricity Sector and of the Company (see Section 1.3), the Development Plan to be determined by the Minister including changes that will be made to it, difficulties in securing licenses and/or changes in legislation in the environmental protection and licensing field; the absence of appropriate charge rate coverage (see Note 3 to the Annual Financial Statements); the inability of the Company to raise the financing required for executing the Development Plan, a change in the expected rate of growth of demand for electricity and an increase in the number of consumers.

9.7.4.1 Renewing the distribution grid

The Company has formulated a plan to renew the distribution grid, and it is expected to spread across ten years, at an amount of NIS 7 billion. The plan has been presented to the Board of Directors of the Company, but has not yet been submitted for the Minister's approval under section 19(a) of the Electricity Sector Law.

The Company has begun to partially implement the renewal of the distribution grid in a security aspect only, in an amount of approximately NIS 95 million in 2014.

9.7.4.2 Smart metering project

The smart metering project includes the installation of "smart meters" that are capable of being read remotely, ability to disconnect and reconnect the feed line and transmit a warning of loss of supply voltage, and also includes the establishment of an information center, providing an indication of the supply state and other indications to consumers via the Internet.

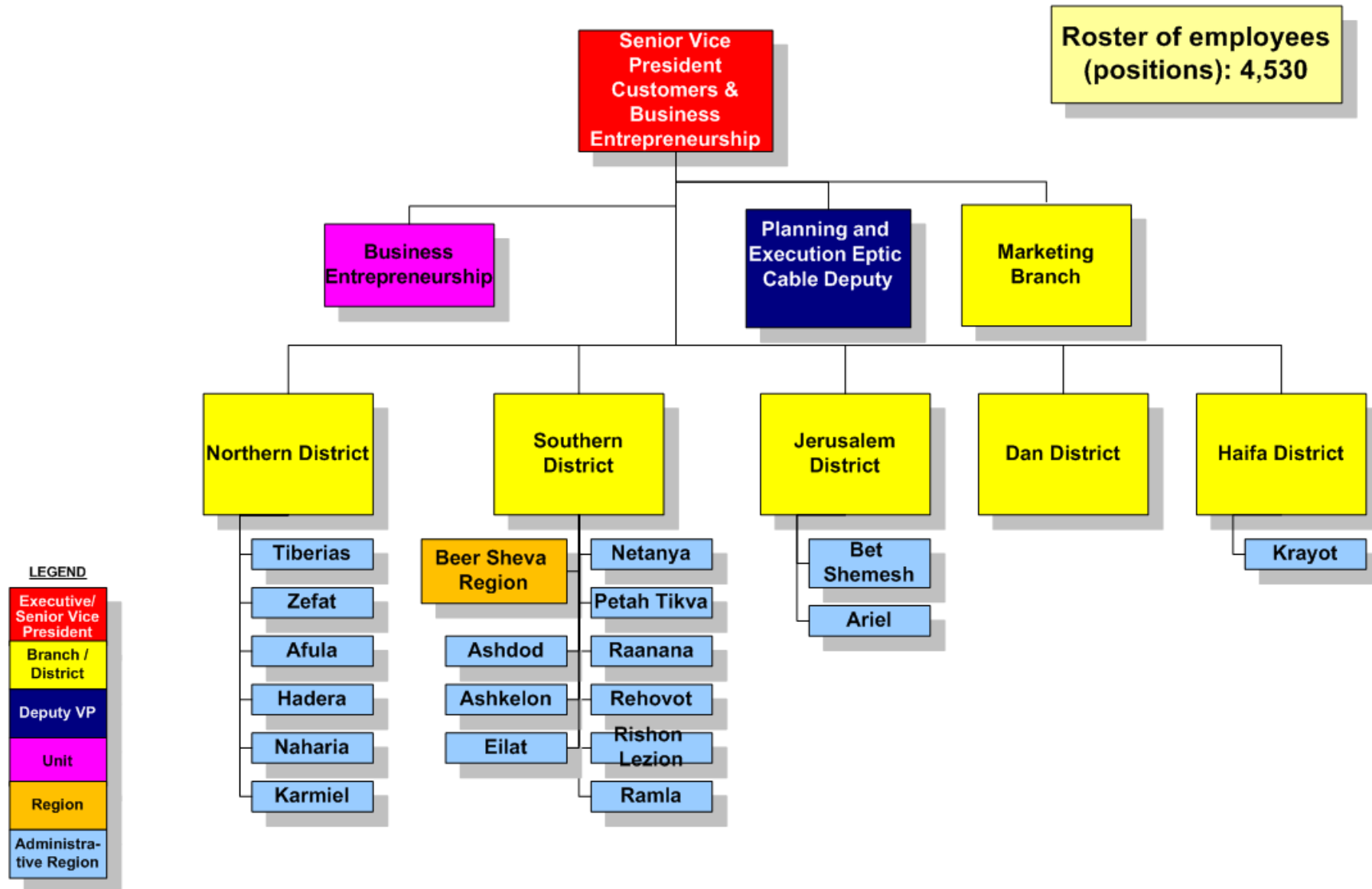
A technological pilot has currently ended in Binyamina, Givat Ada and the Caesarea Industrial Zone, in which approximately 4,600 smart meters were installed and a rate pilot of approximately 32 thousand meters was executed in order to examine the profitability of transitioning to nationwide smart metering in accordance with approval by the Electricity Authority.

For details of the draft of the recommendations of the Steering team with regard to smart metering see Note 1 e 4)g) to the Financial Statements.

9.8 Human capital

The organizational structure of the distribution segment:

Field of Activity – Distribution Segment



It is noted that on January 1, 2015, the Business Development unit moved from the Customer Division to the Engineering projects Division.

As of December 31, 2014, the distribution segment employs 3,465 permanent employees and 1,065 temporary employees in the marketing segment and in the districts (compared with 3,483 permanent employees and 987 temporary employees in the marketing segment and in the districts as of December 31, 2013 (the number of employees relates to organizational assignment and does not include employees assigned to other branches and working for the segment and vice versa)). In accordance with the above, some of the employees who are organizationally affiliated with the distribution segment work, in addition to working in the construction and maintenance of the distribution system, in the constructing and operation of the transmission grids (see Section 8.7). See Section 13 for details with respect to the employment agreements and additional details.

9.9 Raw materials and suppliers

As of the date of the report, there are no suppliers in the distribution field on which the Company has material dependence.

9.10 Environmental risks and their manner of management – distribution segment

9.10.1 Environmental risks and environmental regulation – general

See Section 7.12 for details on this subject.

9.10.2 Non-ionizing radiation

According to the provisions of the Non-Ionizing Radiation Law – 2006 (“**The Non-Ionizing Radiation Law**”), the Company is required to hold appropriate permits provided by the Ministry of Environmental Protection for the purpose of constructing and operating radiation sources, as defined by the law, that it operates. Operating a radiation source without a legal permit or with deviation from its conditions may constitute a violation of the Radiation Law and may even cause the issue of an injunction to remove the source.

The Company holds the permits required for operating the radiation sources it establishes and operates and is acting to obtain them for places where they are missing. Restrictive conditions were integrated into some of the permits received by the Company and the Company has arrived at understandings or is conducting negotiations in order to arrive at understandings with the Ministry of Environmental Protection with respect to them.

During the past 30 years, many studies have been conducted in the world to examine the connection between prolonged exposure to magnetic fields from electricity installations or from household electrical appliances and the increased incidence of certain diseases. Findings that point to a statistical connection between magnetic fields and childhood leukemia were found in some of the health studies conducted. The findings of these studies were attacked by different researchers using the argument that they are based on estimates alone and that the statistical connection found is very weak and does not establish a causal relation, while findings pointing at the existence of any connection whatsoever⁶⁸ were not found in other health studies and in laboratory tests. In November 2010, updated directives were issued by the International Commission for Non-Ionizing Radiation Protection (ICNIRP), for a maximum value of exposure to a magnetic field from the electricity grid for the general population of 2,000 milligauss, based on the known health effects that result from the induction of a magnetic field in the body⁶⁹. In that document, the Commission stated that sufficient information had not been accumulated in order to determine a value lower than that value with respect to epidemiological findings while there may be other health effects from extended exposure to magnetic fields at levels lower than the threshold that has been stated above. As a response to the possibility of the existence of long term health effects, the World Health Organization (WHO) and other

⁶⁸

⁶⁹ Guidelines for Limiting Exposure to Time-Varying Electric and Magnetic Fields (1 Hz - 100 kHz). Health Physics 99(6):818-836; 2010.

agencies in the world support the implementation of a principle of preventive care whereby even in the absence of certainty with respect to the existence of a risk and its limited scope – if any – there is room for taking certain, minor steps in all matters related to exposure to magnetic fields. The principle of preventive care has been vested in Israel with respect to non-ionizing radiation in the Non-Ionizing Radiation Law and also applies to the Company in the construction and operation of radiation sources. According to the recommendations of the experts' committee report regarding magnetic fields from the electricity grid, which is published on the website of the Ministry of Environmental Protection ("Experts' Committee Report"), the Company is working to gradually execute the implementation of the preventive and precautionary principle in existing installations and allocates funds in its budgets for executing such actions.

The Company estimates, according to tests it has executed, that the electricity facilities it owns comply with the directives of the International Commission for Non-Ionizing Radiation Protection (ICNIRP). The Company is building new electricity facilities in accordance with the conditions included in the construction and operation permits in all matters related to implementation of measures for restriction of exposure levels, access denial, placement of warning signs, reporting duties, etc.

The Non-ionizing Radiation Law does not prescribe the maximum permitted levels of exposure of persons to radiation from a radiation source, which were supposed to be prescribed, in accordance with the law, in regulations that were supposed to be promulgated by January 1, 2007. The Non-Ionizing Radiation Law further states that as long as no such regulations have been promulgated on matters pertaining to the Electricity Sector, the resolutions of the Supervisor of Radiation in the Ministry for Environmental Protection on the issue, *inter alia*, of conditions in construction and operation permits on matters relating to the Electricity Sector, are to be in accordance with the recommendations in the Experts' Committee Report. Additionally, the law determines that a resolution on matters that have an impact on costs for the Electricity Sector, requires the approval of the Minister for Environmental Protection and the Ministers. The Expert Committee determined a threshold value for exposure of 1,000 milligauss in short term effects, while at the same time determined the need to implement the preventive and precautionary principle when planning new facilities and operating existing facilities. In December, 2011, the Minister of National Infrastructures, Energy and Water informed the Minister for environmental protection that regulations that will establish threshold values for exposure to non-ionizing radiation that originates from an electrical facility may directly and materially affect the costs for the Electricity Sector. In September, 2012, the Non-Ionizing Radiation Law Memorandum – 2012 was published, its purpose to cancel the need to receive the stated approval of the Minister of Finance and the Minister of National Infrastructures, Energy and Water Resources for the regulations which may have a direct and material implication on the electricity sector, and to be satisfied with consulting them.

At the same time, in recent years, a joint initiative of the Ministry of Health and the Ministry of Environmental Protection has been advanced for establishing binding threshold values for magnetic fields from the electricity grid.

It was noted in a joint letter by the Directors General of the Ministry of Health and the Ministry of Environmental Protection from January 2011 that the ministries intend to recommend a standard of 4 milligauss for continuous and prolonged exposure. If such a standard is adopted within the framework of binding regulations, this may have material implications on investments in facilities that are required for the operation of the electricity sector. As stated above, in accordance with the Non-ionizing Radiation Law, such a decision in matters having effect over costs for the electricity sector requires the approval of the Minister of Environmental Protection and the Ministers.

Following the aforesaid, the Ministry for Environmental Protection appointed an inter-ministerial team headed by it, with its members also including representatives of the Company, and its task is to examine the significance of anchoring a threshold value of 4 milligauss on average for the busiest day.

A number of planning authorities have determined in planning permits for electricity facilities, as well as in an outline plan for the construction of substations, a condition whereby the levels of the magnetic field from the

facility are not to exceed a few milligauss (2 to 10 milligauss). This condition may constitute an obstacle to the construction and connection of facilities to the electricity grid.

The Company is working diligently in order to reduce the magnetic fields in all of the electricity facilities that it owns and to comply with the provisions of the Radiation Law, while acting in accordance with the principle of preventive care. Toward this end, special purpose teams have been established in the Company, including representatives from the relevant divisions, and professional discussions have been held with the participation of representatives of the Ministry of National Infrastructures, Energy and Water and the Ministry of Environmental Protection.

The Ministry of Environmental Protection includes explanatory comments on the issue of non-ionizing radiation in answer to public applications to it on this subject, and in non-ionizing radiation measurement reports that are compiled by the Ministry and by private surveyors. These explanatory comments, in various forms, include information whereby the threshold value for short term exposure to magnetic fields from the electricity grid is 1,000 milligauss, long exposure to levels of more than 4 milligauss is a possible carcinogen and that the recommended average level of 24 hour continuous exposure is to be 4 milligauss. These values were also cited in various correspondences between the Ministry and the Company and contentions and claims are raised towards the Company from the public and from the authorities. The Company has forwarded its objections to this position to the Ministry of Environmental Protection and to the Ministry of National Infrastructures, Energy and Water and has asserted that these values are being translated by the public and by some of the authorities into a binding standard, which the Company cannot comply with.

9.10.3 Material legal or administrative proceedings with respect to environmental protection

As of the date of the report, to the best of the Company's knowledge, there are no ongoing material legal or administrative proceedings with respect to the quality of the environment in the distribution segment.

9.10.4 Material events or matters with respect to environmental protection

As of the date of the report, to the best of the Company's knowledge, it is not exposed to material events or matters that are related to environmental protection in the distribution segment unless specified above.

9.10.5 The policy of the Company with respect to the management of environmental hazards

See Section 7.12 for details.

9.10.6 Environmental costs and investments of the Company in environmental protection

In 2014, the expenses of the Company relating to wise avoidance regarding non-ionizing radiation came at approximately NIS 3.8 million out of approximately NIS 5.5 million which were allocated for the reduction of public exposure to magnetic fields. For additional details, see Section 20.8.

9.11 Restrictions to and regulation of the operations of the Company in the distribution and supply segment

9.11.1 Criteria for the reliability of supply – rules of supply of electricity to consumers

See Sections 8.1.2 and 21.1.3.1 for information on the Book of Criteria.

In addition, the Electricity Authority has determined⁷⁰ the level of reliability that constitutes the basis for the electricity charge rate, as follows:

- (A) The charge rate bases are intended to achieve an overall level of reliability for a low voltage consumer of 100 minutes of average downtime for the average consumer per year ("**the objective**").
- (B) Through to February 2003, the Electricity Authority will establish a binding plan for achievement of the objective (as of the date of the report, no such plan has yet been determined) and in its absence the

⁷⁰ Resolution No. 6 of meeting 109 dated June 26, 2002 in the matter of "[The] level of reliability in charge rate bases".

Company is operating in accordance with indices that it has recommended to the Electricity Authority, In accordance with that which has been set forth below.

- (C) Based on the existing operational set up, the Company is required to reduce the variance between the reliability levels in the different administrative areas and the general average from 100% to 50%.

The Company estimates that it is upholding the Criteria that have been determined, except with respect to the objective of the level of reliability of supply regarding which the Electricity Authority has not yet established a binding plan to achieve the objective.

The Company attempted in the past to convince the Electricity Authority to accept its position that the decision of the Electricity Authority to achieve the goal of 100 minutes downtime will not be applicable, but a general level of reliability for a low voltage customer of an average of about 141 minutes downtime for the average customer per year can be achieved, and this after the ending of installation of all the end units within the Company's D.M.S. project. The D.M.S. project is a project of the Company in the distribution system which is meant to improve the reliability of the electricity and which should end by 2016, subject to budget and supply of required equipment, regardless of the goal which will be confirmed by the Electricity Authority, as mentioned above. The Company estimates that the costs of the project that is intended to improve the reliability of the supply will be recognized in the electricity rate, although the Company cannot estimate the scope of recognition of costs in the rate.

The measured downtime per consumer in 2014 was 139 minutes, and the variance between the areas was 49.7 minutes. There is a possibility that failure to uphold the objective at the times that shall be set in the plan, once these have been determined by the Electricity Authority, will manifest in the non-recognition of certain expenses for the purpose of setting the charge rate in the distribution segment.

The Electricity Authority published a new criterion for compensating consumers and producers with respect to a low level of reliability for supply, which determines the conditions in which customers will be compensated in cases of electricity interruptions exceeding a scope that was determined. The criterion entered into effect on January 1, 2015.

The information that has been presented with respect to the estimates of the Company with regard to recognition of the costs of the project for improving the reliability of the supply of electricity and the implications of the Company failing to fulfill the objectives of the Electricity Authority constitutes forward looking information as per its definition in the Securities Law. This information is based on information that the Company has as of the date of the report and includes its estimates and forecasts as of that date. It is possible that the information may fail to materialize, in part or in full, or that it may materialize in a manner that differs from the forecast of the Company, inter alia as a result of climatic changes and regulatory changes.

- 9.11.2 See Section 8.9 with respect to details of the electricity rate in the distribution segment. See Note 3 i to the Financial Statements for details of the decision of the Electricity Authority according to which the Company will be required to report to the public every year of the differences between the actual expenses and the Company's income from the electricity rate according to the activity segments.

Part 4: Description of the Business Affairs of the Company – Information Relating to Matters that Pertain to the Operations of the Company as a Whole

Information relating to matters pertaining to the activity of the Company altogether – general

Further to the information that has been described above, which addresses each sphere of operations of the Company on an individual basis, information that pertains to matters that relate to the operations of the Company as a whole has been recorded below. The information that appears in this part, along with the information that appears above, reflects a description of all of the areas of business of the Company on a consolidated basis.

10. Customers - electricity consumers

10.1. On December 31, 2014, the number of customers of the Company stood at 2,633 thousand customers, in comparison with 2,594 thousand customers on December 31, 2013, representing an increase of 39 thousand customers. The electricity consumption in 2014 was 49,902 million kWh, which constitutes a decrease of 3,604 million kWh in comparison with 2013.

10.2. The Company classifies its customers into households, the industry, public and commercial buildings and bulk, water pumping and agriculture.

The table that appears below shows the electricity data by customer types.

In the twelve-month (12) period that ended on December 31, 2013, and 2014 (in millions of kWh, and in percentages)(for details of Company revenues according to customer types see Note 28 to the Financial Statements):

	Total electricity consumption In percent	2013	Total electricity consumption In percent	2014
Domestic	29.3	15,662	32.1	15,981
Industrial	19.4	10,372	17.9	8,951
Public and commercial	33.2	17,753	32.0	15,953
Water pumping	5.8	3,109	4.8	2,404
Agriculture	3.6	1,935	3.5	1,769
East Jerusalem Electricity Company	3.5	1,897	3.9	1,945
Palestinian Authority	5.2	2,778	5.8	2,899
<u>Total</u>	<u>100</u>	<u>53,506</u>	<u>100</u>	<u>49,902</u>

10.2.1 The domestic sector – as of December 31, 2014, the Company is serving approximately 2.3 million households, which represent almost all of the households in the State of Israel. This is similar to the statistic for December 31, 2013.

In the year that ended on December 31, 2014, the domestic consumption increased by approximately 2%, relative to the corresponding period during the preceding year. The total electricity invoices issued in this sector increased by approximately 4% in 2014 relative to the corresponding period during the year that preceded it, because of an increase in consumption.

- 10.2.2 The public-commercial sector includes the consumption of electricity by commercial premises, shopping centers, various businesses, and authorities of the public sector, such as: local authorities, Government ministries and schools.

The electricity consumption in this sector decreased in the period that ended on December 31, 2014 by approximately 10.1% relative to the corresponding period during the preceding year. The total electricity invoices issued in this sector decreased in 2014 by approximately 9% relative to the corresponding period during the year that preceded it because of a decrease in consumption. For details of the debt balance of the East Jerusalem Electricity Company see Note 6b to the Financial Statements.

- 10.2.3 The industrial sector - includes electricity consumption by industrial plants and private electricity producers. The electricity consumption of the industrial sector decreased by approximately 13.7% in the year that ended on December 31, 2014 relative to the corresponding period during the preceding year. In 2014, the total electricity invoices issued decreased in this sector by approximately 17% relative to the corresponding period during the year that preceded it, because of a decrease in consumption.

- 10.2.4 Water pumping⁷¹ is required in order to supply drinking water and irrigation water for other purposes to all parts of the country. The electricity consumption in this sector decreased by approximately 22.7% for the year that ended on December 31, 2014, relative to the corresponding period during the preceding year. In 2014, the total electricity invoices issued decreased in this sector increased by approximately 20% relative to the corresponding period during the year that preceded it because of a decrease in consumption.

- 10.2.5 The agricultural sector – in the year that ended on December 31, 2014, the consumption of the agricultural sector decreased by approximately 8.6% relative to the corresponding period during the preceding year. In 2014 the total electricity invoices issued decreased by approximately 7% relative to the corresponding period during the preceding year because of a decrease in consumption.

- 10.2.6 The East Jerusalem Electricity Company – in the year that ended on December 31, 2014, the consumption of the sector increased by approximately 3.9% relative to the corresponding period during the preceding year. In 2014 the total electricity invoices issued increased by approximately 4.5% relative to the corresponding period during the preceding year because of an increase in consumption.

On May 8, 2014, the Company filed an action with the Jerusalem District Court against the East Jerusalem Electricity Company Ltd. in the amount of approximately NIS 531 million. Within this action, the East Jerusalem Electricity Company Ltd. is sued to pay the Company part of the debt it has accumulated towards the Company with respect to electricity that was provided to it in the period until October 2013 and has not yet been paid. The Company is also considering filing an action for the balance of the debt of the East Jerusalem Electricity Company Ltd. On 15 May, 2014, the Jerusalem District Court gave its ruling, and granted the Company's request for imposition of provisional attachment, in light of the existence of allegedly reliable evidence of the existence of a cause of action. In accordance with the stated decision, a temporary attachment order was imposed (by registry) in the amount of NIS 380 million on the office building of the East Jerusalem Electricity Company Ltd. and all its assets that are held by banks and credit companies, except for current accounts insofar as they are in debit balance. Hearings in this action are expected to be held on June 8 and 10, 2015.

For additional details with respect to the debt of the East Jerusalem Electricity Company Ltd., including the Company's activity to collect the debt, see Note 6d to the Financial Statements.

- 10.2.7 The Palestinian Authority – in the year that ended on December 31, 2014, the consumption of the Authority increased by approximately 5.8% relative to the corresponding period during the preceding year. In 2014 the total electricity invoices issued increased by approximately 7.3% relative to the corresponding period during the preceding year because of an increase in consumption.

On June 12, 2014, the Company filed a petition to the High Court of Justice against the Minister of Finance, the Government of Israel, the Minister of Defense, the Minister of National Infrastructures, Energy and Water, the

⁷¹ Mainly Mekorot, water desalination, local authorities, etc.

Electricity Authority and the Palestinian Authority, requesting a decree nisi. In the petition, the Minister of Finance was requested to use his powers and offset the debt owed by the Palestinian Authority to the Company from the monies transferred to the Palestinian Authority. Alternatively, the Court was requested to provide a solution within the State budget or in any other manner for the deficit created for the Company as a result of non-repayment of the total debt of the Palestinian Authority towards the Company. A hearing of this petition is expected to be held on April 16, 2015.

On March 3, 2015, the Company received a sum of approximately NIS 300 million from the Ministry of Finance, on account of the debts of the Palestinian Authority to the Company. For details of the debt balance of the Palestinian Authority and the East Jerusalem Electricity Company see Note 6d to the Financial Statements.

10.3 Types of electricity charge rates

In accordance with the provisions of the Electricity Sector Law, the Electricity Authority determines separate electricity charge rates for the Company for its different segments of activity. However, most of the electricity consumers (consumers of “domestic”, “general” electricity charge rate and some “public street lighting”, in accordance with what is stated below) pay, for electricity, one weighted uniform charge rate for the entire year, which includes all of the segments of operations of the Company.

In accordance with the provisions in the Book of Criteria, as of the date of the report, the electricity charge rates for the consumer are divided into four types, as follows:

- (A) Uniform charge rates – a charge rate that is calculated on the basis of an annual average in accordance with the “load and time charge rate” (in accordance with that which has been stipulated below) and the characteristics of the consumption hours of the group to which the consumer belongs. The groups for this purpose are as follows: (A) “domestic” – homes that are used for the purpose of residence only, buildings for agricultural purposes and places of worship; (B) “public street lighting” – street and public garden lighting; and (C) “general” – an electricity charge rate that is intended for buildings that are used for workshops, industry or commerce, including educational and cultural institutes, absorption centers, buildings that are used by non-profit associations and institutions, clinics, hospitals, Government ministries and buildings that are temporary connected (in other words, relates to the other consumers at a uniform charge rate that is not the “domestic” or “public street lighting” charge rate);
- (B) “Bulk” (a charge rate that applies to the sale of electricity to the Palestinian Authority);
- (C) “Load and time charge rate” – a charge rate that is calculated in accordance with the load of the system and the consumption time;
- (D) A “concentrated sales charge rate” – an electricity charge rate for low and medium voltage consumers that distribute and provide electricity to others.

The load and time charge apply on a mandatory basis to all high voltage, medium voltage and low voltage consumers whose connection size is 3X200 amperes or more, or whose annual consumption exceeds 40,000 kWh. The load and time charge rate is based on the marginal costs in the system and is intended to create a direct connection between the costs of electricity generation and supply at the various times and the price that the consumer pays. In the electricity bill of load and time charge rate consumers, consumption is listed by different hour clusters (in accordance with the seasons of the year, the day of the week and the time of the day) and they have a programmable electronic meter installed for the purposes of this charge rate. The kWh prices for the load and time charge rate also vary in accordance with the supply voltage. In addition, each uniform charge rate consumer to which the mandatory load and time charge rate does not apply can ask to enroll in an optional load and time charge rate.

As of December 31, 2014, the total number of consumers who use the load and time charge rate is approximately 82,409, in comparison with 77,836 consumers as of December 31, 2013. In other words, approximately 3% of the total number of consumers consumes approximately 57% of the total annual electricity consumption.

As of December 31, 2014, the total number of consumers using the “domestic” charge rate is approximately 2.3 million, in comparison with approximately 2.27 million for December 31, 2013. In other words, approximately 88% of the total number of consumers consumes approximately 32.1% of the total annual electricity consumption.

11. Seasonality

The demand for electricity in the State of Israel is seasonal. The seasons in this context are defined as the summer (July to August, inclusive), winter (December to February, inclusive) and the transitional seasons – spring (March to June, inclusive) and autumn (September to November, inclusive). The demands are higher during the summer (due to the use of air conditioners) and in the winter (due to the use of heating appliances) than in the transitional seasons (autumn and spring). In the winter and summer the average electricity consumption was higher than that in the transitional season and also features days of peak demand due to extreme conditions of heat and cold.

In addition, the revenue of the Company in the various seasons is affected by the change in the charge rates for consumers that pay based on load and time (load and time charge rate), representing approximately 57% of the electricity consumption (in accordance with the data for 2014), as the load and time charge rates are higher on average during the summer than the load and time charge rates in the transitional seasons and winter.

Breakdown of Revenues, net, for 2014 and 2013 **(adjusted to the NIS of December 2014)**

In NIS million

	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Total</u>
<u>2014</u>	6,514	5,628	6,748	5,770	24,660
<u>2013</u>	6,307	6,187	8,381	6,347	27,222

12. Research and development

The research and development activity in the Company is intended to promote research and development of modern technologies for the benefit of the electricity sector and is carried out with the help of experts and resources from the Company and in cooperation with external entities from the industry and academy in Israel and abroad. The research is intended to aid, inter alia, in contending with the growing strictness of the environmental requirements (in all of the spheres of operation of the Company) and to aid the improved efficiency, improvement, quality and reliability of the electricity supply, while striving toward the minimization of costs.

New research and development projects for external entities will not be budgeted in 2015. Projects from previous years will continue to be budgeted according to the agreements with them.

Technological incubator (center for the promotion of innovative technological ideas)

In 2008, the Company started to take action toward the establishment of a technology incubator. Within the framework of this effort, the Company established in 2009 the center for the promotion of innovative technological ideas which supports entrepreneurs who have original ideas for development of products that are intended to integrate in the core activity of the Company.

The entrepreneurs who are admitted to the Technology Incubator receive financial support (by way of the grant of a loan that is convertible into shares in the amount of up to NIS three million per project), the accompaniment of a professional team and options of making use of the infrastructures and the connections of the Company in Israel and overseas (usually, for use of this type, the Company charges a separate payment). Through the date of the report, agreements have been signed with fifteen companies (except for two companies whose activity was not successful), within the framework of which the Company has extended a total of NIS thirty six million, which is to be repaid in accordance with the loan agreements or converted, as mentioned above, into shares, subject to any applicable statute. Usually, the Company is entitled to appoint one director or an observer on its own behalf on the Board of Directors of the project company, but without exercising of the option for conversion of shares. The Company regularly takes action in order to locate new projects for the Technology Incubator.

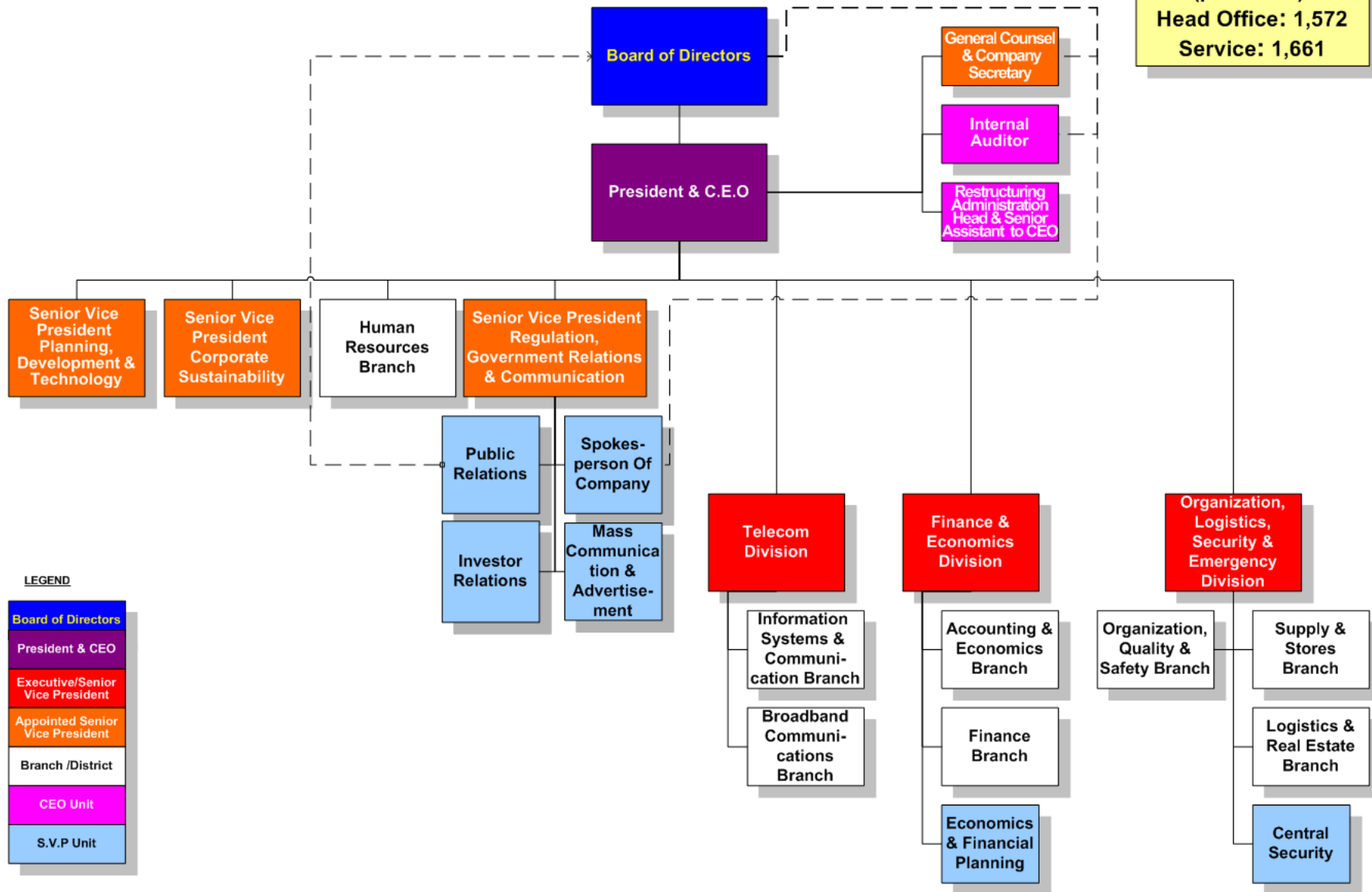
A sum of approximately NIS 5 million was included in the budget for 2015. This is required for providing loans to several companies within the framework of the innovative technological ideas, as well as for its regular operations. During the period between January 2014 and December 2014, the Company spent an amount of approximately NIS 3 million for innovative technological ideas and in 2013, the Company spent an amount of NIS 10.2 million.

13. Human capital

13.1 Organizational structure of the Company

Field of Activity – Head Office & Service

**Roster of employees
(positions):**
Head Office: 1,572
Service: 1,661



From the beginning of 2014, the changes that occurred in the organizational structure of the Company were marginal, mainly inside the branches / divisions.

As of December 31, 2014, 1,090 permanent employees and 784 temporary employees (of which 692 are project - temporary under an arrangement of an “emergent plant” in the performance wing) are employed in the engineering projects segment (engineering performance and planning), compared to 1,105 permanent employees and 1,086 temporary employees (of which 972 are project - temporary under an arrangement of an “emergent plant” in the performance wing) as of December 31, 2013.

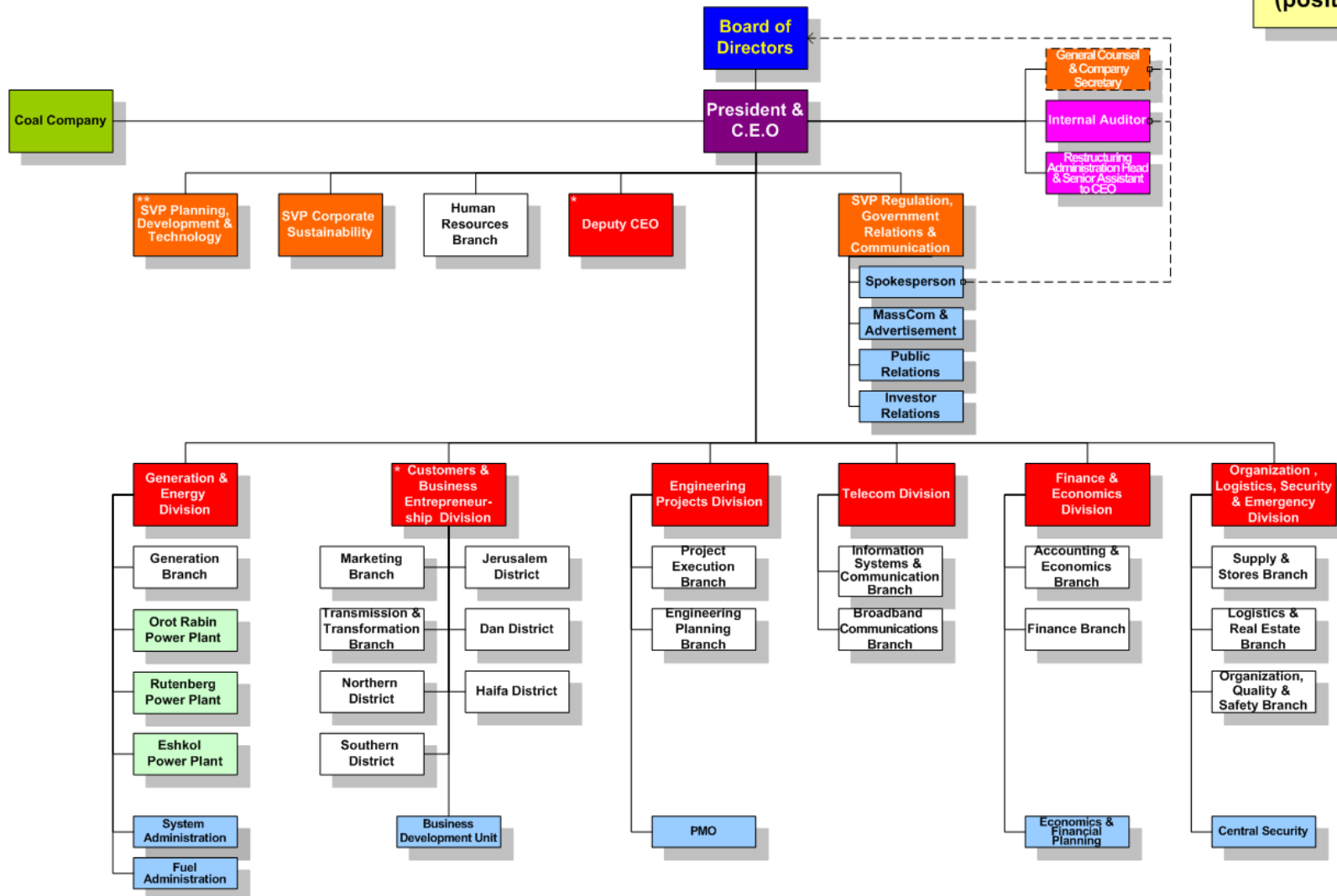
A decrease occurred in this period in the manpower of the project - employees employed in the segment due to release of construction employees (one year extension agreement not realized).

These employees are mainly employed in construction and renovation of power stations, and construction of sub-stations and switching stations.



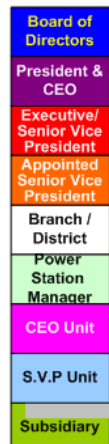
Israel Electric Corporation – Organizational Structure

Roster of employees
(positions): 12,532



* SVP Customers & Business Initiation also serves as Deputy CEO
** SVP Planning ,Development & Technology also serves as VP Planning, Development & Technology

LEGEND



13.2 Employee roster by areas of operation

The personnel roster (number of positions) as of December 31, 2014 is as follows: 12,532 employee positions, in comparison with 12,968 employee positions as of December 31, 2013. As of December 31, 2014, 12,754 employees worked at the Company, compared with 13,188 employees as of December 31, 2013. The segmentation of the job roster by segments reflects the organizational assignment in the Company and not the internal reciprocal activity, which is done between the units of the Company in the different segments. Approximately 40% of the pay of Corporation employees is assigned to the Electricity Sector development activities of the various activity segments.

The employee roster at the Company in the two years preceding the date of the report is as specified below:

Field	Employee roster (positions)	
	As of December 31, 2013	As of December 31, 2014
1. Generation	2,593	2,547
2. Transmission and transformation	350	348
3. Distribution (marketing and districts)	4,470 *	4,530
4. Headquarters (strategic resources, finances and economics, general administration)	1,569	1,572
5. Service (logistics, security and emergency economy, supply and storage organizations)	1,795	1,661
6. Engineering projects (planning and execution)	2,191 **	1,874
Total:	12,968	12,532

* Including employees working in the construction of the distribution system and transmission lines.

** Working mainly in the construction and renovation of power stations, and construction of substations and switching stations.

13.3 Changes in the personnel roster

The change in personnel roster in 2014 compared to 2013 derives from the completion of the emergency plan stage B, from the slower pace of implementing the emission reduction projects as a result of statutory postponements and the suspension of temporary manpower hiring in the second half of 2014 in light of the Company's financial position.

13.4 Training and instruction at the Company

13.4.1 The training system at the Company consists of four schools and a national training headquarters:

The training division of the Company is intended in order to provide support for the improvement of the performance of the Company and in order to raise the level of human, academic and professional capital of the employees of the Company. The division provides vocational training in the primary areas in which the Company is engaged and also provides the certifications that are required by Government ministries (Ministry of Economics, usually), in accordance with laws and regulations.

The expenses for training and instruction at the Company for 2014 were approximately NIS 58 million in current prices. The data does not include direct and related costs with respect to graduate studies that are recorded at the expense of the employee salary and are taxable.

13.5 Employee compensation plans, benefits and employment agreements:

13.5.1 Employment agreements

The labor relations in the Company are regulated by the labor legislation and are subject to various provisions of the law, including the Budget Foundations Law. Additionally, the labor relations are arranged within the framework of collective agreements (hereafter: the “**Employment Agreements**”); these constitute a binding formula for the Company with respect to the hiring and the termination of employees, terms of employment, labor relations, and the rights and the responsibilities of the parties. In addition, the Employment Agreements apply to all of the employees at the Company, with the exception of personal contract employees with the qualifications mentioned here.

The Employment Agreements itemize most of the terms of employment of the employees of the Company, including: salaries and terms of service, eligibility for an energy allowance (eligibility of the 9,761 permanent employees of the Company and 5,488 pensioners and surviving relatives to use electricity for home use in their apartments at the rate of Company employees – namely – without cost up to an annual ceiling, including grossed up tax with respect to it), work and rest hours, overtime work, shift work conditions, paid leave (vacation, illness, etc.), retirement conditions⁷² and more.

In addition, the Employment Agreements include various instructions that pertain to the management of the human resources of the Company, including: the procedure for the hiring of employees and the procedure for the termination of employees (including limitations over the reasons for which Corporation employees may be terminated, the manner of the execution of the termination procedure and the circumstances in which it is necessary to receive the consent of the labor union to the termination of employees); restrictions with respect to the mobility of staff from function to function; disciplinary procedures and so on. Changes and updates in the Employment Agreements are made from time to time, including following negotiations between the management of the Company and the New General Labor Federation and the national labor committee for the employees of the Company, and they require the approval of the Government Companies Authority, the Commissioner of Wages and Employment Agreements at the Ministry of Finance and the Board of Directors of the Company.

The Company’s employees may be classified primarily into two groups: administrative grade staff and professional grade staff (which include engineers, academicians and legalists, jurisprudents, practical engineers and technicians). The Company has a single wage table, in which each administrative grade rank has a vocational grade rank counterpart. The pension rights of employees and other rights with respect to the termination of the employer-employee relations vary in accordance with the group to which the employees belong, in accordance with that which has been set forth in Section 13.5.6 – 13.5.10.

On July 28, 2013, a new collective agreement (salary agreement) was signed between the Company and the Employee Union and the New National Labor Federation (the “**July 2013 Agreement**”). This salary agreement is based on the salary agreement signed at the civil service in May 2013 and became valid with the legislation of the “Participation of Employees, Officers and Other Officials in the Public Service in Measures to Stabilize the Fiscal Position in the Country during 2013 and 2014 (Transition Order) 2013 Law (“Fiscal Stabilization Law”).

The previous salary agreement in the Company of January 31, 2011 granted the employees with a salary increment of 5.75% with respect to the period that ended on June 30, 2012. According to the July 2013 agreement, the employees are entitled to a salary increment at a rate of approximately 1% (completion to 6.75%) from July 1, 2013, but the entitlement to receive this salary increment was postponed and was applied only from January 1, 2015. It was further determined in this agreement that beginning from July 2, 2015, the rates of provision by the Company and the deduction from employees for pension fund will be increased by 0.5%.

⁷² The terms of retirement are governed by the Pension Regulations for Employees of the Israel Electric Corporation, dating from 1958; by the regulations of the Central Pension Fund; and by various Company procedures and provisions.

The July 2013 agreement exhausts the claims of the employees on the subject of salary increments for a period until December 31, 2012, and a commitment for industrial peace was also determined on this subject until December 31, 2014.

According to the Fiscal Stabilization Law, the company has to transfer to the state treasury the sum saved as a result of the postponement of the payment date of the salary increment of approximately 1%, according to instructions of the Minister of Finance. This sum is estimated at approximately NIS 30 million per year. A suitable provision regarding the issue has been included in the financial statements (see Note 12 f to the financial statements). On July 1, 2014, the Minister of Finance published regulations that regulate (inter alia) the manner of transferring the money to the State.

The actuarial liability with respect to the employees is calculated on the basis of the pension salary components that are included in the last salary as of the date of the Financial Statements.

Since the last salary agreement exhausts the salary updates in the Company up to December 2012, the actuarial liability also includes an assessment of a salary raise expected in a future salary agreement for the period from January 1, 2013 to December 31, 2014, at a rate of approximately 0.8% per year (with respect to this period that ended on December 31, 2014 it is an expected salary raise at a rate of 1.6%). This assessment is determined on the basis of past experience. This accounting assumption constitutes the best assessment for a salary raise expected in 2013-2014 in a future agreement.

For details of the Yogev Letter and the draft of the recommendations of the Steering Team with regard to the employment terms of the Company, including changes in the labor agreements and examining the determination of a rate outline for salary costs for the arrangement period with respect to the structural change, and for details with respect to the position of the Company regarding the stated recommendations of the Steering Team, see Note 1 e to the Financial Statements.

On February 25, 2015, a special collective agreement was signed between the Company and the New National Labor Federation and the employee union. It was agreed in the collective agreement, inter alia, on early retirement of 400 to 440 permanent employees in 2015, granting tenure and conditions for eliminating permanent positions, extending employment of temporary employees employed in projects, deducting salary due to participation of employees in sanctions and strikes, industrial peace and exhausting claims in issues arranged in the stated agreement. The agreement is subject to the approval of the Commissioner of Wages and the Government Companies Authority. As of the date of the report, these approvals have not yet been granted.

In accordance with the decision of the Board of Directors of the Company, permanent positions that will not be eliminated as aforesaid will not be manned and will not be budgeted within the framework of the Company's budget.

13.5.2 Employee relations and the conclusion thereof

The employment relations in the Company are based primarily on the principles that have been prescribed by the Employment Rules. The Employment Rules and the relevant procedures instituted constitute the primary normative source in all matters that pertain to employment at the Company, the conclusion of employment, labor conditions and employment relations. The effect of the Employment Rules, whose legal status is that of a bilateral collective arrangement, is valid through to December 31, 2015.

According to the terms of the Employment Rules, the management of the Company is limited, in practice, in its ability to employ efficiency measures which involve the conclusion of the employment of employees of the Company. In cases of differences of opinion on the layoffs of permanent employees and some of the temporary employees with the labor union, it is possible to negotiate on the matter with the Labor Federation, but to the extent that the negotiations should prove unsuccessful, there is no mechanism in the Employment Rules that would provide for the implementation of measures of reorganization that involve layoffs, without the consent of the Labor Federation to these measures having been given. See Section 13.8 for the consequences that this has over the implementation of the Structural Change.

See also Note 34 C to the Financial Statements with respect to the labor relations in the Company and the state of labor disputes as of the date of this report.

13.5.3 Claims of salary irregularities

As a government company, the Company is subject to Section 29 of the Budget Foundations Law which effectively limits its abilities to operate independently on wage issues and benefits to its employees, and imposes upon it a commitment to receive the approval of the Commissioner of Wages on these matters.

For details of the letter from the Commissioner of Wages of October 10, 2013, including decisions about various salary irregularities, including a hearing held by the Commissioner of Wages in this matter and update of his decision as was later published, the legal proceedings pertaining to this decision, as well as agreements by the parties under which the decision of the Commissioner of Wages will not enter into force until a decision is reached in the principal case in this matter, and regarding the negotiations being conducted between the parties regarding this matter, see Note 12 g to the Financial Statements.

13.5.4 Central pension provident fund

Commencing from March 8, 2005, the Company has been depositing money for covering the pension liability for employees that are insured by a budgetary pension arrangement (employees hired up to June 10, 1996) in the central pension provident fund ("**the Fund**"). The Fund is managed as of the date of the report by a managing company, Infinity - Management Central Pension Fund Ltd. See Note 12 l 1) to the Financial Statements for additional details, including with regard to the gap between the actuarial calculations of the Company and those of Infinity.

13.5.5 The trust fund for non-budgetary pension components

For liabilities in respect of pension components that are not of allowance types (as described below), amounts were deposited into a trust account that is managed by the United Mizrahi Bank Trust Company Ltd. (hereafter: the "**Trust Account**"), in accordance with a trust agreement that was signed on March 23, 2000. For details of the proceedings conducted in this matter in the District Court and details regarding the manner of investment of the funds in the Trust Account see Note 13 to the Financial Statements

13.5.6 Permanent employees

As of December 31, 2014, the Company has 9,761 permanent employees (. A permanent employee is one who has received tenure in accordance with the procedures of the Company. This group of employees is divided into those who are insured in the budgetary pension arrangement (employees who started to work at the Company by June 10, 1996, inclusive), in accordance with the pension regulations for the employees of Israel Electric Corporation of 1958 and the regulations of the Pension Central Providence Funds of the Employees of Israel Electric Corporation (managed from May 1, 2010, by Infinity, which is replacing the IEC Pension Fund Company); and employees (who started their work at the Company on June 11, 1996, and onward) who are insured in accumulating external pension insurance funds.

13.5.7 Special agreement employees

As of December 31, 2014, the Company has 678 special agreement employees – an employee who is hired for a non-permanent position, for performing a defined task that lasts for a set period, such as: the construction of power stations or substations. Such an employee is entitled, in accordance with the collective agreement, to the rights as stated in the Employment Rules with respect to permanent employees, except the right to a budgetary pension and to an energy allowance. The compensation that will be paid to special agreement employees, at the time of their termination shall be enlarged as follows: for the first two years of work, compensation at 200% for each year of employment, and for the third year onward, compensation at 300% for each year.

According to collective agreements on the subject, the maximum employment period of employees by special agreement, who began their employment in the Company since January 1, 2005 and onwards, is five work years, and the employment period of employees as stated above who have begun their employment by December 31, 2004, inclusive, is up to ten work years.

13.5.8 Temporary employees

As of December 31, 2014, the Company has 1,309 temporary employees - an employee who is hired for a task that is not as specified with respect to a special agreement employee. Such an employee is entitled to the rights as stated in the Employment Rules, with the qualifications appearing there, except the eligibility for a budgetary pension and an energy allowance. The compensation that will be paid to temporary employees will be as required by law.

13.5.9 Special agreement temporary employees

As of December 31, 2014, the Company has 1,038 temporary special agreement employees – a temporary employee who has worked for less than two years at the Company and who was recommended by his superiors to be transferred to temporary status under a special agreement. In accordance with the collective agreement, such an employee is entitled to rights that are specified in the Employment Rules with respect to a permanent employee, except the eligibility for a budgetary pension and an energy allowance. The compensation that will be paid to temporary employees in a special agreement will be as required by law.

13.5.10 Personal agreement employees

As of December 31, 2014, the Company has 59 personal contract employees - an employee with a personal employment agreement is an employee who is hired for any work at the Company and who has signed a personal contract, which prescribes his salary and regulates all of his terms of employment at the Company. In addition – the company employs 96 trainees and apprentices and 21 scholarship recipients who are working within the “Enlightened Future”⁷³ project (as of the salary data of December 2014).

According to the letter of the Chairman of the Board of Directors of the Company addressed to the Director of the Companies Authority, of February 4, 2015, the Company will act to man the management positions (branch head and higher) with employees employed by personal contracts.

13.5.11 As a government company, the Company is subject to the Government Companies Law and the relevant regulations and the directives of the Companies Authority and the government resolutions, *inter alia* on the issue of personnel.

13.5.12 The procedures for hiring employees for the Company are subject to the Government Companies Regulations (Rules of Employment of Relatives) - 2005, and to the internal instructions of the Company, which are adjusted for the regulations and directions of the Board of Directors of the Company. In view of the above, restrictions have been prescribed in the Company with respect to the employment of relatives in functions in which there are subordination relations or when concern of conflict of interests may arise. Within the internal audit of all of the operations of the Company, the issue of employment of relatives is also audited, and the Company acts in accordance with the recommendations of the Internal Auditor of the Company.

As a government company, the Company is subject to the provisions concerning the proper representation of various sectors among its employees, as appropriate.

13.6 Employee compensation

In general, the Company has no compensation plans for employees who are not senior officers, except the following:

13.6.1 The Board of Directors of the Company is allowed to decide to pay a bonus to the employees of the Company with respect to the Company's excellence and success, subject to the provisions of the circular of the Companies Authority⁷⁴ (in this section – the “circular”), which state, *inter alia*, that the distribution of a bonus to

⁷³ “Enlightened Future” is a project in which scholarships are granted to outstanding students from peripheral regions who are studying subjects at universities in Israel that are in demand at the Company. In the framework of this project, students work at the Company during their studies; in exchange for scholarship grants, the students agree to work at the Company upon their graduation for a commitment period of several years.

⁷⁴ Circular of the Government Companies Authority 2013-7-2 dated June 2, 2013.

employees will not be permitted unless the following threshold conditions are fulfilled and with the approval of the Government Companies Authority: (1) the adjusted annual net profit return on capital is 5% or more, in the year for which the bonus is being paid; (2) in the year that preceded the year for which the bonus is being paid, the Company had a net profit return of 5% or more; and (3) for the year after the year for which the bonus is being paid, the budget of the Company as approved by the Board of Directors expect a net profit return of 5% or more. Additionally, it was determined within the circular that the cost of the bonus to the Company (including all payments involved that the Company must pay for payment of the bonus) is not to exceed 10% of the net annual profit of the Company according to the approved financial statements of the Company and that no distribution of bonus to employees will be permitted if no dividends have been distributed in the year for which the bonus is requested, except with extraordinary approval of the Director of the Companies Authority. The bonus will be paid to the employees immediately following the dividend transfer to the State. The circular also determines that the bonus will be differential and will be distributed according to criteria decided upon by the Board of Directors and under a procedure based on employee evaluation, provided that it will not exceed two salaries. The bonus level will not be uniform for all the bonus receivers, and at least a quarter of the Company's employees will receive a bonus that will not exceed half a salary. .

- 13.6.2 The permanent employees and pensioners of the Company are entitled to an energy allowance, up to a consumption limit of 18,000 kWh per year per employee or pensioner / next of kin, for their own residential homes only, for their domestic consumption and personal use, subject to the Criteria that have been specified within the framework of the procedures of the Company.

13.7 Compensation policy regarding senior officers at the Company:

- 13.7.1 According to the requirements of the Companies Law, the Company's Compensation Committee, Board of Directors and the General Meeting approved the compensation policy of the Company for the senior officers on December 19, 2013, December 26, 2013 and January 9, 2014, respectively ("**Compensation Policy**").

On September 16, 2014 and October 2, 2014, the Compensation Committee and the Board of Directors of the Company (respectively) approved an amendment to the compensation policy of the Company, as required in the circular of the Government Companies Authority with respect to "Principles for a Compensation and Incentive Model for Senior Employees of Government Companies". On February 4, 2015, the general meeting approved the stated amendment.

- 13.7.2 There are 9 officers in the Company who are employed under the collective agreements that apply to all the employees of the Company and 7 officers (including the CEO and the Chairman of the Board of Directors) who are employed under a personal employment agreement in a form that has been approved by the Companies Authority and according to the instructions of the Authority. For details of the Compensation Policy and the terms of office and employment of the senior officers of the Company see sections c.7 and c.8 of the Report of the Board of Directors and regulation 21 of Chapter D of this periodic report.

13.8 Organizational change - economization plan, restructuring

On May 14, 2008, the Board of Directors of the Company tentatively approved the outline of action of the program for organizational change (hereafter: the "**Matzpen [Compass]**" Program for restructuring), which was based, *inter alia*, on the early retirement of approximately 2,000 employees according to management lists and the examination of an additional 500 early retirements and of Corporation staff layoffs that was supposed to be spread out over a period of three years, on the reorganization of the units of the Company that will include a change in the span of managerial control, the joining of functions that have economy of scale, the elimination of duplications and the formation of supportive mechanisms whose goal is to improve processes, management flexibility and optimum utilization of resources and personnel. At the same time, the Company estimated that implementation of the program may involve costs in material amounts.

The labor union notified, after the program was presented, that it opposes the program and forbade the employees to cooperate on the subject. Later on, a few consultation meetings took place, and they led to a limited number of understandings between the parties.

In May 2009, the management and the labor union agreed to enter a dialog process, along with the competent authorities of the State of Israel, with regard to the Structural Change in the Electricity Sector (in accordance with that which has been described in Section 1.3 of this Report and Note 1 e to the Financial Statements), and with respect to organizational changes and economization in the Company.

During 2011-2013, the Company carried out several updates to the "Matzpen" efficiency program and the "Tnufat Or" program was formulated. This program was based on the principles of the "Matzpen" program and included structural and organizational changes in the Company.

On July 22, 2013, the Minister of Finance and the Minister of Energy and Water appointed a Steering Team for executing a reform in the electricity sector and the Electric Company. The Team was headed by Mr. Uri Yogev, who is at present the General Director of the Government Companies Authority, with the participation of senior members of the Ministry of National infrastructures, Energy and Water, Ministry of Finance, and others.

In 2014, the Company presented a program for increasing efficiency for a term of 8 years in the outline of "Tnufat Or" and it is largely based on compulsory retirements.

On February 25, 2015, a special collective agreement was signed between the Company and the New National Labor Federation and the employee union. It was agreed in the collective agreement, inter alia, on early retirement of 400 to 440 permanent employees in 2015, granting tenure and conditions for eliminating permanent positions, extending employment of temporary employees employed in projects, deducting salary due to participation of employees in sanctions and strikes, industrial peace and exhausting claims in issues arranged in the stated agreement. The agreement is subject to the approval of the Commissioner of Wages and the Government Companies Authority. As of the date of the report, these approvals have not yet been granted.

The Company estimates that the cost of retirement of employees, whether within the implementation of the Structural Change, if implemented, or within the implementation of the plans to increase efficiency in the Company, may be material.

For details of the Yogev Letter, the draft of recommendations of the Steering Team with regard to the efficiency plan and organizational change, including details about the preparations of the Company regarding the costs of the Structural Change insofar as will be implemented in accordance with the Yogev Letter, see Note 1 e to the Financial Statements.

13.9 Labor disputes

For details regarding labor disputes see Note 34(c) of the Financial Statements.

13.10 Additional Provisions Regarding Rights of Contractor Employees in the Field of Guarding and Cleaning

Regarding the rights of employees employed by contractors in the field of cleaning and security, the Company is acting in accordance with the lateral orders in the field of cleaning and the field of security, which became effective on March 1, 2013 and on November 1, 2014, respectively.

14. Fixed assets, land and facilities

14.1 General

The Company owns the assets that it uses (subject to the statements in Section 14.3 with respect to the assets arrangement) or possesses either within long term lease agreements (mainly with the Israel Land Administration) or pursuant to purchase or expropriation, or within rights that were extended to the Company by property owners (such as an easement or authorization of use at no cost that is not a lease, or possession rights that have a contractual regulation process) or within rights that the Company has by statute. The Company operates within a work plan for executing an arrangement and register of its rights to its principal assets, which may be registered and regulated, and tracks those that it cannot perform such a proceeding for. In addition, the Company has rights to thousands of small properties (mainly transformation rooms of different types) whose rights regulation and registration has begun, but are subject to restrictions in accordance with what is specified below. For a material part of the real estate assets, the rights of the Company are not registered or regulated. The Company has been leasing some or all of the assets, for a long period, and it is operating to sign contracts or arrange rights when these are not regulated or to evict squatters, if there are any. The status of the real estate assets that have not yet been regulated derives from a number of reasons, such as: planning reasons (absence of parcelization or demands for regulating outline plans, a large number of properties, dependence on outside parties, absence of documents), disputes with various authorities, including tax authorities, which prevent the receipt of approvals for the registration of the rights. In view of the complexity, the Company cannot estimate the length of the period until the conclusion of the registration settlement, but it estimates that the costs involved in this are not expected to be material (see Note 14 c to the Financial Statements).

It is the position of the Israel Land Administration that the land areas that were allocated by the Israel Land Administration to the Company for public purposes, but which are effectively unused or are not being used for the allocated purposes, should return to the possession of the Israel Land Administration. Based on various considerations, the Company believes that this decision does not apply to the land that was leased to it by the Israel Land Administration, based on the recognition of the management of the Administration that the Company has a need to regulate sites for electricity with nationwide coverage in advance. However, even if this decision were not to apply to the land allocated to the Company with a tender exemption, as of the date of the report, the Company is making use of all of the land areas that have been allocated to it by the Israel Land Administration, except a few tracts whose usage date in accordance with the development plan is not yet due, and for which there is future zoning for development and use. In addition, in accordance with this decision, even if the Company is required to return land that has not been used to the Israel Land Administration, the return to the Israel Land Administration will require paying the Company consideration for the return, as prescribed on this matter in this decision, to the extent that the "properties arrangement" does not establish to the contrary; see Section 14.3.

In addition, the Company leases from various parties (such as the Israel Land Administration, local authorities, private entities) approximately 60 more properties that are used for various purposes, including: offices, storerooms, monitoring stations, temporary and portable substations. The agreements are made out for different periods of time, from one year to ten years and are renewed or updated in accordance with the needs of the Company in various places and for different purposes, the rental agreements for the properties, including the option period of the Company for their extension, end in 2015 to 2020. The Company believes that it will be able to renew the lease agreements under terms similar to those existing as of the date of the report.

The information on the preparations of the Company with respect to the assets registration costs and extension of the rental agreements is forward looking information, as per its definition in the Securities Law. There is no certainty with respect to such an estimate, this being, inter alia, due to it being based on the existing information at the time of the report and its dependence on various factors that do not depend on the Company, such as market conditions, the needs of the Company, agreements with the lessors and more.

The Company has created floating charges on all of its assets on which it is allowed to create charges for securing some of its liabilities, including on assets and rights as described, and three fixed charges for securing its liabilities

towards various financing entities for the financing of Stage A of the Emergency Plan, financing the emission reduction project and financing Stage B of the Emergency Plan (see Note 20 g to the Financial Statements).

In addition, the main office building of the Company, covering an area of approximately 80,000 m², is located at the southern entrance to Haifa, and is built on land that is owned by the State of Israel and leased by the Company from the Israel Land Administration on a forty nine (49) year lease (until June 2048), with an option for an extension for an additional forty nine years.

The Company has two head offices in Haifa and in Tel Aviv, as follows:

	Name and location of the site	Nature and registration of the right	Land area in m²	Comments
1.	Head management offices – Haifa	The rights of the Company to this property are lease rights of the ILA for a lease period that ends in 2048 with an option for the Company to extend this period for 49 years more. A cautionary remark is registered to the benefit of the Company for its rights.	80,000	1. The land has comments registered for expropriations and an antiquities site. 2. An agreement exists with the Haifa Municipal Council whereby no additional parts of the parcel will be expropriated.
2.	Head management offices – HaChashmal St., Tel Aviv	Ownership of the Company is registered at the Land Registration Bureau.	14,540	1. There are two comments of use – structure listed for preservation. 2. The Company is acting to improve the property, which will involve zoning of land for public purposes and additional construction rights and uses.

The Company has eight (8) logistics sites that are located on land used as storage areas, as follows:

	Name of the site	Location	Type of site	Site area in m²	Nature of the rights
1.	Giborei Israel warehouse	Tel Aviv	Logistic	8,508	Lease from Tel Aviv Municipal Council
2.	Kiryat Shemona warehouse	Kiryat Shemona	Logistic	3,000	Lease from ILA
3.	Kiryat Gat compound *	Kiryat Gat	Empty compound	3,600	Lease from ILA
4.	North Akko logistic center **	Akko	Logistic	121,572	Lease from ILA
5.	Area for storing equipment trolleys, Jerusalem	Jerusalem	Logistic	775	Rental / authorization from Jerusalem Municipal Council
6.	Beit Dagan warehouse	Beit Dagan	Logistic	85,108	Ownership / right of possession (without documents)
7.	Leyland logistic center, Ashdod	Ashdod	Logistic	106,000	Ownership
8.	Orot Rabin logistic center	Hadera	Logistic	270,000	Sub-lease from the Caesarea Development Company
Total area				598,563	

* As of the date of this report, the property is in the process of being sold.

** Under construction.

14.2 Fixed assets

The fixed assets of the Company are divided into two key groups: operated fixed assets and fixed assets under construction. Operated fixed assets consist mainly of power stations (including land, buildings and machines), and substations, distribution grids, switching stations and 400 kV extra high voltage switching stations. The assets of the Company that are under construction consist mainly of power stations and buildings.

The Company has assets (mainly distribution grids) in the territories of the Palestinian Authority. See Section 9.6 for details on assets of the Company that are in the territories of the Palestinian Authority.

14.3 Arrangement for the transfer of rights and assets pursuant to Section 62 of the Electricity Sector Law

Section 62 of the Electricity Sector Law states various provisions with respect to rights and assets that were held by the Company prior to the expiration of the Concessions that were given to the Company pursuant to the Electricity Concessions Order with (March 4, 1996), despite the statements in Section 46 in Part A of the Addendum to the Electricity Concessions Ordinance.

For additional details, including details of the draft of recommendations of the Steering Team and the position of the Company with respect to the draft of recommendations as stated, and of the Yogev Letter, see Note 1.f to the Financial Statements.

The information included in this report, and within the framework of the Financial Statements of the Company, with respect to the effect of the assets arrangement on the Company and its financial position, constitutes forward looking information, as per its definition in the Securities Law. Information as stated is based on interpretation of legislation with regard to assets with respect of which the Company will be obliged to pay and on the determination of the method for determining the value of those that are not under the sole control of the Company, but depends, inter alia, on the decisions of the Ministers. The Company cannot estimate which opinion will be accepted – whether the opinion of the Company and its legal advisors or the opinion of the State, or other interpretation, and what method will be used to calculate the value of the stated assets. Additionally, and inter alia by paying attention to the draft of the report and the Yogev Letter with respect to the arrangement of the assets, the Company has no certainty as to the manner and method in which the arrangement of the assets will be implemented, insofar as will be implemented, and it has no certainty that it will not have a material effect on its business, the results of its activity or its financial position. In addition, this data is based on the estimations of the Company as of the date of the report. Such estimates may not be realized or may be realized partially or differently than expected due to, inter alia, the changes in the position of the Ministers and the Government or the applicable law, which are not under the Company's control.

15. Intangible assets

15.1 Information and teleprocessing systems

The Company engages in the characterization, development and implementation of information systems and solutions that support business processes in the Company in the following fields: customer service and billing, the electricity chain, planning and construction of engineering projects, programs on security and safety, and programs that deal with managerial, business and logistic issues. In addition, the Company has extensive experience and knowledge that have accrued on the following issues: planning, hosting and operation of computer infrastructures on all types of platforms, telecom and command and control infrastructures and services, protection packages specialization in diverse IT architectures and technologies with emphasis on the protection of the cyber space, smart counting, integration of a SAP package, business information strategy as well as all stages of the lifecycle of large-scale IT and telecom projects.

15.2 Concessions

The Company owns a license for the use of 20 VHF frequencies, which are intended for use in the DMS project.

16. Suppliers

16.1 General

Suppliers in Israel and Overseas:

According to the instruction of the Head of the Finances and Economics Division (in this section; the “Instruction”), the terms of payment for the suppliers (not including fuel suppliers) in the Company’s contractual engagements, except for exclusions as detailed in the instruction, are end of month + 90 days from the day the Company receives the request for payment or receives the goods or the service, by the later of the two dates.

Nevertheless, terms of payment of less days than the aforesaid can be determined with an approval of the Head of the Finances Division CFO.

The terms of payment for fuel suppliers are shorter and change according to the type of fuel.

Gas Suppliers

The terms of payment that were set with the “Tamar” Partnership, the major gas supplier of the Company, are 15 days from the date the pro-forma invoice is submitted.

16.2 Agreements with Material Suppliers

The following table shows the material suppliers of the Company, rates of purchase that in 2014 exceeded 10% of the rate of purchases of the Company from suppliers throughout 2014:

Name of the supplier	Raw material	Acquisition rate
The National Coal Supply Corporation Ltd.	Coal	24.31%
The Tamar Partnership	Gas	24.35%

See Section 9.6 and 7.9.9.2 (b) for details on the Company’s contracts with these suppliers.

17. Working capital

17.1 Credit policy

17.1.1 Customer credit:

For details of days of credit for customers and average balance of credit to customers see section a.6.b)4) of the Report of the Board of Directors.

17.1.2 Credit from suppliers:

For details of average days of credit for suppliers and average balance of credit from suppliers see section a.6.b)4) of the Report of the Board of Directors.

18. Financing

18.1 General

The electricity charge rate for the consumers is determined by the Electricity Authority in accordance with the provisions of the Electricity Sector Law as stated in Note 3 to the Financial Statements. In view of the principles of determining the charge rate as stated, the revenue of the Company that is based on the electricity rate that the Company collects from the consumers does not constitute a principal source of financing of the development activity of the Electricity Sector, and the Company is therefore required to raise most of the necessary financing for this purpose and for recycling the existing debt of the Company from external financing sources.

However, in recent years, the financing of part of the Development Plan of the Company has been carried out, *inter alia*, through the raising of the charge rate with special approvals of the Electricity Authority. and, *inter alia*, on March 7, 2011, the Electricity Authority published a resolution whereby a debt in the amount of NIS 2 billion out of the debt of the Company to consumers would be spread through to 2025 for the purpose of implementation of Stage B of the Emergency Plan (see the Immediate Report of the Company dated March 17, 2011, Reference No.: 2011-01-084180). In the resolution of the Tax Authority of May 6, 2013, it was determined that the debt balance will be spread anew until 2017. See Note 9 h to the Annual Financial Statements for further information.

As part of the multi-annual planning of the Company, the Board of Directors of the Company resolved in June 2014 to reduce the financial debt in an amount of NIS 0.5 billion a year and to gradually reduce the Company's debt-to-balance ratio (hereafter: the "**Financial Leverage**") to 81%.

For details of the draft of recommendations of the Steering Team, that included, *inter alia*, a draft of recommendations with respect to the financial strength of the Company, the outline for decreasing its debt, for details of the position of the Company regarding the recommendations of the Steering Team as stated, and for details of the Yogeve Letter, see Note 1. e to the Financial Statements.

On November 5, 2012, the Company's board of directors resolved to gradually increase the Company's minimum cash reserve (the "**Safety Cushion**") from NIS 1 billion to NIS 3 billion. On February 27, 2014, the Board of Directors of the Company decided that the safety cushion of the Company will continually have a monetary value of NIS 3 billion, and the diesel oil and fuel oil inventory surplus of the Company, with a value of up to NIS 800 million, will constitute a part of the safety cushion of the Company, and in addition, the cash balance will not be less than NIS 2.2 billion.

On August 4, 2014, a letter was received from the professional team of the Electricity Authority, under which the money in the special purpose account of the emergency plan will serve as a safety cushion only in exceptional cases where the Company will not have a financial balance, except for the one in the special purpose account of the emergency plan. This letter followed the application of the Company where it noted that in order to continue to reduce the financing costs and in order to be able to regard the special purpose account of the emergency plan as part of the minimal cash balance, and to continue to decrease the raising needs, it is requesting the approval of the Electricity Authority to use the special purpose account as part of the safety cushion. The balance of the special purpose account as of December 31, 2014 is NIS 386 million. For additional details of the special purpose account of the emergency plan see section 7.7.5.

On May 1, 2014, the Company executed a private placement of debentures to institutional entities⁷⁵.

As part of a comprehensive plan of the Company to issue debentures (Global Medium-Term Note Program), within which the Company is permitted to issue debentures in a total amount not exceeding USD 5 billion (the "**GMTN Plan**"), on November 5, 2014, the Company issued debentures that were distributed by the Barclays and Citi investment banks to institutional purchasers in the U.S.A. and elsewhere, in a total amount of USD 1.25 billion par

⁷⁵ See Immediate Report of the Company of May 1, 2014, reference no.: 2014-01-055842.

value, the stated debentures were listed in the "Institutional Continuous Trading System" of the Stock Exchange. The accumulated amount issued within the GMTN Plan as of this date is USD 4.65 billion par value.

For additional details of capital raisings by the Company and material repayments see Note 20 c to the Financial Statements.

18.2 **Average interest rate of loans**

The Company finances its actions using bank credit and non-bank credit. A breakdown of the average nominal interest rate for the twelve month period that ended on December 31, 2014, except for the loan for financing the gas transmission project (as detailed in Note 33 b. (1)(a) to the Annual Financial Statements) that are not intended for the exclusive use of the Company, segmented by short-term credit and long-term credit from bank and non-bank sources, is provided below.

Details	Average interest rate (%) for long term credit
Bank credit sources	1.67
Non-bank credit sources	5.91

Notes:

1. Average interest rate relates to loans and debentures with fixed interest and variable interest for all the currencies.
2. Average interest rate relates to loans and debentures that have not yet been repaid on December 31, 2014.
3. Short term credit is credit whose repayment date is within one year from the raising date.
4. Long term credit is credit whose repayment date exceeds one year from the raising date.

18.3 **Restrictions applying to the Company at the time of receipt of credit**

To finance the Development Plan of the Company, the Company is required to have external financing sources of significant magnitudes.

The ability of the Company to borrow from the Israeli banking system is limited because of the credit restrictions that apply in accordance with the Proper Banking Management Regulations of the Bank of Israel (Regulation No. 313). In accordance with these regulations, the Bank of Israel will not extend loans to a "single borrower" at a rate exceeding 15% of its equity capital, after adjustments, and in addition, the Bank of Israel will not extend loans to a "borrower group" at a rate exceeding 25% of the equity capital of the bank, after adjustments. The term "borrower group" includes, *inter alia*, the borrower, the person controlling it and any person that is controlled by them, except banks and other borrowers such as borrowers with material commercial dependence on the Company. With respect to these restrictions, the State of Israel is not considered a borrower and it is not included in the "borrower group". To the best of the Company's knowledge, government companies that do not control each other do not together constitute a borrower group. In addition, according to the Bank of Israel's Letter dated November 8, 2011 (whose validity was extended until September 30, 2013) the banks are required to provide special disclosure to the Supervisor of banks regarding credit risk in respect of significant exposure to groups of borrowers. To the best of the Company's knowledge, this disclosure is likely to include the group of borrowers to which the Company belongs.

In accordance with the Regulations of Supervision over Financial Services (Provident Funds) (Investment Rules that Apply to institutional Bodies), 2012, in general, a provident fund is allowed to hold securities of a certain corporation, make deposits in that corporation or extend to it loans at a rate of up to 5% of the revalued market value of its assets, or beyond this, subject to the conditions prescribed in the aforementioned regulations.

In addition, in accordance with these regulations, a provident fund or a group of investors are allowed to hold negotiable bonds (that are not bonds of the State of Israel) to a rate of up to 25% of the total par value of the bonds of that series, or beyond this, subject to the conditions prescribed in the aforementioned regulations.

In effect, based on public publications of some to the financial institutions, the provident funds' holdings of the Company securities do not reach the maximum rate that is permitted for them in accordance with the aforementioned regulations.

The theoretical potential for the receipt of loans from the banking system and from the institutional market in Israel stands, in accordance with the Company's estimate, reaches an amount that is significantly lower than the needs of the Company, which cannot in any case constitute a unique funding source for the Development Plan of the Company (taking into account the fact that, to the best of the Company's knowledge, the ability of institutional investors to provide financing to the Company, is affected by their exposure to the electricity sector in Israel (i.e. – including material suppliers that are dependent on the Electric Company, private electricity producer and gas suppliers, including the Gas Lines Company that is responsible for the gas transmission), and not only by their exposure to the Company). Regulatory restrictions that apply to the banking system and the institutional market in Israel, along with internal investment restrictions that are prescribed by these entities, make it difficult for the Company to raise the debt required for the Company in Israel and therefore the Company sometimes raises its required credit from the capital markets and the banking system overseas.

18.4 Credit that has been obtained from the date of the statements until the date of signing this Report

After December 31, 2014 and until the date of publication of the report, the Company took a loan of NIS 1 billion from Bank Hapoalim, which replaced a previous loan the Company took from Bank Hapoalim which was repaid on December 15, 2014.

18.5 Restrictions that apply to the Company pursuant to financing agreements

For details with respect to conditions that may cause the calling of debt of the Company pursuant to the agreement, for immediate repayment, see Note 20 d to the Financial Statements, and regarding the causes for immediate repayment that are included in the financing agreements the Company has entered, that are defined as “**Material Loans**” with respect to the implementation of the Securities Authority Directive pertaining to “Reportable Credit Event” see section 18.9 below.

18.6 Credit facilities for December 31, 2014

As of December 31, 2014, the Company has credit facilities in an amount of NIS 800 million:

Bank	Credit facility NIS millions	Amount available for use NIS millions
Bank Hapoalim Ltd.	500	500
Isarel Discount Bank Ltd.	300	300

18.7 Variable interest credit

As of December 31, 2014, the Company has variable credit interest coming to a total of approximately NIS 5,455 million. A breakdown of the variable interest credit that the Company has received follows:

Currency	Interest rate range		Interest range in 2014 (in %)		Balance for December 31, 2014 (in millions)	
	High	Low	High	Low	Original currency	NIS
U.S. dollars	Libor 6m + 2.5	Libor 6m + 0.1875	2.85	0.58	388	1,508
Euro	Libor 6m + 2.5	Libor 6m + 0.325	2.90	0.50	445	2,101
CPI linked NIS	Government bond yield + 0.25	Government bond yield + 0.25	0.05	0.05	96	96
Unlinked Shekel	Telbor 6m + 1.15	Telbor 6m + 1.15	2.35	1.82	250	250
Unlinked shekel	Bank Israel + 0.51	Bank Israel + 0.49	1.51	0.74	1,500	1,500

Note: Does not include loan for financing the gas transmission project that is not designated for a unique use by the Company.

18.8 Credit rating

The Company is rated by two (2) local credit rating companies and two (2) international credit rating companies. For details with respect to the credit rating of the Company see Note 20.f to the Financial Statements.

18.9 Reportable Credit Event

In accordance with Legal Position No. 104-15 of the Securities Authority of October 30, 2011 with respect to a reportable credit event (in this section: "Securities Authority Directive"), a disclosure with respect to the material loan agreements to which the Company is a party follows⁷⁶.

⁷⁶ It should be noted that after the Company examined all of its liabilities for December 31, 2014 (coming to a total of approximately NIS 71 billion), the Company determined that for the purpose of implementation of the Securities Authority Regulation in its periodical reports, a "material loan" shall be any loan whose outstanding balance as of the date of the relevant statement constitutes more than 5% of the total liabilities of the Company for that time, in other words, an amount of NIS 3.6 billion as of the date of this report.

<u>Loan / bond contract</u>	<u>Characteristics of the lender</u>	<u>Revalued principal balance as of date of Report</u>	<u>Amortization schedule</u>	<u>Contractual interest and effective interest</u>	<u>Linkage mechanisms</u>	<u>Sureties extended to the lender</u>	<u>Restrictions applying to the Company with respect to the loan</u>			
							<u>Cross default or cross acceleration clause</u>	<u>Negative charge undertaking</u>	<u>Comments on material conditions to receipt of credit (*)</u>	<u>Material changes that occurred in the loan agreements / credit extension agreement</u>
Issue in the USA 05/2008 (GMTN)	Non-negotiable overseas bond	Revalued par value balance NIS 3,889 million	Principal will be repaid in one installment on January 15, 2019	Contractual interest 7.25% and effective interest 7.41%	U.S. dollars	Floating charge on all assets of the Company	The bond holders have a right of early repayment in the following cases: (1) debt towards lenders of the Company in the amount exceeding US\$ 25 million or equivalent has not been paid (after the remedy period for non-payment has ended); or (2) another lender of the Company has a right to call the debt to it for immediate repayment in the amount exceeding NIS 25 million or equivalent in NIS	Negative charge undertaking, except: (A) floating charges of equal degree to a floating charge securing the bonds and securing amounts relative to the amounts secured by this floating charge; (B) permitted charges as per its definition in the bond terms.	----	----

Other material conditions –

- A. Endorsement of the debt to the transmission company: in the case of another company, which is not the Company, engaging in all or most of the electricity transmission activity in Israel (“**the Transmission Company**”), the debt in accordance with the agreement shall be endorsed to the Transmission Company, and this company will assume

the place of the Company as the issuer of the bonds (hereinafter: the “**Relevant Time**”) and the Company is committed to act (in accordance with certain conditions) for this debt endorsement to take effect.

- B. The Company shall manage, finance and operate its business affairs in an adequate manner, while considering its cash flow, subject to any law, including demands that are in its incorporation documents and environmental permits.
- C. The bond holders have an option (under certain conditions) to demand early repayment of the bonds (a put option), *inter alia*, in accordance with common causes and upon the fulfillment of one of the following conditions.
 - (1) At the Relevant Time (as defined above), the following cumulative conditions are fulfilled: (A) the State of Israel has an investable rating; (B) the bonds are rated below an investable rating; and (C) the Company has not taken the utmost effort to achieve an investable rating for the bonds; or
 - (2) At the Relevant Time (as defined above), the Company was not acting in accordance with its commitments for the endorsement of the debt to the Transmission Company to take effect;
 - (3) The Company does not legally engage in electricity transmission activity in Israel, or, at the Relevant Time (as defined above) or thereafter, the primary occupation of the Company has ceased to be electricity transmission;
 - (4) The State of Israel has ceased to be, directly or indirectly, the controlling shareholder of the Company (on this matter, “controlling” means the ability to direct the operations of the Company or a holding of 50% or more of the voting rights of the Company);
 - (5) In the occurrence of a case or circumstances that may constitute an event that has a material adverse effect over the Company – as such an event is defined in the terms of the bonds.
- D. The bond holders have a right (under certain conditions) to immediate repayment of the loans in accordance with accepted causes, *inter alia*, upon the fulfillment of:
 - (1) Attachment or expropriation of the assets of the Company to the benefit of the creditors to a value in excess of US\$ 25 million, or equivalent to this amount in foreign currency.
 - (2) Impairment of the validity and/or enforceability and/or rating of the floating charge in accordance with the terms of the bonds.
 - (3) The debentures are not rated through two international rating companies

<u>Loan / bond contract</u>	<u>Lender characteristics</u>	<u>Revalued principal balance as of date of report</u>	<u>Amortization schedule</u>	<u>Contractual interest and effective interest</u>	<u>Linkage mechanisms</u>	<u>Sureties extended to the lender</u>	<u>Restrictions applying to the Company with respect to the loan</u>			
							<u>Cross default or cross acceleration clause</u>	<u>Negative charge undertaking</u>	<u>Comments on material conditions to receipt of credit (*)</u>	<u>Material changes that occurred in the loan agreements / credit extension agreement</u>
Linked Electricity 2022	Non-negotiable bond in Israel	Revalued par value balance of NIS 3,905 million	The principal will be repaid in six equal semiannual installments from July 18, 2020 to January 18, 2023	Contractual interest 6% and effective interest 4.57%	Linked shekel loan (principal and interest) linked to the Consumer Price Index	Floating charge over the assets of the Company	The bond holders have a right of immediate repayment in the case of a debt of another financial financier of the Company in the amount exceeding US\$ 100 million or equivalent in NIS being called for immediate repayment	Negative charge undertaking, except: (A) floating charges of equal degree (<i>pari passu</i>) or inferior than that of the floating charge given to secure the bonds; (B) permitted charges as per its definition in the terms of the bonds	----	----

Other material conditions -

The mechanism for raising the contractual interest for the bonds in the case of decreasing of the rating

The bond holders have a right to immediate repayment of the loan in accordance with common causes, and when:

1. The State of Israel has ceased to be the controlling shareholder of the Company ("controlling" – as per its definition in the Securities Law).
2. A material deterioration has occurred in the business affairs of the Company and there is genuine fear that the Company will not be able to repay the bonds.
3. A termination of rating for a period that exceeds sixty (60) consecutive days (except as a result of changing of the rating company).

4. A merger has been performed without the receipt of prior approvals of holders of at least 75% of the par value of the bond, unless the Company or the receiving company, as relevant, has declared towards the bond holders that there is no reasonable concern that due to the merger the receiving company will not be able to fulfill the undertakings towards the bond holders.
5. An attachment to a material amount is imposed on the assets of the Company and is not removed within forty five (45) days of its date of imposition.

<u>Loan / bond contract</u>	<u>Characteristics of the lender</u>	<u>Revalued principal balance as of date of Report</u>	<u>Amortization schedule</u>	<u>Contractual interest and effective interest</u>	<u>Linkage mechanisms</u>	<u>Sureties extended to the lender</u>	<u>Restrictions applying to the Company with respect to the loan</u>			
							<u>Cross default or cross acceleration clause</u>	<u>Negative charge undertaking</u>	<u>Comments on material conditions to receipt of credit (*)</u>	<u>Material changes that occurred in the loan agreements / credit extension agreement</u>
Dollar Electric 2024 within the GMTN Plan	Non-negotiable bond offered to institutional purchasers in the U.S.A. and listed in Israel	Revalued par value balance NIS 4,861 million	Principal will be repaid in one installment on November 12, 2024	Contractual interest 5% and effective interest 5.125%	U.S. dollars	Floating charge on all assets of the Company	The bond holders have a right of early repayment in the following cases: (1) debt towards lenders of the Company in the amount exceeding US\$ 25 million or equivalent has not been paid (after the remedy period for non-payment has ended); or (2) another lender of the Company has a right to call the debt to it for immediate repayment in the amount exceeding US\$ 25 million or equivalent in NIS	Negative charge undertaking, except: (A) floating charges of equal degree to a floating charge securing the bonds and securing amounts relative to the amounts secured by this floating charge; (B) permitted charges as per its definition in the bond terms.	----	----

Other material conditions –

- A. The Company shall manage and operate its business affairs in an adequate manner and in accordance with the law, including demands that are in its incorporation documents.

- B. The bond holders have an option (under certain conditions) to demand early repayment of the bonds (a put option), in accordance with common causes and upon the fulfillment of one of the following conditions:
- (1) Insofar as the bonds will be rated by S&P or by Moody's, two levels below the international credit rating and the senior debt rating of the Company by S&P or Moody's, respectively, and this rating has not been raised back by S&P or Moody's, respectively, during a period of 3 months.
 - (2) The State of Israel has ceased to be, directly or indirectly, the controlling shareholder of the Company (on this matter, "controlling" - the ability to direct the operations of the Company or a holding of 50% or more of the voting rights of the Company);
 - (3) In the occurrence of a case or circumstances that may constitute an event that has a material adverse effect over the Company (as such an event is defined in the terms of the bonds).
- C. The bond holders have a right (under certain conditions) to immediate repayment of the loans in accordance with accepted causes, *inter alia*, upon the fulfillment of:
- (1) Expropriation of the assets or request to realize asserts to a value in excess of US\$ 25 million, or equivalent to this amount in other currency.
 - (2) Impairment of the validity and/or enforceability and/or rating of the floating charge in accordance with the terms of the bonds.
 - (3) The liabilities of the Company under the bonds become invalid, illegal or unenforceable and this may have a material adverse effect on the bond holders.

19. Taxation

On this matter, see Note 22 to the Financial Statements.

20. Environmental risks and environmental regulation – general

20.1 General

For details of the aspects of quality of the environment and environmental risks in each of the operational segments of the Company, see sections 7.12, 8.8 and 9.10 above.

20.2 Hazardous materials

The Logistics and Assets Branch possesses a poison permit for conveying hazardous materials for the national transport segment, which is renewed every two years, a poison permit for a logistic site in Ashdod and a poison permit for the technical center with respect to the Section's operations in the technical center, in cooperation with the Supply Section and the Southern District. In addition, an application has been submitted for a poison permit for another logistic site in Beit Dagan, which is currently being addressed.

20.3 Business licensing

Various activities of the Company at the logistic and administrative facilities require licensing in accordance with the Business Licensing Law. As of the date of the report, the Company is operating to regulate the licensing of the activities whose licensing proceeding has yet to be completed in accordance with the provisions of the law and the requirements of the authorities. The operation of the sites of the Company without a business license constitutes a violation of the Business Licensing Law and may lead to the termination of the activity of the business. For additional detailing of this subject see section 21.9. For details of the integrative licensing procedure see section 7.12.12.

20.4 Material events or matters relating to environmental protection

As of the date of this report, to the best of the Company's knowledge, it is not exposed to material events or matters with respect to environmental protection in its activities, which have not been set forth in the report.

20.5 Energy saving

The Company's activity is subject, *inter alia*, to the Energy Sources Law and various relevant regulations that deal with energy saving and Government resolutions that are published from time to time with respect to the policy for energy saving and greenhouse gas emissions abatement. The Company is acting to comply with this regulation and is studying its consequences and the consequences of new regulation initiatives in the field. The Company estimates that at this stage the existing regulation does have material implications for the Company.

20.6 Material legal or administrative proceedings with respect to environmental protection

A number of class actions and other material actions have been filed against the Company. See Note 34 B to the Financial Statements, for details.

20.7 The policy of the Company in environmental risk management

See Section 7.12 for details on this issue.

20.8 Environmental costs and investments of the Company in environmental protection

A breakdown of the investments of the Company in environmental protection in the generation segment, over the three recent years, is as follows. The figures do not include the generation segment for which separate information has been provided in Section 7.12.16, and includes the transmission and transformation segment and the distribution segment and general expenses that may not be attributed to a particular segment.

NIS millions (December 2014 prices)	2014	2013	2012
Total investment in environmental protection facilities, misc. purchases and investments	Approx. 6	Approx. 5	Approx. 6
Current costs (without depreciation) (fuels, research and development and more)	Approx. 2	Approx. 2	Approx. 5

The Company is of the opinion that the material costs that are required for compliance with the provisions of the legislation pertaining to environmental protection, to the extent that there are any, will be covered within the electricity charge rates, based on the fact that in the past similar expenses were approved by the Electricity Authority, even if after many discussions and cost controls. The decision on the recognition of the cuts is with the Electricity Authority.

The assessment of the Company with respect to covering the costs required for compliance with the provisions of the legislation pertaining to environmental protection is forward looking information, as this has been defined in the Securities Law, which is based on the past experience of the Company in its connections with the Electricity Authority, which have no certainty of materialization, in part or in full.

21. Restrictions and control over the operations of the Company

21.1 Provisions of the Electricity Sector Law, relevant regulations, licenses issued accordingly and resolutions of the Electricity Authority

21.1.1 General

From March 4, 1996, the activity of the Electricity Sector has been regulated under the Electricity Sector Law and its regulations by which the Company operates. The provisions of the Electricity Sector Law state that its purpose is to regulate the activity in the Electricity Sector to the benefit of the public, while securing reliability, availability, quality, efficiency and while creating conditions for competition and minimization of costs.

In accordance with the Electricity Sector Law, no person shall conduct activity in the Electricity Sector other than under a license that has been given to them pursuant to this law. The types of licenses that are given for activities in the Electricity Sector are as follows: (1) a license for generation of electricity; (2) a license for transmission of electricity – transmission of electricity from a high voltage or extra high voltage generation source to a substation; (3) a distribution license – transfer of electricity from a substation to a consumer, through medium and low voltage lines; (4) a supply license – sale of electricity to consumers in general or types; (5) an own-use generation license – generation of electricity for own use without selling it to another party, with certain exceptions; (6) a license for system administration – administration of the electricity system in the generation and transmission segments, including constant balancing out of the supply and demand of electricity, and securing the survivability of the electricity generation and transmission array, management of the transfer of energy from power stations via the electricity grids or substations at the required reliability and quality, scheduling of the execution of maintenance works in the generation units and in the transmission units, management of trade in electricity under competitive, equal and optimal conditions, including execution of agreements for the purchase of available capacity and energy from electricity producers and planning of the development of the transmission and transformation system. In addition, the Electricity Sector Law states that a holder of a license for system administration, transmission or distribution of electricity is an essential service supplier license holder. Additionally, a holder of a generation license or licenses for which the Minister has determined, in accordance with the factual state of the electricity sector, that it concentrates a material part of the generation in the Electricity Sector – will be considered as a holder of an essential service supplier license. The provisions of the Electricity Sector Law regarding a holder of an essential service supplier license will apply to an electricity producer and a license holder having direct or indirect control of an electricity producer, except for a provision requiring the holder of an essential supplier license to purchase electricity from a private electricity producer, and provide infrastructure services and backup services.

In accordance with the Electricity Sector Law, the Minister is the party in charge of execution of the law. In addition, in accordance with the Electricity Sector Law, the Electricity Authority, which was established pursuant to this law, shall act in accordance with its goals and the policy of the Government, the policy of the Minister in accordance with their lawful authorities in the Electricity Sector field, and shall be responsible for giving the licenses in accordance with the law and supervision of fulfillment of the provisions of the law and the licenses. In addition, the Electricity Authority fulfills the functions that have been prescribed for it in the Electricity Sector Law (or that have been imposed upon it in accordance with any other law), including the setting of electricity charge rates and ways to update them, establishing of criteria for the level, standard and quality of the service that an essential service supplier license holder provides and supervision of fulfillment of its duties in accordance with these criteria. In addition, in accordance with Section 37 (2) of the Law, the Electricity Authority has the authority to check and decide on complaints of consumers.

The Electricity Sector Law empowers the Electricity Authority to give licenses for all of the activities in the Electricity Sector. A license will take effect after its approval by the Minister. The Electricity authority is allowed to prescribe in a license conditions and to restrict or not restrict its valid period. The Electricity Sector Law states that the Electricity Authority, when deciding whether to give a license or establishing conditions, shall act in accordance with the policy of the Government or the policy of the Minister in the Electricity Sector field, and

will consider, *inter alia*: the contribution of giving of the License to the level of services to the public, the benefit of consumers and the contribution of giving of the License to competition in the Electricity Sector.

The Electricity Sector Law states that the Minister is allowed, if he considers it necessary for the advancement of the goals of the Law and the policy of the Government or his own policy in the field of the Electricity Sector, to order the Electricity Authority to give a license, to change a condition or the conditions of the License, to add to or subtract from its conditions (based on explanations that will be given, after hearing the position of the Electricity Authority on the matter and after giving the government a notice thereof).

The Electricity Sector Law further states that the Minister, upon consulting the Electricity Authority, is allowed to establish conditions for giving a license. Accordingly, in 1997, the Electricity Sector Regulations (Terms and Procedures for Granting Licenses and Obligations of the License Holder), 1997 ("**Conditions and Procedures for Giving a License**") were updated to prescribe, *inter alia*, procedures and conditions that a license applicant must comply with, including: conditions on the matter of minimal equity capital, minimal self-financing rate and so on. In addition, the Law states that transactions with a holder of an essential service supplier license will be conducted in accordance with rules set by the Minister, in consultation with the Authority or according to its proposal. Accordingly, the Minister enacted the Electricity Sector Rules (Transactions with an Essential Service Supplier), 2000. The rules determine, *inter alia*, that a transaction for purchase of electricity will be conducted under a contract to be signed by the supplier and the producer. If a tender is issued, the contract will be signed in accordance with the terms of the tender. If a tender is not issued, a contract adjusted to the method of the transaction will be signed and will require the approval of the Minister.

The Electricity Sector Law has been amended on numerous occasions, *inter alia* with the goal of regulating structural changes in the Electricity Sector, including the future structure of the Company. See Note 1 e to the Financial Statements for details on the provisions of the Electricity Sector Law pertaining to the Structural Change in the Company that is required by the provisions of the Electricity Sector Law.

21.1.2 Licenses that have been granted to the Company pursuant to the Electricity Sector Law

The first license that was granted to the Company pursuant to the Electricity Sector Law, in 1997, is a license for transmission, distribution, supply, sale and trading of electricity, which is referred to by the Company as "the general license" (hereafter: the "**General License**"). In addition, the Company has been granted generation licenses for the generation units that it operates. In 2007, a new sphere of operations was included in the Electricity Sector Law that was defined as "system administration". The system administration activity is carried out by the Company within the General License, without it having been given an additional, specialized license for system administration. For details of the draft of recommendations of the Steering Team with regard to the system administration see Note e to the Financial Statements

As the Company holds a license for the transmission and distribution of electricity, it is considered to be an "essential service supplier" in accordance with the Electricity Sector Law. In addition, as the Minister has stated that the Company concentrates a material part of the generation in the Electricity Sector, the provisions of the Electricity Sector Law relating to an essential service supplier apply to it. Additionally, the Company is deemed an essential service supplier in light of the fact that in accordance with the general license the system management activity is performed by the Company.

For additional details with respect to licenses that have been granted to the Company pursuant to the Electricity Sector Law see section 1.1 and section 7.1.2 above.

In accordance with the licenses of the Company, the Company must act in accordance with the provisions of the law, including any law that takes effect after the giving of the licenses and international treaties to which Israel is a party with respect to the actions pursuant to the License, which as stated is subject to the law. A violation of the law constitutes a violation of the licenses, and the Electricity Authority is allowed to cancel or suspend the licenses if it has found that any of their conditions has been violated (see Section 21.1.4 with respect to the power of the Authority to cancel the licenses). As of the date of the report, except in accordance with that which has been stated in Section 22.1.3.6 with respect to the violation of duties related to activity and reporting as profit centers, the Company materially complies with the terms of the licenses that have been given to it.

21.1.3 Duties and restrictions in accordance with the provisions of the Electricity Sector Law, the relevant regulations and the provisions of the licenses of the Company

21.1.3.1 Duties of the Company with respect to the type and nature of the services provided by it

In accordance with the provisions of the Electricity Sector Law, the Company as an essential service license provider holder is committed to –

- (a) Providing service to the entire public without discrimination in accordance with the Criteria that the Electricity Authority has prescribed with respect to reliability and efficiency, and in accordance with the terms of its license and any law; see below for the Criteria that have been established.
- (b) Purchasing electricity from a private electricity producer, and providing infrastructure services and Backup Services, in accordance with the terms of its licenses and in accordance with any law;
- (c) Providing Backup Services to a self-consumption generation license holder, at its request, in accordance with the terms of its licenses and in accordance with any law;
- (d) Acting in order to ensure the provision of all of its services throughout the period of its licenses, including the provision of services in accordance with the Development Plan that has been approved in accordance with the Electricity Sector Law (see Section 7.7.1 on this matter), while performing all of the actions required for the provision of these services.

In accordance with the licenses of the Company, it has been determined that the activities that are being performed by it and the services provided by it pursuant to its licenses will be executed by the Company reliably and efficiently, without discrimination and in a manner that will not infringe on the possibility of fair cooperation.

In addition, the General License of the Company states that the Company shall provide infrastructure and Backup Services to other license holders and that the Company will purchase electricity from private electricity producers in accordance with the terms of their licenses and in accordance with the rules that will be prescribed by the Minister, including quantities of electricity to be sold, dates of purchase and dates of changes. See Section 7.4.1.

The Electricity Sector Law further states that an essential service supplier license holder will charge payments in accordance with the charge rates that the Electricity Authority has prescribed and that an essential service supplier license holder shall pay payments to a license holder or to a consumer in accordance with the charge rates that the Electricity Authority has prescribed (including in case the payments are collected for it by another). The term “charge rates” includes all of the following payment types: (1) that a consumer, private electricity producer or self-consumption generation license holder pays to an essential service supplier, including payments for provisions of infrastructure services and Backup Services; (2) that an essential service supplier license holder pays to another license holder, except payment that is prescribed in a tender that has been published by the State of Israel; and (3) that an essential service supplier pays to a consumer for generation of electricity by the consumer and payments to the consumer for consumption management arrangement.

In addition, in accordance with the provisions of the Electricity Sector Law, the Electricity Authority has to establish criteria by which an essential service supplier license holder will be allowed not to provide the service or not to make the acquisition that it is required to provide or make in accordance with the Electricity Sector Law, terminate, delay or restrict them, if the payments for them have not been paid to the license holder as required by law or if the conditions for the provision of the service or execution of the acquisition have not been fulfilled as required by law. The Electricity Authority has prescribed such criteria in the Book of Criteria that have been set forth below. In addition, the Minister has prescribed the Electricity Sector Regulations (Rules, Conditions and Cases for Termination of Electricity Supply), 2003, which regulate the cases in which an essential service supplier license holder is allowed to terminate the electricity supply.

In July 2014, the Electricity Authority published, pursuant to Section 30 (B) of the Electricity Sector Law, the updated version of the Book of Criteria, which prescribes criteria and metrics with respect to the level,

standard and quality of the service that a holder of an essential service supplier provides⁷⁷, as they are subject to updates and amendments executed by the Electricity Authority from time to time. The prescribing of the Criteria is intended to regulate the activity in the Electricity Sector, supervise and secure the quality of electricity and the standard of service that the Company provides to consumers. Additionally, the Electricity Authority continuously publishes updates to the Book of Criteria.

The Book of Criteria covers, *inter alia*, the following issues: electricity consumption (including electricity consumption rates), connection to the electricity grid, reliability of supply, infrastructure services, purchase of electricity, maintenance, and operation regime of private generation license holders.

The Electricity Sector Law states that the Electricity Authority will prescribe instructions with respect to payments that an essential service supplier license holder is to pay consumers due to violation of the Criteria which it prescribed. Accordingly, the Electricity Authority has determined in the Book of Criteria that an essential service supplier that violates one or more of the Criteria shall pay the consumer for this violation payment in accordance with that which has been prescribed by each of the Criteria that have been violated, within sixty (60) days of commission of the violation. In 2014, the Company paid consumers following cases of failure to fulfill the provisions of the Criteria, of various types (mainly for failing to meet the schedule prescribed in the Criteria for performing an action) relatively negligible amounts totaling approximately NIS 829 thousand.

21.1.3.2 The duty of the Company to submit Development Plans for the Electricity Sector

The Minister, upon consultation with the Electricity Authority, is allowed to demand that the Company, as a holder of an essential service supplier license, submit for his approval, in a manner and on a date as required, a Development Plan, complete or in parts, for the purpose of its activities in accordance with the provisions of the Licenses. The Minister, in consultation with the Electricity Authority, approved the plan. The Company, as a holder of an essential service supplier license, has to operate according to the approved plan. If it has not submitted a Development Plan for his approval, the Minister is allowed to prescribe for the Company, upon consultation with the Electricity Authority, a Development Plan, in which case it must act in accordance with it. See Sections 7.7, 8.6 and 9.7, for details on the Development Plan of the Company. Accordingly, the licenses of the Company state that a license holder that is an essential service supplier is to submit to the Minister a Development Plan with respect to its activity in accordance with the License.

In addition, in accordance with the Electricity Sector Law, the Minister, upon consulting the Electricity Authority, is allowed to establish regulations with respect to the responsibility of a transmission license holder for the development of the transmission system, in accordance with the Development Plan that has been approved in accordance with what was mentioned above, and in accordance with the planning of the transmission system by a system administration license holder. As of the date of the report, no such regulations have been prescribed.

21.1.3.3 Restrictions on the types of activities that the Company is allowed to execute

The Electricity Sector Law states that no essential service supplier license will be given except to a company that has undertaken to engage only in activities in accordance with the licenses that have been given to it pursuant to the Electricity Sector Law and ancillary actions. However, an essential service supplier license holder is allowed to engage in other actions, that the ministers have approved for it, upon consultation with the Electricity Authority, engagement in which will not impair its actions or the supervision of fulfillment of its duties in accordance with the Electricity Sector Law.

Accordingly, each of the licenses of the Company states the activity for which the License has been given and in which the Company is allowed to engage. In addition, the licenses of the Company state that the license holder is allowed to perform actions that are ancillary to the activities in accordance with the license, which

⁷⁷ The Book of Criteria is made available to the public on the website of the Electricity Authority, at the address: <http://www.pua.gov.il/31-339-he/Electricity.aspx>

are determined in the appendix to the License. In some of the licenses, certain ancillary actions require the approval of the Manager of the Electricity Administration.

Therefore, when the Company is going to engage in a related act that requires the approval of the Head of the Electricity Administration or in another activity that is not regulated within its licenses, the Company applies to the head or the ministers, respectively, for approval for this purpose.

21.1.3.4 Restrictions to the transfer, pledging or attachment of a license

In accordance with the Electricity Sector Law, a license or any part thereof may not be transferred, pledged or attached, directly or indirectly, except with the approval of the Minister. In addition, guarantees that a license holder and money stemming from their realization may not be pledged or attached. In addition, in accordance with the law, the Minister is allowed to determine in the License that certain properties of the license holder, which are required, in the opinion of the Minister, for the execution of the activity in accordance with the provisions of the License, may not be transferred, pledged or attached, directly or indirectly, except with the approval of the Minister. The Minister, upon giving approval for such a transfer, pledge or attachment, shall act in accordance with the policy of the government or the policy of the minister in the Electricity Sector field, and will consider, *inter alia* the contribution of giving of the License to the level of services to the public, the benefit of consumers and the contribution of giving of the License to competition in the Electricity Sector.

In accordance with the provisions of the Electricity Sector Law in accordance with the above, the licenses of the Company prohibit the pledging, transfer or attachment, directly or indirectly, of assets as stipulated in the licenses (which include most of the assets of the Company), except with the approval of the Minister. The General License also states that the Minister is allowed to add to or subtract from the list of assets that are in the appendix to the License, during the term of the License. The inclusion of or reference to an asset, in the appendix, does not serve to grant the license holder any right to the asset or detract from its duties with respect to it in accordance with the provisions in the Electricity Sector Law. In addition, the licenses state that if any third party is granted, as of the effective date of the License, rights with respect to any of the properties that are used for the provision of the activity of the license holder, the license holder shall ensure, to the maximum extent possible that no situation will occur in which the exercising of rights to a property as set forth may impair the execution of its undertakings in accordance with the License. See Section 14.3 and Note 1 f to the Financial Statements with respect to the Property Settlement.

In accordance with the provisions of the law and the licenses of the Company as stated, the Company is applying for the approval of the Minister for creating charges on its assets – whether a floating or fixed charge of assets that are included in the licenses of the Company as started.

In the past, the approvals that the Minister gave for the charges on the assets of the Company did not include special stipulations with respect to charge realization, but charge realization will require approval in accordance with the provisions of the law. With the Minister's approvals for charges provided to the Company, as of 2011, all the approvals for the floating charges over the assets of the Company that were given to the Company by the Minister, include restricting conditions, primarily as follows:

- No sale, transfer or rental of assets that are being used for carrying out activity in accordance with the Electricity Sector Law is to be made except to a party that is allowed pursuant to the law in Israel to engage in activity as stated using those same assets, which will receive its rights to and keep the assets for executing those activities, in accordance with licenses permitting their execution;
- The assets listed shall be kept at all times by a party that has a license to operate them in accordance with the Electricity Sector Law and shall be used at all times for the purposes of the licenses only;
- The appointment of a temporary or permanent receiver (in this section: the “**Receiver**”) shall be contingent to its undertakings to act in a manner that fulfills the duties of the Company, as they may be from time to time;
- The approval for creation of the charge does not constitute an approval to realize the rights conferred under the charge, including appointment of the Receiver;

- The identity of the Receiver requires prior approval of the Minister and his appointment will be contingent to further fulfillment of the duties in accordance with the licenses of the Company, including continuing the regular operation of the activities in accordance with the Electricity Sector Law, using the assets and facilities of the Company..
- The authorities that are granted to the Company by law as the license holder shall apply, *mutatis mutandis*, to another holder of the pledged assets.

The aforementioned approvals state that they do not detract from any other undertaking of the Company, including pursuant to other charge agreements, and do not establish priorities for other charges of the Company.

For details with respect to debt raisings by the Company during 2014 see Note 20 c to the Financial Statements.

21.1.3.5 Restrictions over change or reorganization in a license holder

The Electricity Sector Law states that the Minister is allowed to state in the License that a change or reorganization in the license holder, including merger, split of compromise, settlement or voluntary liquidation, requires the approval of the Minister. Accordingly, such a prohibition is prescribed in most of the licenses of the Company.

Beyond that detailed above, the Electricity Sector Law and the generation licenses of the Company state that control of a license holder shall be transferred, directly or indirectly, except with the approval of the Minister. In addition, a license holder shall not purchase or keep means of control of another license holder, and shall not control it in any other way, directly or indirectly, except with the approval of the Minister. In accordance with the Electricity Sector Law, the Minister is allowed to approve the transfer such control, as long as of the time of the transfer, the conditions that are required to give the License in accordance with the Electricity Sector Law are fulfilled as well.

The Conditions and Procedures for Granting Licenses Regulations state that the Minister is allowed to stipulate conditions of a license of an essential service supplier, such as a requirement for an organizational and legal structure of the license applicant or to the giving of an undertaking to make a structural change as mentioned and order a change of organizational and legal structure during the period of validity of the License. The Minister shall not order as stated until after having given the license holder notice, a reasonable time in advance, and an opportunity to voice its contentions before the Minister with respect to his instructions as stated. As of the date of the report, the licenses of the Company have not been made contingent upon any particular organizational or legal structure.

21.1.3.6 Execution of activity as a profit center, manner of preparation and submission of Financial Statements

For details with respect to execution of activity as profit centers, manner of arranging and submitting financial statements of the Company, see Note 1.b.2) to the Financial Statements of the Company.

In accordance with the decision of the Electricity Authority of January 15, 2015⁷⁸, by the middle of March, 2015, the Company has to submit to the Authority a schedule on its behalf for completion of the process of preparing a profit center report according to the requirements of the Company's licenses.

The issue of the financial reporting and managing the Company's operations according to profit centers constitutes a component in the Steering Team's recommendations draft which was formulated with regard to the structural change, and according to which the Company will act through profit centers that will enable full transparency and assignment of costs in a model that will be determined by the nature of the activity of the

⁷⁸ Decision no. 5 of Meeting no. 451 of January 15, 2015, regarding "Decision implementing reporting duties on the Israel Electric Corporation Ltd. - generation, delivery, distribution, supply segments and general reports".

Company. The issue of the profit centers is also referred to in the Yogev Letter, according to which the various activity sectors of the Company will be managed as separate audited profit centers.

In view of the above-mentioned, the Company estimates that this issue is supposed to be regulated as part of the Structural Change that will be agreed upon. Notwithstanding, and despite sanctions not being imposed on the Company in this matter as of the date of the report, the opinion of the management and the board of directors of the Company is that as long as the issue of reporting by profit centers is not resolved, there is exposure for the Company in the form of steps or proceedings that may be taken against the Company for failure to fulfill the provisions stipulated in its licenses. For details of the draft of recommendations of the Steering Team and the Yogev Letter with regard to reporting under profit center see Note 1 e to the Financial Statements.

21.1.3.7 The responsibility of the State of Israel within the framework of the licenses and the duties of the Company towards it

In accordance with the provisions of its licenses, the Company is committed to indemnifying the Company for payment that it is charged for an act or default of the Company, with respect to its activity in accordance with the License. In addition, the Company will bear all of the legal and other expenses of the State of Israel, to the extent that there are any for the charge. The duty of indemnification shall not apply unless the Company has been given, at a reasonable time, a notice of the claim that a third party filed against the State of Israel in order to allow it to participate in the defense and the State of Israel has consented to the participation of the Company in the legal proceeding. This duty of indemnification is not limited in time or amount.

In addition, in accordance with the terms of the licenses, any approval, permit or instruction that has been given to the Company for the purpose of or within the License, whether given before the giving of the License or given thereafter, shall not impose on the State of Israel any liability towards the Company or any third party and shall not serve as a cause of claim of the Company or a third party towards the State.

In addition, the authority of approval or supervision that is given in accordance with the License, including the exercising of such authority, does not impose on the State of Israel any liability that is imposed pursuant to the License on the Company, or negate or diminish from that liability.

21.1.4 Cancellation, suspension and change of the terms of the licenses

In accordance with the Electricity Sector Law and the provisions of the licenses of the Company, the Electricity Authority is allowed, at any time, to cancel or suspend a license, and it is allowed, with the approval of the Minister, to add or modify its conditions, rules and duties, if it has found that any of the conditions of the License has been violated, that any of the qualifications for receiving it is fulfilled or the capacity required for its possession by law has ceased to be fulfilled. In addition, in accordance with the Electricity Sector Law and the provisions of the generation licenses of the Company, the Minister or Electricity Authority is allowed (as prescribed in the License) to do so, based on considerations of the contribution of the License to the level of services to the public, the benefit of consumers or the contribution of the License to competition in the Electricity Sector. A cancellation or modification of the Electricity Sector with respect to the voiding of the terms in the License or the part of a condition shall only apply to the condition or part of the condition as relevant and they by themselves will not impair the binding validity of the License or detract from the duties of the Company in accordance with the License. The Electricity Authority shall not cancel or suspend a license unless the license holder has been given an opportunity to voice its contentions. In the case in which the License that have been given in accordance with the Electricity Sector Law has been cancelled, suspended or modified based on these considerations, the Ministers may prescribe rules for giving compensation to the license holder, but in accordance with the rules as determined, the compensation rate may be zero.

Although some of the generation licenses of the Company confer upon the Minister rather than to the Electricity Authority the authority to cancel, suspend or modify the terms of the License, in view of

Amendment No. 3 to the Electricity Sector Law⁷⁹ whereby the authorities of the Minister with respect to the giving of licenses and their regulation has been transferred to the Electricity Authority, including such authority, the instructions in these licenses are to be read as granting the authority to the Electricity Authority.

As of the date of the report, the licenses of the Company have not been suspended or cancelled and the Company has not received a notice that it is not fulfilling any of their conditions.

In addition to what has been stated above, the Electricity Authority is granted authority to cancel the validity of an essential service supplier license (after having warned the holder of this license), if it has learned that the essential service supplier license has not made the payments that are due (in accordance with the Electricity Sector Law or the terms of the License) to another license holder. The Company, except in exceptional cases and in circumstances that have not been under its control, (such as a strike), has made sure to pay other holders of licenses for activities in the Electricity Sector the payment that is due to the by law, on time and as required. In effect, the Company has not received any notice of intent to cancel the validity of a license that has been given to it and it estimates, in view of its function as an essential service supplier in the Electricity Sector, that even in the case of violation of the duty to pay another license holder a payment that is due to it by law, the likelihood for such a severe sanction of far-reaching consequences for the Electricity Sector to be enacted is very low.

The information with respect to the likelihood of enactment of sanctions in the case of violation of a duty of payment towards another license holder is forward looking information, as per its definition in the Securities Law, and is based on estimates of the Company in view of its status as an essential service supplier in the electricity economy. However, the future effects of the notice as stated may be affected by external factors that are not under the control of the Company.

In accordance with the Conditions and Procedures for Granting Licenses Regulations, the authority has been vested in the Minister⁸⁰ to demand by license the giving of guarantees or sureties for securing the fulfillment of the undertakings of the license holder to execute the activity pursuant to the License. Accordingly, in May 2007, the Electricity Authority announced its intent to establish in the permanent generation licenses, a duty to deposit a guarantee to secure the fulfillment of the terms of the licenses. In accordance with the resolution, the limit of the guarantee for a license holder shall not exceed a total amount of 15 million dollars. In accordance with the resolution set forth, the demand to extend guarantees for the generation licenses that have been given to the Company shall be executed in accordance with the progress in the Structural Change proceedings of the Company, including providing of licenses for the operations of the Company. As of the date of the report, the Company has not yet been requested to extend such a guarantee in effect.

21.1.5 Sanctions for execution of activity in accordance with the Electricity Sector Law without a license, for violation of the terms of the licenses and for violation of other duties of the Company in accordance with the Electricity Sector Law

The Electricity Sector Law states, inter alia. that the execution of the activity that is licensable in accordance with the Electricity Sector Law (including in the field of generation of electricity) without a license constitutes a criminal offense punishable by three (3) years' imprisonment or a fine that is four times the fine rate determined in Section 61(A)(3) of the Penal Code 1977 (hereafter: the "**Penal Code**") and an additional fine for each day that the offense continues, at four times the fine rate determined in Section 61c of the Penal Code.

In addition, the Electricity Sector Law states that a violator of the provisions of Sections 17(B) (dealing with the preparation of Financial Statements in accordance with the principles prescribed by the Ministers), 17(C) (dealing with the duty of collection of payments in accordance with the charge rates determined by the

⁷⁹ Dated April 11, 2005, which was made within the Economic Policy for the 2005 Fiscal Year Law (Legislation Amendments), 2005.

⁸⁰ Although in the Regulations, authority has been conferred upon the Minister, in accordance with Amendment No. 3 to the Electricity Sector Law, the authorities of the Minister with respect to the giving of licenses and control thereof have been transferred to the Electricity Authority, as stated above, and the regulations are considered to grant this authority to the Electricity Authority as a result.

Electricity Authority), 34 (dealing with accounting entry and reporting to the public requirements that will apply to a holder of an essential service supplier license, as determined by the Electricity Authority) or 35 (dealing with requiring the holder of an essential service supplier license to submit to the Electricity Authority reports and any information in accordance with its demands, for fulfilling its duties), or a license holder violating any of the terms of the License, with respect to the activity of the license holder, is liable for one (1) year's imprisonment or a fine of three (3) times the rate of the fine determined in Section 61(A)(2) of the Penal Code, and an additional fine for each day on which the offense has continued, at three times the rate of the fine determined in Section 61(C) of the Penal Code. In addition, in accordance with Section 65 of the Electricity Sector Law, this law is part of the list of laws specified in the first addendum to the Administrative Offenses Laws - 1985.

The Electricity Sector Law further states that the violator of the provisions of Section 17(A) (dealing with provision of service to the entire public without discrimination, according to the criteria set by the Authority, reliably and efficiently, according to the terms of the license and the law, purchase of electricity from a private producer and provision of infrastructure and Backup Services to a private producer, according to the terms of the license and the law, provision of Backup Services to a self-generation license holder according to its request, according to the terms of the license and the law, and ensuring the provision of all of its services throughout its license period, including provision of services in accordance with the development plan that was approved pursuant to Section 19, while performing all actions required for providing these services) is subject to three years' imprisonment or a fine that is four times the fine rate as stated in Section 61(A)(3) of the Penal Code and an additional fine for each day on which the offense continues, at four times the fine rate set forth in Section 61(C) of the Penal Code. In addition, the Electricity Sector Law states that an officer who has violated a duty to supervise and do everything possible to prevent violations of the law by the Company or any of its employees is punishable by one (1) year's imprisonment or a fine (as stated in Section 61(A)(3) of the Penal Code). The Electricity Sector Law states that if a violation of it has been committed by a corporation or any of its employees, it is presumed that the officer in the Company violated the duty of regulation, unless he proves that he acted without *mens rea* and without negligence and did everything he could to fulfill his duty.

21.1.6 Provisions of the Electricity Sector Law and the Resolutions of the Electricity Authority with respect to the electricity charge rate

In accordance with the provisions of the Electricity Sector Law, the Electricity Authority prescribes the electricity charge rate. As described above, most of the electricity consumers pay one weighted charge rate for electricity, which includes all segments of activity.

See Sections 7.11.1 and 8.9.1 for details on the principles for setting the charge rate and the manner of setting the electricity charge rate in each of the segments.

21.2 Contentions of the Company with respect to the electricity charge rate

In the view of the Company, the resolutions of the Electricity Authority on the matter of the charge rate do not provide full, adequate coverage for its costs. In its view, the non-recognition by the Electricity Authority, within the charge rate, of the costs that the Company has incurred on certain issues, leads to significant erosion of the revenues of the Company, which is estimated to be to the tune of billions of shekels. It is the position of the Electricity Authority, as delivered to the Company, that the electricity charge rate need not recognize all of the costs of the Company in accordance with its actual costs, if they are not required in the opinion of the Electricity Authority for discharging the duties of the Company as an essential service supplier.

For details of the gap between the revenues of the Company under the rate formula and the expenses of the Company under the Financial Statements, see section a.1.e) of the report of the Board of Directors.

The management of the Company and the Board of Directors are conducting an ongoing dialogue with the Electricity Authority in order to advance the discussions with respect to the issues under dispute pertaining to the electricity rate.

21.3 Resolutions of the Government and the Cabinet

In accordance with that which has been stated above, the operations of the Company are materially affected by the resolutions of the government, including on the issue of the Electricity Sector and because of its identity as a “government company” (see Section 21.5). During the years that have passed since the date the Electricity Sector Law was legislated, the Government of Israel and government entities adopted a number of resolutions and recommendations with respect to the Electricity Sector, some of which were later adopted as amendments to the Electricity Sector Law, and some were not adopted by the law and were not even implemented, because of various considerations, including the continued discussions between the Company and Government entities on the issue of the Structural Change and the sanctions of the employees with respect to these resolutions.

On October 5, 2014, the Ministerial Committee for Social and Economic Affairs (Socio-Economic Cabinet) (hereinafter: the “**Cabinet**”) approved a “Multi-annual Plan to Execute Issue of Minority Stakes in Government Companies” which was approved by the Government Resolution number 2093 of October 7, 2014 (hereinafter; the “**Decision**”). Within the Decision it was decided, inter alia, to approve a multi-annual plan to execute issue of minority stakes in government companies (hereinafter: the “**Plan**”), and to promote the creation of an appropriate legal infrastructure for executing the issue of minority stakes in government companies in order to implement the Plan. The Cabinet classified the Company as a company in which the State has an interest in maintaining long term government control. Accordingly, under the Plan outline, in 2017, subject to a Government decision to perform a structural change in the Company, as far as a decision will be reached, and minding the nature of the structural change that will be formulated, an issue of minority stakes of the Company will be executed at a total amount of up to 25% of the share capital of the Company (fully diluted). Additionally, within the Decision, the Cabinet instructed the Government Companies Authority to act so that the companies included in the Plan (including the Company) will distribute dividends to the State budget in a total amount of approximately NIS 500 million in each of the years 2015-2017, all subject to the progress of the privatization proceedings according to the timetables set and subject to the distribution analysis and permits required under the law, as amended, insofar as will be required.

21.4 Formation of a team of regulators to increase efficiency and coordinate the regulation of the Company

On May, 2009, pursuant to a Government resolution⁸¹, a team was established with the participation of the Director General of the Ministry of National Infrastructures, Energy and Water, the Budgets Commissioner in the Ministry of Finance, the Director General of the Companies Authority, the Manager of the Electricity Administration in the Ministry of National Infrastructures, Energy and Water, the Electricity Authority, the Superintendent of Wages and Employment Agreements and the Comptroller General at the Ministry of Finance or their representatives, headed by the Director of the Companies Authority (“**the Regulator Team**”). According to the Government Resolution of November 2010⁸², the Supervisor of the Capital Market or his representative and the Deputy Attorney general (economic-fiscal) or his representative were added to the team. The goals of the Regulator Team are, inter alia, increasing the coordination and transparency of the work of the entities supervising the Company, increasing the efficiency of the regulation and consultation budgets, and giving recommendations with respect to the manner and degree of regulation of the Company, including regulation of a fixed coordination procedure among the team members. The activity of the team is to focus on material issues of the operations of the Company, including in the field of pension, wages, actions permitted by law, in accordance with the authorities of the regulatory agencies of the State of Israel.

It was further decided to instruct the Regulator Team to act for an examination to be carried on its behalf in the following issues:

- 21.4.1 Return of surplus funds, insofar as exist, which were transferred by the Company to third parties (Central Pension Fund, or other accounts included in the Financial Statements of the Company, pertaining to pension and pension components and non-pension components).

⁸¹ Resolution No. 129: Increase of Competition in the Electricity Sector, dated May 12, 2009.

⁸² Government Resolution No. 2442: Establishing a Regulator Team for increasing the coordination and efficiency of the regulation of the Israel Electric Corporation Ltd., of November 18, 2010.

- 21.4.2 The manner of handling differences between the estimate of the Company's liability towards the insured in the Company's reports and the estimate of the liability in the Central pension Fund.
- 21.4.3 Risk management and dividing liability between the Company and the Central Pension Fund regarding the manner of management of the Fund's funds.
- 21.4.4 Examining the factors that led to errors in the pension items, in the Financial Statements of the Company for previous periods that were amended in the Financial Statements as of June 30, 2009. 21.4.5 The factors that cause delay in publication of the quarterly and annual financial statements of the Company.
- 21.4.6 Examining the aspects related to the Company's segregated account funds that are deposited in a trust account for payment of various Company liabilities with respect to wage components that are not included in the Central Pension Fund.
- 21.4.7 Regarding the issues mentioned above, especially in sections 21.4.4-21.4.6, insofar as the team will decide that coordination is required between the regulators and the Company, the Regulator Team will act through the Companies Authority. This, inter alia, in order to coordinate between the work carried out by the Regulator Team and additional tests and a process of drawing conclusions that will be conducted by the Board of Directors of the Company, and its committees, to locate the factors responsible for the stated issues. The team will submit an interim report to the Ministers within ninety (90) days. The date for submitting the final report will be set in the interim report.

On March 9, 2011, a draft interim agreement was forwarded for the comments of the Company, and its main points are:

- (a) Specific supervisory arrangements should be examined for decision making pertaining to actuarial assumptions that are included in the Company's financial statements.
- (b) The Company is required to provide explanations pertaining to the accounting principles, accounting alternatives and calculations performed concerning the creation of the accounting provision with respect to non-pension components in the amount of approximately NIS 2.2 billion in the statements of the Company (as of December 31, 2009), and it is necessary to examine if it is possible and right to transfer the sums deposited with respect to these components in the amount of approximately NIS 1.7 billion (as of December 31, 2009) from the trust account to the Company and if there is a restriction concerning the transfer to the Company.
- (c) The Company should provide explanations pertaining to the involvement of the Board of Directors of the Company and its representatives with the Board of Directors of the Fund.
- (d) The interface between the Board of Directors and the Management, the information flow and the oversight should be examined with regard to the decision making pertaining to the Fund.
- (e) The decisions in the Company and the tools at its disposal should be examined, regarding changes in the articles of the Fund that have implications, inter alia, on the deposits to the Fund, compared with what is customary worldwide, while taking into consideration the rate and cash flow coverage ability of the Company.
- (f) It is necessary to complete the comparison between the rights in the articles of the Fund of 2004 and the rights included in the pension liability calculation in the financial statements of the Company, and the rights included in the 1958 pension articles and components lawfully approved after 1958, including the rights included in the 1975 and 1996 pension agreements and the rights included in the labor and wages agreements of the Company.
- (g) The taxation arrangements concerning deposits in the Fund should be examined.
- (h) It is proposed to reexamine the significance of the assets arrangement under section 62 of the Electricity Sector Law, 1996, including in light of the existing legal and economic opinions on the subject and its implications during implementation of the structural change.
- (i) It is proposed that the team will establish rules under which each regulator will update the team with respect to the material information it has on behalf of the Company and with respect to events or decisions within its areas of responsibility that pertain to the Company, that may materially affect its conduct, and particularly insofar as these pertain to the areas of responsibility of other regulators.

The Company forwarded its comments to the draft, but as of the date of the report, no summary report had been received at the Company. The Company does not know if the team of regulators intends to produce a summary report.

Regarding the recommendation of the Regulator Team concerning the issue of a trust account of non-budgetary pension components, see note 13 of the Financial Statements.

21.5 Provisions of the Government Companies Law and status of the Company as a government company

21.5.1 As of the date of the report, the Company is a “government company” as per its definition in the Government Companies Law. As a government company, the Company is subject to the provisions of the Government Companies Law and the relevant regulations. Subsidiaries of the Company, which are government subsidiaries as defined in the provisions of the Government Companies Law are governed by most of the provisions of the Government Companies Law, with the modifications stated in Section 57 of the Government Companies Law.

21.5.2 According to the Government Companies Law⁸³, as long as the Company is a government company, the Government shall not invest in the Company except with the approval of the Knesset Finance Committee. In addition, the Government Companies Law determines a series of actions and decisions that require the approval of the Government (including a change in the objectives of the Company and granting rights, or obligation by the Company that may limit the Government, directly or indirectly, including with respect to executing structural changes and privatization, promoting competition and regulating the sector in which the Company operates), establishing companies, including an enterprise, and purchasing shares of companies and enterprises, as well as offering securities to the public under a prospectus.

21.5.3 The Government Companies Law includes a set of additional provisions regarding the conduct of the Government Company, including:

- (a) Provisions with respect to the business considerations under which a Government company should operate, except if the Government determined for it, with the approval of the Finance Committee, other operating considerations. As of the date of the report, other operating considerations have not been determined for the Company.
- (b) The need for approval by the Government Companies Authority with respect to the decision of the Board of Directors regarding the designation of the profits of the Company.
- (c) Provisions with respect to the duty of the Government Company to prepare financial statements, responsibility of the Board of Directors for preparation of the financial statements, and in companies with subsidiaries – consolidated financial statements as well as the need to attach an additional report to the financial statements, with respect to the effectiveness of the internal control over the financial reporting.

It should be noted that the Government Companies Regulations (Additional Report on Actions Taken and Representations Given to Ensure Correctness of the Financial Statements and the Report of the Board of Directors) - 2005, determine that government companies are required to attach to the Financial Statements an additional report with respect to the actions that have been taken and the representations that have been given to secure the correctness to the Financial Statements and the report of the Board of Directors, including separate signed declarations of any officer who has signed those reports. In addition, pursuant to that section, the Government Companies Regulations (Additional Reports of Effectiveness of Internal Control of Financial Statement), 2007, (in this section: the “**Government Companies Regulations**”) have been promulgated, whereby certain government companies, including the Company, have a duty to attach to the Financial Statements an additional statement with respect to the effectiveness of the internal control over financial reporting based on a customary control model, elaborating the material weaknesses, if any, and including signed declarations of each officer signing the reports or the Report of the Board of Directors, and

⁸³ Section 10 of the Government Companies Law.

a report of the independent auditor of the Company that will include his expert opinion on the effectiveness of the internal control of financial reporting in the Company and material weaknesses that he has identified based on a customary control model, including those that did not receive proper disclosure in the estimate of the Board of Directors and the management, as detailed in the additional report of the independent auditor.

In accordance with the Securities Regulations (Periodical and Immediate Statements) - 1970 (hereafter: the **"Reporting Regulations"**), the duty applies to all reporting corporations whose securities are listed for trading on the Tel Aviv Stock Exchange, to declare the effectiveness of their internal control over their financial reporting and disclosure.

Within the amendment of the Reporting Regulations of October 7, 2010, the Chairman of the Securities Authority was granted the authority in accordance with Sections 9B(F) and 38C(F) of the Reporting Regulations, to establish that a government company, which is also a reporting company in accordance with the Securities Law, which implements the Government Companies Authority Regulations, is to report the effectiveness of the internal control in the form prescribed in the Companies Authority Regulations.

The Company applied to the Chairman of the Securities Authority with a request for him to exercise his authority in order to establish that the Company, by definition as a government company that complies with all of the Government Companies Regulations, including those specified above, is to report the effectiveness of its internal control in the form prescribed in the Companies Authority Regulations.

In answer to the application of the Company, the Chairman of the Securities Authority decided on January 4, 2011, to grant its request for the reports of the Company with respect to the effectiveness of the internal control to be made out in the form prescribed in the provisions of the Government Companies Regulations, as long as the Company would comply with these instructions.

This arrangement is subject to the undertaking of the Company whereby on each statement date, the Company shall examine whether any changing event involving the set of facts that was shown before the staff of the Securities Authority in the applications of the Company has occurred and shall inform it of any such change. Within this undertaking, the Company shall examine changes in the provisions of the Regulations or the provisions of the Government Companies Regulations, changes in the status of the Company that affect the law applying to it, changes in the manner of implementation of the provisions of the Government Companies Regulations in the Company and any other relevant change.

As of the date of the report, the Company has complied with the stipulations that have been imposed upon it and has found no change in the Regulations or other relevant change.

Various differences exist between the Reporting Regulations and the Government Companies Regulations with respect to implementation of principles of internal control over financial reporting, including:

- (1) Under the Reporting Regulations, when determining the limits of the business processes, it is necessary to focus on the examination of the effectiveness of the internal control of processes that are defined as "highly material to the financial reporting" alone, and not on every material business process, whereas under the Government Companies Regulations, every material business process will be included when determining the limits of the business processes.
- (2) Under the Reporting Regulations, in the event that there is a "material weakness" that was not corrected in the year following the subsequent year, "the reports of the corporation will be considered not to have been prepared according to the law and it will not be possible to publish them". Nonetheless, under these regulations, the Secretary General of the Securities Authority is permitted to exempt a company and to approve publication of its reports, even if it has not met the requirement. There is no reference to this in the Government Companies Regulations.
- (3) Under the Reporting Regulations, a quarterly report on the issue will be attached, and it will provide disclosure of whether a change has occurred in the estimation of the effectiveness of the internal control over the financial reporting and the disclosure, as was presented in the previous reporting period. However, under the Government Companies Regulations, only an annual report will be attached, and the Quarterly Report of the Board of Directors will provide disclosure of whether a change has occurred in the estimation of the effectiveness of the internal control over the financial reporting and

the disclosure, as was presented in the report of the previous year. Despite the abovementioned, every quarter, the Company attaches a report of the Board of Directors and the Management with regard to the internal control of financial reporting.

For details of additional procedures the Company performs to ensure the correctness of the financial statements of the Company, including the establishment of a disclosure committee headed by the Company CEO, see section c. 6 c) of the Report of the Board of Directors.

Principles for preparing financial statements

Section 33A of the Government Companies Law determines that in addition to the provisions of any other law, the Minister of Finance is entitled to determine, in consultation with the Minister of Justice and, in the event of a public company, in consultation with the Securities Authority, in accordance with a proposal of the Companies Authority, principles for preparing financial statements of a Government company, that was defined by him as a company that provides essential service to the public.

By virtue of this provision, the Government Companies Regulations (Principles for Preparing Financial Statements of the Israel Electric Company Ltd.) (Temporary Order) - 2004 (hereafter: the "Financial Reporting Regulations") were enacted, according to which the Company prepares its Financial Statements in light of its being a government company, in addition to the Securities Regulations (Annual Financial Statements) – 2010, that apply to the Company by virtue of being a public company.

On May 22, 2012, the Minister of Finance signed a document extending the validity of the provisions of the Regulations of Financial Reporting, including their amendments, up to December 31, 2014, and the extension of the regulations was published in the Official Gazette on May 30, 2012. Accordingly, for the reporting periods commencing on January 1, 2015, the Company fully implements the International Financial Reporting Standards ("IFRS"). For details with respect to the transition by the Company to reporting under the IFRS principles, see Notes 2a and 36 to the Financial Statements.

The Financial Reporting Regulations which applied with respect to the reporting periods included in this report determined that the financial statements of the Company will be prepared according to the IFRS, subject to two exceptions:

- (1) The Company will prepare its Financial Statements with adjustment for changes in the general purchasing power of New Israeli Shekels (NIS) (according to the rules established in Opinion No. 36, including the provisions set in Opinions Nos. 40, 50 and 56, of the Institute of Certified Public Accountants in Israel) (the "Opinion").
- (2) The Company is a regulated company and therefore, prepares its Financial Statements under the principles of the US Financial Accounting Standards Board (FASB) as listed in Chapter RE6 with respect to regulated activities, in the combined version of the standards of said Board, including revisions, clarifications or additions to these principles, as they were from time to time. For additional details see Note 2a2) to the Financial Statements. For details of standard IFRS 14 that deals with regulatory assets and liabilities and that will apply to annual reporting periods beginning from January 1, 2016 or later, see Note 2z4) to the Financial Statements.

Section 33B of the Government Companies Law determines that should the Companies Authority perceive that the public interest so requires, it is permitted to instruct a Government company as to the manner in which to present details in its financial statements, or in any other report that the Company is required to submit pursuant to any law, provided that the instructions covering this matter are not determined in the rules, laws or generally accepted accounting principles or generally accepted reporting principles; and if the Authority disagreed with the manner of presenting details in the financial statements or any other report the Company is required to submit by law, it is permitted, should it perceive that the public interest so requires, to instruct the Company to disclose the position of the Companies Authority and describe the dispute in the reports, to the Authority's satisfaction. Section 33C of the Government Companies Law authorizes the District Court of Law, at the request of the Companies Authority, to order a company and the officeholders of a company that did not act in accordance with the provisions of sections 33A and 33B or that submitted a report not in accordance with the provisions of the stated sections, or did not amend such a report within the time instructed to do so by the Authority or by an employee authorized by it to do so, or did not submit an explanation, details, knowledge or documents concerning the details included in the report under section 33B that satisfied the Authority or the Government, to submit the report or amend it within the time set by the court. Additionally, section 33D of the Government Companies Law determines the sanctions that the

Government Authority may impose on the Chairman of the Board of Directors and the CEO of a Government Company that did not submit reports as required by the Government Companies Law.

For additional details, and instructions provided by the Companies Authority to a company with respect to the manner of presenting details, see Note 39 to the Financial Statements.

In the Financial Reporting Regulations, it is determined that if a Company has not implemented the instructions of the Government Companies Authority, the Company shall not prepare the financial statements in accordance with the instructions determined in the Opinion, as defined in the regulations. The "Instructions of the Authority" are defined in these regulations as "Instructions by the Authority under section 33B to the law that were given to a company on March 2, 2004 and on September 14, 2004, as well as additional instructions under the aforesaid section with respect to the operations of the Company, as will be given from time to time".

As of the date of the Report, to the best of the Company's knowledge, the Company is implementing the instructions of the Government Companies Authority as aforesaid, as far as they apply to it.

- (d) Regulating the function of the Government Companies Authority with respect to the issues relating to Government Companies⁸⁴, including permission that the Government Companies Authority may send to any board meeting of a government company a representative on its behalf. The representative of the Companies Authority in such a meeting is as that of a director, except that his voice is not to be counted in the quorum and that he has no voting right.
- (e) Provisions regarding directors, their competence and manner of their appointment to the Board of Directors of a Government Company, his duties and manner of his work.
- (f) Provisions regarding CEO of a Government Company and the manner of his appointment.
- (g) Provisions with respect to office holders with special duties in a Government Company, appointing a representative of the State in a general meeting of the company by the Ministers, choosing senior officials, employing family relatives, the duty of adequate representation for various sectors among the Company's employees, and the duty to deliver information to the public and the Government Companies Authority.
- (h) Provisions with respect to settlement of disputes between Government Companies regarding infrastructures.

21.5.4 In accordance with Section 55 of the Government Companies Law, the Companies Authority is allowed (including anyone the Authority authorized to do so according to the rules set by the Minister of Finance, according to the Authority's proposal), for the purpose of the discharge of its duty, to demand of a government company and of a director on behalf of the state, of the Chief Executive Officer of a government company, and through him, of any person who works at the Company or is employed in its ranks, information and material on the matters of a government company, and is allowed to inspect records and documents of such a company.

21.5.5 In accordance with the Government Company Regulations (Rules of Authorization of an Inspector by the Authority), 2005, if the Companies Authority decides, for the purpose of discharge of its duty, to execute an inspection, it is allowed to authorize an inspector to inspect the records and documents of the Company, and demand of the Company, or of the persons enumerated in section 21.5.4 above, information and material on the affairs of the Company. An inspector shall be of an appropriate profession, as relevant, including an advocate, accountant, appraiser and economic consultant, in accordance with the conditions prescribed in these regulations. The Government Companies Authority used these powers in 2008 and 2009.

21.5.6 For details regarding the rules for preparation of Financial Statements by Government Companies see Notes 2.a.1, 38 and 39 to the Annual Financial Statements.

21.5.7 On November 10, 2014, the Government Companies Law (Amendment 31) (Public Government Company) Bill, 2014, was published in the Official Gazette. The Bill proposes to add to the Government Companies Law a

⁸⁴ Section 27 of the Government Companies Law.

definition of a “Public Government Company” which is a Government Company that is a Public Company as defined in the Companies Law, whose shares are traded in the Israeli Stock Exchange and at least 25% of its shares were offered to the public under a prospectus. It is proposed that a decision of such a Public Government Company regarding the establishment of a company or purchasing shares in an existing company will not require Government approval, provided the company notified the Authority and the Ministers of its intention to establish a company or purchase shares as stated, and the Authority or one of the Ministers (the Minister of Finance or the Minister set to be responsible for the affairs of the company) did not notify that the decision requires Government approval. Additionally, it is proposed that the Government, according to the Authority’s recommendation, will be permitted to determine that the provisions of the Government Companies Law will not apply, in full or in part, or will apply with changes, to a Government subsidiary, of whom more than half of its voting power in its general meetings or the right to appoint more than half of its directors lies with a Public Government Company, provided that the Public Government Company, alone or together with other Government Companies or Government subsidiaries, does not have more than 65% of the stated voting power or the right to appoint more than 65% of the number of directors as stated.

It is noted that within the framework of the stated bill, it is proposed to set a provision under which a Government Company CEO will be appointed for a period not exceeding five years which may be extended by the Board of Directors of the company by one additional period only, that will not exceed five years. A CEO whose term of office has ended may be appointed for one additional term of office that will not exceed five years. The bill includes a transitory provision regarding a serving CEO, under which his term of office will end at the end of the latest of: (1) five years in office; or (2) two years from the date of application. Additionally, according to the transitory provisions, the Board of Directors of a company may extend the term of his office in accordance with the provisions of the Government Companies Law, provided that his comprehensive term of office does not exceed 15 years.

21.6 Laws, regulations and other orders applying to the Company as a government company

21.6.1 The State Comptroller and the Public Complaints Commissioner

(A) The State Comptroller

The State Comptroller Law - 1958 [Consolidated Version] (hereafter: the “**State Comptroller Law**”) subjects any “audited entity” (as per its definition in the State Comptroller Law), and states, *inter alia*, that: any government company is an audited body that will be subject to the scrutiny of the State Comptroller; an audited body is subject to various instructions to serve documents and information and assumes a duty to appoint a team to rectify the deficiencies and make resolutions found in an audit; by law, a person may file a complaint to the Public Ombudsman against an audited body and the Ombudsman may, in the case of finding the complaint to be justified, indicate the need to correct the deficiency and the way and time to do so.

Reports of the State Comptroller in 2014:

On May 15, 2014, two reports were published by the State Comptroller:

- 1) A report on the subject of establishing a comprehensive computerization system (ERP) - in which the Company’s project for establishing a comprehensive computerization system that the Company had begun in 2002 was being examined.
- 2) Report on the subject of foreigners that cannot be expelled from Israel - in which various aspects of the treatment of this issue by Government authorities and the Electric Company were examined.

The Company established a team to prepare a plan to correct the faults raised in the report of the State Comptroller. The plan was approved by the Board of Directors of the Company and was sent to the Government Companies Authority and the State Comptroller’s office.

On October 29, 2014, the Annual State Comptroller's Report no. 65 A was published, and it includes an examination of two issues pertaining to the Company:

- 1) Promoting energy saving - the report does not point out any fault or finding that requires correction by the Company. The Board of Directors has therefore determined that there is no need to establish a team to correct faults with regard to this report.
- 2) Employing relatives and appointments in government companies - the Company has established a team headed by the CEO to prepare a plan to correct the faults mentioned in the report. The plan was approved by the Board of Directors of the Company and was sent to the Government Companies Authority and the State Comptroller's office.

On December 29, 2014, the State Comptroller's reports on inspection in local authorities were published, and they include examination of two issues pertaining to the Company:

- 1) Report on the issue of the treatment by local authorities and private owners of non-ionizing radiation in educational institutions.
- 2) Report on the issue of street lights in local authorities.

The Company has established a team headed by the CEO to prepare a plan to correct the faults mentioned in the reports.

The plan was approved by the Board of Directors of the Company and sent to the Government Companies Authority and the Office of the State Comptroller.

(B) The Public Complaints Commissioner

In accordance with the State Comptroller Law, the Public Complaints Commissioner is allowed to adjudicate complaints against the Company in its capacity, as determined, as an "audited body", owing to an act or default or delay in an action that directly harms the complainant himself, or that denies him directly a benefit, when the complainant has received, to the satisfaction of the Public Complaints Commissioner, the consent of that person to file a complaint on his matter. The findings of the Public Complaints Commissioner with respect to the inquiry made and his recommendations to correct deficiencies are forwarded to the audited body.

The public complaints commission in the Company is responsible for processing complaints and objections of the customers of the Company and the contact with the State Comptroller on this matter.

21.6.2 Provisions and other legislation applying to the Company as a government company

Beyond that detailed above, additional rules, regulations and orders apply to the Company as a Government Company, inter alia as detailed below: The Freedom of Information Law - 1998, under which every Israeli citizen or resident has a right to receive information from a public authority, inter alia, from the Company (but subject to the restrictions determined in the law); The Budget Foundations Law - 1985, under which, inter alia, the Company is restricted, as a "budgeted body" it can agree to changes in salary conditions, retirement conditions or pension - or other financial benefits related to work; the Equal Rights for Women Law - 1951, according to which the Company has to give adequate expression, in the circumstances of the matter, to the representation of women; the Obligation for Tenders Law - 1992 ("**the Obligation for Tenders Law**"), and the regulations promulgated under it, states, inter alia, that a Government Company and a Government subsidiary shall not execute a contract for executing a business arrangement involving goods or land, or for the execution of work, or for the purchase of services, except in accordance with a public tender that gives any person an equal opportunity to participate therein (subject to exceptions determined in the Obligation for Tenders Law and its Regulations); the Internal Audit Law that obliges the execution of an internal audit by an internal auditor (for details of the internal auditor of the Company see section C.4 to the Report of the Board of Directors), 1992, and the Law for the Arrangement of Security in Public Bodies - 1998.

In addition, as a government company, the Company has additional duties pursuant to other laws applying to public bodies, such as the Equal Rights for Persons with Handicaps Law - 1988, the Antitrust Law – 1988, the Law for Increased Enforcement of Labor Laws - 2011 and Chapter F1 to the Government Companies Law relating to adequate representation of government company employees.

In addition, as a Government Company, the Company is subject to the directives of the Attorney General of the Government with respect to settlement of legal disputes between Government companies and the State⁸⁵, under which a Government company should make every effort to settle such a dispute without submitting an action to court. According to the directive, a Government company that did not succeed in settling the dispute in another manner and wishes to submit an action should notify the General Director of the Government Companies Authority of this and he will act to settle the dispute outside the court, in ways detailed in the directive. If the dispute is not settled within a reasonable period of time, the General Director of the Government Companies Authority will refer the dispute to be handled by the Attorney General or whoever he authorizes to do so. If the dispute is not settled within a reasonable period of time, the Attorney General will provide the parties with his opinion as to how they should continue to act.

21.7 Quality control and quality assurance

21.7.1 Quality control - Within the organization, quality and quality assurance branch of the Company, there is a quality control sector, whose functions are as follows: conducting quality control of products that are purchased by the Company including: preparation of quality requirements in the product specifications that are attached to the purchase requirements; examining the suitability of the product to the requirements at the manufacturing stages of the product until its receipt at the Company; participation in the processing of products in which a failure has occurred during the warranty period.

21.7.2 Quality assurance - the units of the Company are certified under the 2008 standard: ISO9001. Some units of the Company implement a combined management system in accordance with the requirements of various standards (ISO9001 (quality management system), ISO14001 (environmental management system), OHSAS18001 (system for the management of safety and health in the work place) or SI 9301 (system for the management of safety and quality of the land transportation and transport), as well as an information security management system according to the ISO/IEC 27001 standard.

An accelerated process is underway for the certification of the Company's relevant units for the ISO 14001 standard and the OHSAS 18001 standard.

The certification for the said standards are voluntary and are not currently required by law.

In addition to the certificates indicated above, some of the laboratories of the Company are certified for the ISO / IEC 17025 standard (general requirements for the adequacy of laboratory tests and calibration), and some of the laboratories of the Electric Company are required by law to be authorized to the above mentioned standard, or for the legal recognition of the correctness of the results arrived at by measurements carried out at premises of customers of the Company.

21.8 Planning and construction

The construction of all of the facilities of the Company is carried out in accordance with construction permits that are issued pursuant to the provisions of the Planning and Construction Law, the construction of overhead electricity grid facilities as per its definition in the Planning and Construction Regulations (Regulation of Transmission, Distribution and Supply of Electricity), 1998, which is carried out in accordance with the authorizations given pursuant to these regulations and according to the Planning and Construction Law.

⁸⁵ Directive no. 6.1201 – Settling disputes concerning civil matters between the State and public corporations or Government Companies and directive 6.1202 – Settling disputes concerning civil matters between a Government Company and another Government body.

If it is found that the Company has any construction works, which require such a permit, have not been performed in the past as required by law, the Company acts before the relevant authorities to receive permits for working by law. Working without a permit exposes the Company to criminal proceedings against it and against its executives, as well as a demand for demolition of the illegal construction, in accordance with the Planning and Construction Law and its proceedings.

In accordance with the provisions of the National Planning and Construction Council, for the purpose of construction of 400 kV lines, national outline plans are required. The preparation of the outline plans, as well as the procedural processes for their approval, are carried out in accordance with the provisions of the Planning and Construction Law.

In accordance with the Planning and Construction Law, a land rights holder is allowed to submit against the local committee to whose jurisdiction an outline plan applies a claim for compensation for decrease in value of the land, not by way of expropriation, as a result of the approval of the plan. For certain outline plans, the Company has undertaken to indemnify the local committees in whose jurisdiction these plans apply to the full amounts that the committees would have to pay to the affected landowners, subject to and in accordance with the provisions in the text of the indemnification statement (except one plan in which the burden of compensation will be shared among the institutional bodies involved in the plan). Appeals have been submitted against the local committees to the relevant appellate committees that deal with decrease in value. In accordance with the provisions of the indemnification statements, the Company was enrolled in the appeals as a party that might be harmed by their acceptance (see also Note 34B 8 to the Annual Financial Statements). In the statements of indemnification themselves, or in the indemnification clauses in the plan, no amounts are indicated, but rather the indemnification is 100% or another rate out of the amount of the appeal that has been filed against the local committee. The total claims are stipulated in the Financial Statements and are updated from time to time. For additional details with respect to planning and construction see sections 7.12.8 and Note 34.b.8 to the Financial Statements.

21.9 Business licensing

- 21.9.1 In accordance with the Business Licensing Law, the Company is required to receive a business license for about 203 licensable items out of those stipulated in the Business Licensing Order, including, *inter alia*, power stations, fuel stations, dining rooms and other sites. The operation of the sites of the Company without a business license constitutes a violation of the Business Licensing Law and may lead to the termination of the activity of the business. As of the date of the report, most generation units in the generation segment themselves have business licenses, which are updated or renewed from time to time.
- 21.9.2 As of the date of the report, the Company has a license for about 41% of these items only and applications have been prepared or submitted for about 57% of the total items, and handling has not yet begun for approximately 2%. The Company is acting to regulate a business license for items that require a business license at the sites and facilities of the Company, in accordance with the Business Licensing Law and pursuant to an internal procedure of the Company on the issue. Regulation of the issue of licensing requires compliance with the requirements of the fire brigade, in accordance with the most current standards, whose cost for regulation in 2015 may reach approximately NIS forty million for each of the sites (most of the works with respect to firefighting). From time to time the Company receives warnings for activity without business licensing and in the past indictments have even been filed against the Company and its employees. As of the date of the report, there are no indictments against the Company. A few warnings that were received by the Company are being dealt with at present in order to remove them.
- 21.9.3 The Company has received conditions from the Ministry of Environmental Protection for granting a business license for the generation units of the Company, and the Company is acting to fulfill the conditions of the Ministry as part of fulfilling the conditions of the business licenses.

See Sections 7.12, 8.8 and 9.10 with respect to environmental conditions within business licenses.

For additional details with respect to business licensing see sections 7.12.11, 7.12.12 and 20.3.

21.10 Antitrust

Pursuant to his authority under the Antitrust Law 1988 (“**the Antitrust Law**”), on January 5, 1999, the Antitrust Commissioner (“**the Commissioner**”) declared the Company to have a monopoly in the fields of electricity supply (generation and sale of electricity), electricity transmission and distribution and provision of Backup Services for electricity consumers and producers. The status of the Company as a monopoly derives from the definition of “monopoly” under the Antitrust law and it is therefore valid as long as the Company holds more than half of the electricity supply and service provision in the stated fields.

- 21.10.1 The statutory tools prescribed in the Antitrust Law grant the Commissioner, *inter alia*, the power to apply to the antitrust tribunal and request to instruct a monopoly to sell an asset it holds in order to prevent damage or concern of significant damage to business competition or to the public, the authority to intervene in the operations of the Company that may harm the public or impair competition, by giving instructions to the Company on the steps that it must take to prevent such harm and, starting in May 2012, the authority to impose financial penalties in a maximum amount of NIS 24 million with respect to competition inhibiting activities, such as abuse of a monopoly status. With respect to activities such as this, there already exists at present a criminal offense in the Antitrust Law. In addition, the law grants the Commissioner the authority to apply to the Antitrust Tribunal (“**the Tribunal**”) with a request to separate the monopoly into two or more separate business corporations, upon the existence of the circumstances set in the law.
- 21.10.2 On May 4, 1999, the Company filed an appeal with the Tribunal against the decision of the Commissioner with respect to the declaration, following which the Company reached (on March 19, 2001) an agreement with the Commissioner, which received the validity of a verdict, as follows:
- (A) The Company has a monopoly in the Electricity Sector, which includes, *inter alia*, the following components: supply of electricity – generation and sale of electricity, transmission and distribution of electricity, provision of Backup Services to electricity consumers and producers.
 - (B) The provisions of Chapter D to the Antitrust Law (on monopoly issues) apply to the Company as a monopoly holder, both in the Electricity Sector altogether and with respect to each of its segments, in accordance with that which has been set forth in Section A above.

Through the date of publication of this report, the declaration of the Company as a monopoly had no material effect over the activity, profitability or financial state of the Company. Notwithstanding, in view of the existing level of control over the Company, on the part of the Electricity Authority and other authorities, and in view of the Structural Changes that are required pursuant to the provisions of the Electricity Sector Law insofar as will be implemented as it is (see Note 1 e to the Financial Statements), including the incorporation of generation units within separate subsidiaries, and in light of the hearing held by the Commissioner regarding the letter of the Antitrust Authority (see section 7.1.3), the Company cannot assess what the future implications of this declaration over the operations of the Company, its profitability and financial status will be although this may have material consequences

Taking into account the declaration for the Company as a monopoly, the clauses preventing private electricity producers from selling electricity to others were not included in agreements of the Company with electricity producers.

In addition to the foregoing, the Company is subject to the aggregate of the provisions of the Antitrust Law, including with respect to binding arrangements and mergers. The Company is implementing an internal enforcement plan on the issue of antitrust. The enforcement plan is intended to prevent in advance, to the extent possible, a violation of the Antitrust Law, and minimize the damage of violations that have occurred. In effect, a Corporation procedure has been disseminated, and is in effect as of the time of the report, for prescribing principles and courses of action, including: responsibility, establishing the internal enforcement officer as the supreme professional authority on antitrust issues, appointment of a national internal enforcement team and unit internal enforcement teams, procedures and their approval, dealing with cases of violations of law or fear of such violation, keeping of documents, contacts with outside parties, instructing, auditing and reporting with respect to internal enforcement on antitrust. The procedure imposes responsibility

on each Vice President to fulfill the provisions of the Law and the procedure in the units that answer to him directly and imposes responsibility on each branch / district manager to fulfill the provisions of the Law and the procedure within his responsibilities.

21.11 Law for Promoting Competition and Reducing Centralization

On December 11, 2013, the Law of Centralization was published. Chapter B of the law deals with weighing pan-economy centralization considerations and sectorial competition considerations when allocating rights. Within the law, a “committee for reducing centralization” was appointed, and its members are the General Director of the Antitrust Authority (as Chairman of the Committee), the Director General of the Ministry of Finance or head of division of the Ministry of Finance, and the head of the National Council of Economics or one of his deputies.

The Law of Centralization may have a principal significance for the Company in light of the fact that the Committee determined in light of the law that the Company is a centralistic factor, as defined in the Law of Centralization, , due to it being a significant real corporation under the definition in section 4 of the law, and because the scope of its accumulated activity in an area of essential infrastructure (as this term is defined by law), exceeds half of the total activity in that field.

The definition of the Company as a centralistic power may affect the Company as detailed below:

21.1.1 Allocation of rights, as well as renewal or extension of rights granted to the Company - according to the provisions of the Law of Centralization, every factor authorized to allocate, renew or extend a right (right meaning license, contract or holding of a significant rate as defined by law) in a field of essential infrastructure should consider pan-economy centralization considerations when allocating the right. The allocating regulator is permitted not to allocate it to a centralistic factor. If it wishes to allocate it to a centralistic factor or to enable a centralistic factor to participate in the process of allocation, it must first consult with the committee for reducing centralization. Additionally, Part C of Chapter B of the Law of Centralization requires the regulator to consider considerations of promoting sectorial competition when allocating certain rights. In addition, if the allocated right will be included in a list published by the Commissioner of the Antitrust Authority, he will have to consult with him prior to the allocation. Regarding Part C the definition of “right” includes in addition to the aforesaid a license in a field of activity that is not an essential infrastructure if the number of operators in that field is inherently limited.

21.1.2 Extending the Company’s operation to an additional essential infrastructure field by process under the Government Companies law - the Law of Centralization requires to weigh pan-economy centralization considerations when reaching a Government resolution that enables a Government Company that is a centralistic factor to operate in an additional essential infrastructure field. Under the law, the Government Companies Authority has to consult with the committee for reducing centralization prior to formulating its opinion for the Government in this manner.

Furthermore, since the Company is a Government Company, the Law of Centralization affects the Company as detailed below:

21.1.3 Allocation of an essential infrastructure right by the Company - according to the Law of Centralization, insofar as a Government Company wishes to enter an agreement with a third party for executing an activity that is one of the essential infrastructure fields, this is a process of allocating a right by the Company. In this situation, the tender committee of the Government Company, as an allocating factor, must weigh pan-economy centralization considerations in the process of allocation. Accordingly, the Government Company is permitted not to allocate the right to a centralistic factor. If the Government Company wishes to allocate the right to a centralistic factor, it must first consult with the committee for reducing centralization. Additionally, under Part C of Chapter B of the Law of Centralization, the tender committee will be required to consider considerations of promoting sectorial competition when allocating those rights. In addition, if the allocated right will be included in a list published by the Commissioner of the Antitrust Authority, it will have to consult with him prior to the allocation.

21.11.4 Privatization of a Government Company - when formulating a decision to privatize a Government Company (as defined in section 1 of the Government Companies Law), the Government Companies Authority will consult with the committee for reducing centralization before formulating its opinion or a memorandum on its behalf, under section 59B of the Government Companies Law, regarding the possibility of allocating rights in a Government Company to a centralistic factor and regarding the terms for this, and regarding the definition of the centralization considerations as an essential interest. In addition, under Part C of Chapter B of the Law of Centralization, as part of the stated opinion, the Government Companies Authority will consider considerations of promoting the sectorial competition. In addition, if the allocated right will be included in a list published by the Commissioner of the Antitrust Authority, it will have to consult with him prior to the allocation.

22. Material agreements

The agreements that have been described below are material agreements that are outside of the ordinary course of business of the Company that are not elaborated in other sections in this chapter.

22.1 For details of the agreement of the founders for establishment of the IBC Company and of the agreement to grant right of use and services which was signed between the Company and IBC, see section 25.3(f).

22.2 Agreement for the construction of a desalination facility at the Orot Rabin site

For details with respect to the agreement for the construction of a desalination facility at the Orot Rabin site see Note 33 b (1)c) to the Financial Statements.

22.3 State guarantee for debentures Series 24 and Series 25 and for loan agreements of the Company

Between 2011 and 2012, significant disruptions occurred in the supply of natural gas to the Company, which led to a significant surcharge to the costs of fuels required in the production of electricity, and a very material cash flow burden on the Company. In light of the above mentioned, in 2012-2013 the Company entered a contractual engagement with the State of Israel in a number of agreements to provide guarantee, according to which the State of Israel provided the Company with guarantees for debentures raised by the Company and for loans taken by the Company from banking corporations, whose total principal amount that has not yet been repaid is NIS 5.5 billion. The engagement of the Company with the State in agreements to provide guarantee were approved by the audit committee and the Board of Directors of the Company in accordance with the provisions of Section 275 of the Companies Law and Regulation 1(6) of the Companies Regulations (Exemptions in Transactions with Interested Parties), 2000.

The stated guarantee agreements include provisions with respect to the State's entitlement to receive information from the Company, the approvals that need to be obtained from the State for making changes to the terms of the debentures (or of the loan agreements – as appropriate) and the guarantee provision fees that are payable to the State by the Company for the provision of the guarantee.

Furthermore, the Guarantee Agreements stipulate that, if the guarantee is forfeited, in whole or in part, or a payment is made by the State in lieu of the Company to the holders of the debentures (or, as appropriate, to the lenders), the amount of the guarantee forfeited as above and/or the amount paid by the State shall be deemed as a loan that has been extended to the Company by the State on the date of forfeiture of the guarantee or of the payment of such amount. Such loan shall be repaid by the Company to the State with the addition of interest, as set out in each of the Guarantee Agreements.

To secure the repayment of the Company's liabilities to the State in the event of the forfeiture of a guarantee or payment by the State in lieu of the forfeiture of a guarantee, under any of the Guarantee Agreements, the Company has registered, in respect of each of the Guarantee Agreements, a floating charge in favor of the State on all of the Company's assets, ranking *pari passu* to the registered pledges that existed on the date of registration of the aforesaid charge, in accordance with the debenture that was issued by the Company.

23. Legal proceedings

A breakdown of material legal proceedings⁸⁶ that the Company is a party to, as of the time of the report:

23.1 Pending actions

23.1.1 Class actions

See Note 34 B-1 to the Financial Statements for information on class actions.

23.1.2 Derived actions

See Note 34 B-4 to the Financial Statements for information on derived actions.

23.1.3 Pending proceedings

Pending proceedings that are not stated in Note 34 to the Financial Statements, in which the Company is the plaintiff in the proceeding, follow below.

- (A) On October 20, 2010, the Company filed a declaratory action, at the Tel Aviv - Jaffa District Court against the Tel Aviv Municipal Council (in this section: **"Municipal Council"**) with respect to land that the Company is leasing from the municipal council of a total area of tens of thousands of square meters, and various buildings that serve the Company are built on them. The lease contracts with the Municipal Council are for a period of 60 years (that ended on August 31, 2010) and with a right to extend the lease period by 49 years more (**"Option"** and **"Additional Lease Period"**, respectively).

On June 17, 2010, the Municipal Council delivered a "lessee guide" to the Company, which detailed the conditions that the Municipal Council set for exercising the right to extend the lease period as stated.

Within the lessee guide it was determined, inter alia, that the lessee has to pay the Municipal Council 91% of the value of the land for exercise of the option (if the lessee will choose to pay the Municipal Council capitalized lease fees for every 49 years, in advance) or 29% of the value of the land for every 7 years (if the lessee will choose to pay the Municipal Council lease fees every 7 years, in advance), and that at the end of the Additional Lease Period the leasehold will be returned to the possession of the Municipal Council, including all that is built on it and planted in it, and the lessee will not be entitled to any consideration from the Municipal Council.

As part of the action that was filed against the Municipal Council, the Court was requested to declare, inter alia, that the conditions that were prescribed by the municipal council in the lessee guide are depriving, unfair, illogical and contravene the original lease contracts that were signed between the parties and the intent of the parties and are therefore void.

On December 24, 2010, the municipal council filed a statement of defense on its part, in which it denied the contentions raised in the statement of claim and contended that the action must be dismissed. On September 12, 2011, a pretrial hearing was held, and the parties told the court that they might reach an arrangement that will make the need for hearing the claim unnecessary, without deciding as to the main point under dispute. In order to enable the parties to hold discussions as stated, the Court scheduled the case for a reminder with the presence of the parties on January 24, 2012.

On December 6, 2011, the municipal council sent the Company a proposal for an interim arrangement (**"the Municipal Council Interim Arrangement Proposal"**), for the period from the date of signing the new lease contract until the date of receipt of a final ruling in the matter.

According to the Municipal Council Interim Arrangement Proposal, the Electric Company will pay lease fees under one of the following alternatives: a sum equal to 20.3% of the value of the land for the first seven years of the Additional Lease Period; or, alternatively, a sum equal to 63.7% of the value of the land for all the lease period (49 years).

⁸⁶ This section includes legal proceedings that are class actions and pecuniary actions in an amount in excess of NIS 100 million.

In order to exhaust the negotiations held between the parties as stated, the parties submitted requests to postpone the pretrial hearing date of the case (that was set, as stated, to November 10, 2013). These requests were accepted and the pretrial hearing is scheduled for May 4, 2014. This hearing did not take place and it was postponed by agreement between the parties. A new date has not been scheduled.

It should be noted that within a united claim submitted against the Municipal Council for the same cause of action, some lessees filed with the District Court an application for stay of proceedings of the eviction claims that were filed against them by the Municipal Council with the Magistrate's Court of Tel Aviv - Jaffa.

On October 15, 2013, the Court's decision was given, denying the application for stay of proceedings because, *inter alia*, the Court was of the opinion that a situation in which lessees use land without paying lease fees to the Municipal Council should not be enabled, and since the interim arrangement proposed by the Municipal Council is a correct and just arrangement for clarifying the issue. An application for leave to appeal the decision that was filed with the Supreme Court was also denied. As of today a new date for a hearing in court has not been set and the Court has referred the parties to formulate an arrangement between them. During this period and until formulation of an arrangement or other decision, the Company is paying according to a temporary arrangement.

- (B) On October 17, 2007, the Company filed a petition in the District Court in Tel Aviv for the appointment of an external arbitrator for adjudicating the disputes between the Company and IGL on all matters relating to the agreement between the parties, which was signed on November 10, 2004 (Miscellaneous Civil Petitions 20092/07). In May, 2008, Dr. Udi Nissan, then the Director General of the Companies Authority, was appointed by the Government's Attorney General, to serve as an arbitrator in the dispute between the parties on its behalf. Position papers on the part of the parties were filed to the arbitrator in January 2009 and answer papers to the position papers were filed in August 2009.

In the position paper on the part of the State and IGL, various contentions and demands towards the Company were raised. The contentions have not yet been quantified into exact amounts, but they may reach tens of millions of dollars.

The main disputed questions are: (A) the status of the Company in the project and its degree of responsibility; (B) repair of damage to the northern segment of the gas line; (C) deficiencies in the execution of crossings at junction points; (D) rust and smart pig damage; (E) the depth of burial (F) additional flaws and deficiencies that were discovered in the system; (G) responsibility for claims of third parties – claim of trawl fishermen; (H) schedule.

Within the arbitration, the Company filed a claim against the State, whereby the State was required to indemnify the Company for various amounts that it bore within the conduct of the project.

In accordance with a consensus that was achieved between the Company and IGL and the State, as of the date of the report, contacts are ongoing between the professional elements of each of the parties, with the goal of attempting to solve the disputes, in part or in full, between them.

For further details, including with regard to the advanced negotiations between the parties in order to solve the disagreement between them and the sums that are meant to be paid to the Company, insofar as these negotiations will come to fruition, see Note 33(B) to the Financial Statements.

- (C) On December 14, 2000, District Outline Plan/3/6/A, dealing with route regulation was published for validation, covering the route through which electricity lines, a railway and Highway 431 will jointly pass. The infrastructure route is south of Rishon le Zion near an existing road. Within its instructions the plan established a mechanism for dividing the burden of compensation that will be set (if set) for it. The mechanism stated that out of the total compensation that is set, the local committee would bear 30% while the rest of the compensation amounts (70%) would be borne by the three utility bodies (Israel Roads, Israel Railways and the Company) in a division that will be determined by the compensation committee headed by the Chief Government Appraiser or a person appointed thereby.

With respect to the approval of the plan, many claims were filed with respect to it pursuant to Section 197 of the Planning and Construction Law, and once these were rejected by the local committee, appeals were filed to the Central District Appellate Committee. In accordance with the decision of the Appellate Committee, the appeals were transferred for hearing before a deliberating appraiser, setting guiding principles for her appraisal in the process. In May 2011 the final appraisals were received. The total compensation that the decreeing appraiser awarded stands at approximately sixty two (62) million new Israeli shekels as of the effective date. This amount also includes compensation for ground that was expropriated by Israel Roads and Israel Railways, and therefore the expropriation compensation is to be deducted for it (so that no double compensation is given).

Until an agreement is reached between all entrepreneurs of the plan with respect to the allocation of the payments among the parties, Israel Roads, Israel Railways and the Company negotiated a temporary outline for dividing the compensation amount, which has been formalized in an agreement that was signed on May 5, 2012 in accordance with which: out of the total compensation, the amount due to be paid by the local committee (30%) is to be subtracted. From the balance (NIS 43 million), the expropriation compensation money that was paid to the appellants, standing at about NIS twenty nine (29) million, is to be subtracted. The balance (approximately fourteen and a half million New Israeli Shekels) is to be paid by the parties by equal distribution. The part of the Company, at this stage, stands at approximately NIS 12 million in values correct as on the actual payment date (which was overwhelmingly executed).

Some of the appellants filed against the decrees of the deliberating appraiser to the Central District Appellant Committee, and they were fully dismissed by the Committee. Following the dismissal of these appeals, the appellants filed an administrative appeal to the Central District Court of Administrative Affairs. As of the time of the report, a hearing in front of the Court for Administrative Affairs has not yet been held. In light of that, a change may occur in the amounts stated above.

- (D) On December 29, 2013, the Company submitted a claim to the District Court of the Center District against the following foreign companies: Alstom grid AG, Alstom Societe Anonyme, ABB Ltd., Siemens AG and Alstom Grid SAS (together: the “**Cartel Companies**”), who supplied GIS arrays to the Company (gas insulated voltage arrays).

The claim is based on the determination of the General Director of the Antitrust Authority of September 16, 2013, which exposed that the global cartel that was occurring in the GIS array market during 1988-2004 was also implemented by the cartel companies in Israel towards the Electric Company, and that the acquisition proceedings conducted by the Company for purchasing GIS arrays during the operation years of the cartel were coordinated in advance by the cartel companies, who presented to the Electric Company a false representation of competition between them.

Within the claim, the Company is claiming damages which were caused by the cartel companies, as well as return of invalid profit the cartel companies gained at its expense, within approximately 20 acquisition proceedings the Company conducted during the years that the cartel was operating. The Company estimates that its damages from the actions of the cartel, as of the date of submission of the claim, amount to NIS 3,777,994,817.

- (E) For details of the legal proceedings between the Company and the Egyptian Gas Companies EGAS and EGPC and the EMG Company see section 7.9.9.1.

For further information regarding ongoing procedures against the Company see note 34 to the Financial Statements.

24. Insurance

24.1 General

Based, *inter alia*, on the risk management policy, and the risks that have been identified in the risk review that the Company carried out, the Company determines what the risks worth insuring against are. The Company is a company rich in assets that conducts extensive activity throughout the State. Thus, the Company is purchasing insurance policies such as insurance for property, liabilities, construction, liability of officer holders, vehicle insurance and maritime insurance, which are supposed to provide an appropriate solution to damages that may be sustained by the Company's property, its employees and for actions of third parties. It must be noted that the insurance policies usually make an exclusion for damages that originate from acts of terrorism and war, that are covered by way of a special fund that the State of Israel makes available for the purpose of compensation for damages that result from acts of terrorism and war, by virtue of the Property Tax and Compensation Fund Law.

24.1.1 The principal insured risks

The principal risks insured are as follows: physical damage to property, loss of revenue and increased fuel expenses, natural damages and liabilities towards third parties and towards employees.

The Company purchases insurance policies as prescribed in the electricity license. In addition, the Company purchases additional insurance policies with the goal of providing adequate, broader coverage for the risks to which it is exposed, in accordance with the decision of the competent organs in the Company, after consultation with professional parties in the Company and insurance consultants outside it. The insurance policies that are purchased by the Company are as follows:

- (A) An "all risks insurance policy for the coverage of damages to the property of the Company (except the electricity grid), the coverage limit of this policy is \$ 1 billion. The coverage includes loss of revenue and increased fuel expenses.
- (B) A liability insurance policy that includes coverage of general third party liability, product liability, professional liability, liability for accidental pollution damages, liability for electromagnetic radiation and employers' liability. The limit of coverage within the framework of this policy is \$ 100 million.
- (C) A construction policy for the coverage of damage during the course of the construction of power stations and other major projects. The limit of coverage within the framework of these policies is the value of the projects.
- (D) An officers' liability insurance policy that covers the liability of the office holders of the Company. The limit of coverage is \$300 million.
- (E) Third party maritime liability and lessees liability insurance that covers the maritime operations of the Company (such as: the loading / discharging of fuel, operation of the gasifying vessel, towing of ships carrying coal and more). The limit of liability within the framework of this policy is \$300 million.
- (F) Mandatory and third party insurance for the fleet of vehicles of the Company.
- (G) Cargo insurance for sea, air and ground transport.
- (H) Insurance for the watercraft of the Company.
- (I) Additional insurance in accordance with the needs of the Company.

The Company estimates that the purchased insurance policies as stated provide adequate insurance coverage.

25. Objectives and business strategy

25.1 Vision

25.1.1 General:

The Company is aiming at continuing to be the leading company in Israel in the field of electricity generation and supply, adapting its business activity to the varying market conditions and economic, social and technological transformations in Israel and in the world, while adapting the procurement and operations of the Company to these transformations and, subject to the provisions of the law, to developing additional areas of engagement and breaking into new, international markets.

For this purpose:

- (A) The Company will operate— with dignity, fairness, reliability and transparency towards customers, employees, suppliers and shareholders;
- (B) The Company will provide optimal service, while ensuring reliability, quality and safety;
- (C) The Company aims for excellence, innovation and maximum managerial and technological efficiency;
- (D) The Company recognizes its employees as a key asset of the Company and supports their advancement, while aiming to instill a sense of pride and belonging and encouraging commitment and creativity;

All of these are done while upholding the law and the principles of good governance, aiming for sustainable development and social and environmental development.

25.1.2 The main values of the Company

The Company puts the customer at the center of its affairs, but its employees are its most important asset, and it operates based on a business view, emphasizing quality and reliability in its actions, sensitivity to the community and environmental protection, and compliance with the provisions of the law.

25.1.3 Key goals:

- (A) Achievement of the highest quality of service while adhering to the treaty between the Company and its customers and improving the quality of supply, Meeting schedules, giving instructing and professional consultation to customers and flexibility in complying with the needs of the public.
- (B) Nurturing the human assets of the business - while increasing the professional standard of the Company's employees through increasing their academic level, constant instructing, motivation, sharing and encouragement for taking initiative and for excellence and development and empowerment of managers from within, ensuring the work conditions and adequate salary conditions, and attention to the welfare of the worker and his family.
- (C) Demonstrating National and community responsibility while taking actions to protect the environment, devotion to public safety, implementation of technological progress and assistance in the shaping of the energy policy in the State of Israel and in the Middle East.
- (D) Achievement of financial strength – while coping with competition, increasing profitability, and identifying additional markets.

25.1.4 The goals will be achieved through:

25.1.4.1 Development

- (A) Maintaining the generation capacity of the Company is subject to the implementation of an optimal reliability criterion, to the effect of a balance occurring between the cost of unsupplied energy and the cost of an addition in generation measures.

- (B) Optimal integration of natural gas and coal production assets for reducing the use of expensive fuels and reduction of pollutant emissions into the environment.
- (C) Design and development of the transmission and transformation systems and adapting them to the increase in the sector's needs and entry of new private producers at standards that ensure the transmission of the energy generated using the production assets to consumption centers at the required level of reliability and quality, while maintaining the survivability of the system.
- (D) Development of the distribution system as an answer to the increase in the number of consumers, for the increase of demand from existing consumers, for achieving the level of reliability and quality of electricity that is required, and an answer to safety problems, while minimizing costs.
- (E) Planning and execution of emission reduction projects at power stations and making other investments in the environmental protection field.
- (F) Development of additional areas of engagement.

25.1.4.2 Operation

- (A) Adoption of an environmental operation and development policy.
- (B) Optimal operation of generation assets, while maintaining economic balance in the allocation resources, at a high level of availability and reliability.
- (C) Implementation of an optimal operation and maintenance policy, which ensures the reliability of systems during peak demands, and conducting renovations at the minimum possible cost, based on economic viability considerations.
- (D) Operation of the generation array using an optimal fuel mix.

25.1.4.3 Customers

- (A) Development of new products and services for the customers.
- (B) Provision of service with respect to the needs of the different market segments with emphasis on strategic customers.
- (C) Development of relations with the customers of the Company while implementing a customer relations management approach.

25.1.4.4 Resource management

- (A) Preservation, enhancement and development of the human resources through development of professional and managerial promotion and training tracks.
- (B) Conducting intelligent acquisitions of fuel in accordance with the operation requirements, with attention to the quality and cost of fuels, environmental protection, reliability of electricity supply and diversification of fuel sources.
- (C) Finding of an overall, systemic solution for the charge rate outline, including improvement in the interface with the Electricity Authority.
- (D) Responsible financial management that will provide for achievement of adequate profitability, maintaining of a stable cash flow, capital raising for financing the needs of the Company, maintaining the Company's credit rating and acts to improve the rating.
- (E) Consent, startup and implementation of all of the changes required, including structural changes in the Electricity Sector, organizational changes and economization in the Company.

25.2 Company objectives for 2015

- (A) Reform – advancing the structural change in the Company and increasing efficiency internally even if the reform will ultimately not be implemented.
- (B) Electricity supply –supply of available and reliable electricity, while improving the quality of the service.
- (C) Financial strength – maintaining the Company's financial position, while reducing the debt and adapting the activity to the budget.
- (D) Entry of private electricity producers - preparation for the entry of additional private electricity producers and a competitive electricity sector. The significance is, among others, closing or bringing to a state of preservation of power stations with volume of 2,300 MW.
- (E) Broadband communications - the communications enterprise - continuing access network deployment, continuing to connect private customers and continuing to connect business customers.
- (F) Business development – establishing a subsidiary for business entrepreneurship, subject to the required approval by the regulators.
- (G) Development – execution of plans to develop the electricity sector, with an emphasis on emergency plans in the transmission segment and on the emissions reduction projects.
- (H) Cyber - maintaining the information warfare and preserving intactness and confidentiality of the sensitive information in the Company.
- (I) Human resources planning and development – continued implementation of a long-term strategic HR plan – “Light of the Future”, fostering of management staff, with an emphasis on the promotion and empowerment of women. Continuing the process of preserving the knowledge of the Company and maintaining an enrichment program for senior managers.
- (J) Regulation and the image of the Company - deepening the cooperation with the various regulators, continuing to improve the image of the Company and developing and expanding the activity of the investor relations unit.
- (K) Sustainability and quality of the environment - continuing the program to expand the activity in the matter of sustainability and quality of the environment and advancing the natural gas revolution.
- (L) Technological innovation projects - continued promotion of projects as part of the center for the promotion of innovative technological ideas and promoting energy savings.
- (M) Sale of assets - the Company will prepare to sell assets, including the Ramat Hovav power stations, the open area at Alon Tavor as well as inactive assets, subject to receiving all the approvals required for this (if any).
- (N) Safety - emphasizing the safety issue including - appointing safety officers, maintaining the safety instructions, conducting training and refreshing guidelines.
- (O) Preparing for extreme events in the Company - advance preparation for the winter and summer seasons, including drills, continuing to implement the conclusions drawn from the December 2013 weather events and advance preparations for extreme events such as war.

25.3 Information on business enterprising

The business development and enterprise unit was set up in 1995. The unit operates in fields that are contiguous with the fields of activity of the Company that are not an inherent part of the activity of the Company as an essential service supplier, in Israel and abroad. The goals of the unit are the expansion of the areas of engagement of the Company and making the best and most optimal use of the professional knowhow, the skilled human resources, the byproducts, the infrastructures and the other resources that are in its possession. The activity of the unit, the principles of its activity and its goals have been approved as necessary in discussions that have been held by the Board of Directors or the committees of the Company. The business development activity overseas is

mainly in the countries of the former Soviet Union, Russia and Eastern Europe, Africa, India and others. The business development activity in Israel is focused on selling services and intelligent utilization of the Company's infrastructures and resources.

The Company is operating in the sphere of business enterprise, this being within the framework of the licenses of the Company, while some of these operations, which require the approval of the Manager of the Electricity Administration, are forwarded for approval on an ongoing basis. Other operations, requiring the approval of the Ministers, are forwarded for their approval. As of the date of the report, the unit is operating in a number of main fields:

- (A) Activity for the construction and the operation of power stations and other electricity facilities overseas that is conducted by the Company as a provider of professional services. The Company is interested in acting in this field as an enterprise company and in becoming the owner and in holding shares of companies abroad that own electricity facilities. Toward this end, the Company is required to receive approval from agencies of the State of Israel (approval of the Government and the Ministers of Energy and Water, the Minister of Finance);
- (B) Activity involving the sales of knowhow, consulting services and engineering services in Israel and abroad;
- (C) The commercialization of the byproducts that are created as a result of the generation of electricity – such as ash, coal, steam, various gases and so on;
- (D) Effective utilization and renting of the infrastructures of the Company;
- (E) Other services that are offered by the Company.

For details of the draft of recommendations of the Steering Team with regard to the establishment of an entrepreneurship subsidiary abroad see Note 1 e to the Financial Statements.

(F) The communications field

Another sphere of operations that the Company has recently entered into is the area of communications, by establishing a new communications company (IBC) that is destined to operate in the field of communications and to supply stationary Bezeq services to communication operators and large business clients approved by the Minister of Communications, through an optical fiber communication infrastructure that will be deployed, among others, on the infrastructures of the Company, as will be detailed further on.

In accordance with the resolutions of the Government of Israel of 2010-2012, and under their authority according to section 6d to the Electricity Sector Law, and after consultation with the Electricity Authority, the Minister of Finance and the Minister of Infrastructures, Energy and Water signed, on March 3, 2013, a permit permitting the Electric Company to deal in other actions in the field of communications.

Following the Selection Process conducted for selecting the partner of the IBC Company, the winning offerer who is holding 60% of the total shares of IBC is a consortium composed of the following companies: Via Europe Israel Ltd., who will hold 50% of the shares of the winning offerer; and BATM Advance Communications Company Ltd., Rapac Communications and Infrastructure Company Ltd., Tamares Holdings Sweden AB Company, and Zisapel Assets (1992) Company Ltd. (together: the "**Consortium**"), who will each hold approximately 12.5% of the shares of the winning offerer. The Company will hold 40% of the total shares of the IBC Company.

On July 11, 2013, the transaction between the Electric Company and the Consortium was completed, including the signing of the founders agreement of the Communications Company by the Company, the Consortium and a representative of the Communications Company, against 60% of the shares of the Communications Company. In accordance with the agreement, the Consortium infused NIS 100 million and undertook to transfer an additional NIS 50 million. All the Consortium members undertook to provide a loan in the amount of NIS 150 million. The Communications Company received a bank guarantee in the amount of NIS 200 million to secure the stated committed sums. As of the date of publication of the report, the loans have not yet been received. The Communications Company is entitled to receive a Government grant in the

amount of NIS 150 million. The first payment was received in December 2013 and the second half will be received in 2015.

On July 14, 2013, the Communications Company was incorporated under the name I.B.C. Israel Broadband Company (2013) Ltd. (hereinafter: "IBC"). As stated above, the Company holds IBC at a rate of 40% of the share capital and voting rights of IBC at a shareholders meeting.

On July 25, 2013, an agreement to provide right of use and services was signed between the Company and IBC. Within this, the Company granted IBC an exclusive right of use, to use the infrastructures of the Company for the deployment of its communications network and a future right to order wavelength allocations according to IBC's demand in the optical network of the Company. In addition, the agreement regulates the ownership rights of the IBC Company as to the various communications network components, and the services that IBC will be able to order from the Company.

On August 27, 2013, the Minister of Communications granted IBC with a license to provide Bezeq services.

IBC is destined to provide stationary Bezeq services to communications operators and large business clients approved by the Minister of Communications, through an optical fiber communications network that will be deployed, among others, on the infrastructures of the Company⁸⁷.

The Company and the employee union reached consents pertaining to arrangement of the rights of the Company's employees with regard to the Electric Company's profits from the communications enterprise, subject to receiving all the approvals from the required entities. These consents required the State's approval. The Company submitted a request to receive the State's approval for these consents. As of the date of the report, the State's representatives made it clear to the Company that in their opinion the employees are not entitled to compensation in the form of shares in the communications enterprise. The Companies Authority commenced a process of examination of the matter and it has not yet been completed. The required approvals for the stated consents have not yet been received from the factors, and the stated agreement has not yet been signed.

For further details regarding the establishment of a communications company see Note 11 to the Financial Statements.

(G) Technological incubator

For details, see section 12.

- (H) The establishment of a subsidiary for business operations outside of the borders of the State of Israel - in October 2011, the Board of Directors of the Company approved the establishment of a subsidiary, the purpose of which was to carry out business activities outside of Israel (in other words, projects that involve the construction and operation of power stations and other electricity facilities overseas, as well as other business enterprises that are to be carried out overseas). The Company is interested in the establishment of this company in Cyprus, on the basis of various business considerations. In addition, within the framework of that resolution, the Board of Directors approved a financial framework for that activity in the scope of 100 million euro. The establishment of this subsidiary requires the receipt of approval in accordance with Section 11(A)(9) of the Government Companies Law. In view of the above mentioned, on October 10, 2012, the Company applied to the Government Companies Authority to receive the approval of the Government and the Companies Authority for the establishment of a subsidiary in Cyprus, subject to the limitation of the volume of operations to € 20 million only. On December 24, 2012, the Company reapplied, requesting to approve the application with an additional reduction of the volume of operations to € 10 million only, while the Electricity Company will hold all of the shares in the subsidiary. On October 26, 2014, the CEO of the Company applied to the Government Companies Authority, requesting to conduct a discussion in order to

⁸⁷ For additional details see the immediate reports of the Company of June 17, 2013 and July 11, 2013 (Reference nos.: 2013-01-066081 and 2013-01-090756, respectively).

advance the issue as soon as possible. The Companies Authority and the Company agreed to establish teams in this matter and to start discussions to advance the process.

(I) Agreement with the Palestinian Energy Authority for building substations

For details with respect to the agreement with the Palestinian Energy Authority for building substations, see Note 34.a.3) to the Financial Statements.

26. Forecast of the investments that will be required for execution of the development plan of the Company

According to the five-year financial plan for the years 2014-2018, which was approved by the Board of Directors on June 26, 2014, the average annual investment for the years 2016-2018 at Company level is approximately NIS 4 billion per year.

In 2014, a sum of approximately NIS 3,749 million was invested in the development plan of the Company.

According to the decision of the Board of Directors, the development budget of the Company for 2015 is approximately NIS 1 billion.

In 2014, a sum of approximately NIS 573 million was invested in the development of various acquisitions and investments (that do not belong to a specific segment).

According to the decision of the Board of Directors, the development budget of the Company in the development of various acquisitions and investments (that do not belong to a specific segment) for 2015 is NIS 491 million.

The estimates that have been described above with respect to the forecast of investments that will be required for executing the Development Plan of the Company constitute forward looking information, as per its definition in the Securities Law, which are based on the forecasts and assumptions described above, which the Company has as of the date of the report, and at the end of the formulation of an updated investment forecast or due to instructions that will be given to the Company by the Minister as an essential service supplier with respect to the Development Plans that it must implement, the Company may be required to make investments that differ from those described above. This information includes forecasts, subjective assessments, estimates and other plans of the Company as of the date of the report with respect to the working assumptions that it used in the development of the forecast and the dates of materialization of those assumptions. Such information is based on future figures whose materialization is not certain and that are not under the exclusive control of the Company. The main factors that might affect the forward looking information such that it will not materialize or that changes will occur in the estimated timetable for the execution of the development plan and the investments thereof, according to the aforesaid, are, inter alia: a change in the expected growth rate of the demand for electricity; implementation of the structural change of the electricity sector and the Company (see sections 1.3); availability of natural gas for use in the generation system; difficulties in obtaining a license and/or change in regulation in the field of quality of the environment and licensing; changes with respect to the development plan, lack of suitable rate cover (see Note 3 c to the Financial Statements), and the ability of the Company to raise the financing required for executing the development plan.

27. Event or matter outside of the ordinary business affairs of the Company

- 27.1 For details of the position of the staff of the Securities Authority on the subject of the existence of a high quality corporate debentures deep market in Israel, and its impact on the Company, see Note 2 u 1) to the Financial Statements.
- 27.2 On December 28, 2014, a number of present and past employees of the Company were arrested, among them two senior officers of the Company, by the Securities Authority, on suspicion of taking a bribe from the Siemens Company in order to bias tenders entered into by the Company. It is emphasized that the Company is not a party to this affair and the Company has not received any official notice in the matter.
- 27.3 In 2014, a number of senior officers of the Company retired or announced their retirement, including the Company CEO, Deputy CEO and Deputy Customers, Deputy Finances and the legal advisor of the Company⁸⁸. As of the date of publication of the report, the Board of Directors appointed Mr. Itzik Balmas as Deputy CEO Customers and Adv. Yael Nevo as legal advisor of the Company. This appointment is expected to enter into force in the near future. Additionally, the Board of Directors appointed Mr. Ofer Bloch as Company CEO. The appointment requires the approval of the Minister and the Minister of Finance, after consultation with the Committee for Reviewing Appointments at the Government Companies Authority. Additionally, the Company is in the process of locating a Deputy CEO Finances and Economics.

⁸⁸ For additional details see the immediate reports of the Company of September 22, 2014, December 25, 2014, January 7, 2015 and January 1, 2015 (reference nos.: 2014-01-162864, 2014-01-231000, 2015-01-005719, 2015-01-000151, respectively).

28. Discussion of risk factors

Risks constitute an integral part of the business environment and the work and business management processes in the Company and are affected by external and internal factors, such as strategic risks, operational risks, financial risks, and compliance and regulation risks. In accordance with the directives cited in the Companies Authority Circular 2009/2 on the issue of risk management, the Company executes a risk management process at the company level.

Pursuant to a risk survey at Company level that was conducted in the year 2013 with the assistance of a risk management consultant, presented below are the main actions that were taken and are taken by the Company based on the findings and recommendations raised in the survey:

- Regular reporting to the Board of Directors' committee in charge of risk management in the Company: "Budget, Financial Management and Risk Management Committee".
- Coordinating a management committee for risk management, headed by the Company's VP Corporate Sustainability, who has been appointed risk manager, and which is in charge of overseeing all matters pertaining to the management of risks in the Company.
- Formulation of work plans based on gap surveys performed.
- Updating of the Company's risk management procedure.
- Integration of a risk management information system.

Additionally - as of the date of this report, the Company is currently reaching the end and approval of formulating detailed policy portfolios for all the risks that have been mapped in the Company, including the definition of the appetite for risks (the risk level that the Company is willing to accept) and risk metrics, and conducting minimizing plans as determined within the preparation of the portfolios.

The policy objectives for risk management are, *inter alia*:

- (A) Minimizing of losses that derive from realization of risks to which the Company is exposed.
- (B) Adjustment of the frameworks of authority and responsibility among employees of the Company.
- (C) Holding of effective controls and actions for risk reduction.
- (D) Creation of an infrastructure for ongoing evaluation of risk, including mechanisms for reporting loss events on an ongoing basis and use of these reports as a tool for monitoring risk level.

The table that appears below shows the risk factors of the Company, which have been rated, in accordance with the estimate of the Company, by the degree of effect that they may have over the operations of the Company:

The risk factors of the Company are listed below:

	Effect			Classification of the risk factor in accordance with the Government Companies Authority circular of June 11, 2009
	High	Medium	Low	
	Significant effect on the Company	Moderate effect on the Company	Slight effect on the Company	
Macro risks				
(1) Regulation, corporate governance and compliance	X			Compliance and regulation risks
(2) Security, geopolitical and economic situation in Israel and its surroundings	X			Strategic risks
(3) Natural disasters		X		Strategic risks
(4) Fires	X			Strategic risks
(5) Market risks	X			Financial risks
(6) Teleprocessing and Cyber Systems and information security	X			Operational risks
Industry risks				
(1) Setting of the electricity charge rate	X			Compliance and regulation risks
(2) Debt raising and management	X			Financial risks
(3) Fuels	X			Strategic risks
(4) The Electricity Sector Law and licenses of the Corporation		X		Compliance and regulation risks
(5) Environmental protection	X			Operational risks
(6) Human capital	X			Operational risks
(7) Technical failures	X			Operational risks
(8) Suppliers and contractual engagements (without fuels)		X		Operational risks
(9) Safety		X		Operational risks
(10) Project risks		X		Operational risks
Risks unique to the Company				
(1) Liquidity risks			X	Financial risks
(2) Causes for calling for immediate repayment and cross violation clauses in existing financing contracts of the Company	X			Financial risks
(3) Transition to reporting in accordance with the IFRS rules		X		Financial risks
(4) Submission of audited Financial Statements to profit centers		X		Financial risks
(5) Competition	X			Strategic risks
(6) Planning of Development and advancing the development program in the generation and transmission segments	X			Strategic risks
(7) Structural change	X			Strategic risks
(8) Asset arrangement	X			Strategic risks
(9) Legal	X			Financial risks
(10) Customers		X		Financial risks
(11) Labor relations	X			Operational risks
(12) Liabilities for pension fund		X		Financial risks
(13) Generation array management	X			Operational risks
(14) Planning in the life cycle of the transmission, transformation and distribution array		X		Operational risks
(15) Embezzlements and fraud			X	Strategic risks

28.1 Macroeconomic risks

28.1.1 Regulation and Compliance with Laws and Regulations

The activity of the Company depends to a great extent on regulation that applies to its activity, including the provisions of the Electricity Sector Law and its regulations, pursuant to which licenses are issued for its activity, the policy and resolutions of the Government (including resolutions of the Ministry of National Infrastructures, Energy and Water and the Ministry of Finance, and including provisions relating to the duty of the Company involving major investments in infrastructure development), the resolutions of the Electricity Authority (including with respect to the electricity charge rate that is set by the Electricity Authority and collected from the customers of the Company), the provisions of the Government Companies Law and its regulations and the resolutions of the Government Companies Authority (*inter alia* with respect to the conduct of the Company as a corporation, the manner of adoption of resolutions by its organs, the manner of financial reporting appointment of directors and special functionaries and more), the Companies law and its Regulations, the provisions of the Antitrust Law (*inter alia* pursuant to it being a monopoly), the provisions of the Centralization Law, the provisions of the Securities Law and its relevant regulations and the circulars of the Securities Authority (pursuant to the Company being a reporting entity and a public company, as these terms are defined in the Companies law), and regulations related to business licensing, planning and construction and environmental protection (see Sections 7.12, 8.8, 9.10 and 20). See Section 21 for restrictions and control over the activity of the Company.

Failure to comply with laws and regulations (existing or new) that apply to the Company may lead to the cancellation or suspension of its licenses, imposition of heavy fines on the Company, the issue of personal orders against senior executives in the Company, the filing of criminal indictments against some of them and also severe damage to its image.

In addition, the costs involved in the compliance with the various provisions of the law that apply to the Company are material costs.

Regarding the internal enforcement plan executed by the Company on the subject of antitrust see section 21.10.2(b).

Regarding the internal enforcement plan executed by the Company on the subject of securities laws see section C.5 of Chapter B of the report of the Board of Directors.

In addition, the Company is working to adopt an internal enforcement plan in the field of prohibition to give a bribe to a foreign public official, and has also appointed a team whose duty is to formulate a proposal to assimilate the subject of prohibition of trading with enemy countries into the Company procedures, and this as part of the Company's activity in accordance with the provisions of the law in this subject.

The Company cannot predict whether the various provisions of law that apply to it will change in the future in a manner that may adversely affect its condition. The Company cannot predict the costs that may be involved in the future in the compliance with the existing regulatory provisions that apply to it or compliance with laws, regulations and new rules that will be enacted and that may apply to it. The costs stated may have an adverse effect over its business activity and the financial outcomes, mainly if the costs of compliance or noncompliance with the broad regulation are not recognized in full in the charge rate or if recognized, will not be recognized on time.

28.1.2 Security, geopolitical and economic situation in Israel and its surrounding area

The security, geopolitical and economic situation in the State of Israel and its surrounding area directly affects the Company, whose assets and activity are located in the State of Israel in their entirety or nearly so.

Among the geopolitical events that have taken place recently is the change of government in Egypt, the instability in Syria and additional countries in the Middle East and threats made by various entities to carry out terror acts that may lead to security tension in the area, the Israeli-Palestinian conflict, and the ongoing tension with Iran.

Security events may impair the activity of the Company in each of its segments, including in the electricity generating, transmission, switching, transformation and distribution facilities and the fuel transport and storage arrays. Harm to the facilities of the Company would impair its generation capacity and might impair its ability to provide electricity continuously, reliably and to a high level of quality to all of its customers. Emergency officials and the Company estimate that some of the facilities may be an objective for terrorist attacks or other security events. The Company is executing a series of actions to deal with the various threats, among them applying to the heads of the emergency entities in the country for the provision of defense for the sensitive Company installations, promoting the handling of save and rescue issues in the Company, executing internal exercises and joint exercises with external entities to improve the preparedness, coordinating the arrangements for times of emergency with the Israel Police, the home front command and so forth.

The Company is the primary electricity supplier in the State of Israel and there is no alternative to the Company with regard to the generation and supply of electricity. In the case of war events, the State has no backup to the electricity grid of the Company and in effect the electricity grid in the State of Israel is isolated with regard to the generation and supply of electricity, without an option of purchasing electricity and/or a backup from other suppliers within or without Israel.

In addition, the various fuels that the Company uses in the electricity generation process and a major part of the equipment for the various facilities of the Company are acquired directly or indirectly from sources outside of Israel (except natural gas as stated in Section 7.9.5). A material part of the fuel and the equipment are acquired in contracts whose validity is limited. Due to the great dependence on foreign sources, the Company is exposed to many risks, such as a delay in the supply of equipment or fuels that may result from political or security instability, including in the case of a long war or closure of seaports or airports in its wake, boycott of goods against Israel, strikes in ports and so on.

The disruptions in the supply of the various fuels that are used for the generation of electricity have adverse consequences for the Company financially and image-wise.

The insurance policies that are purchased by the Company usually exclude damages that originate from terrorism and war, that are covered by a special fund that the State of Israel extends for compensation due to terrorist and wartime damages pursuant to the Property Tax and Compensation Fund Law. If it is determined in the future that the Company is not entitled to payment from property tax with regard to the payment of direct war damages, or if the amounts of the compensation that are set for the Company are lower than those to which the Company is currently entitled in accordance with the provisions of the law, this may have an adverse effect over the outcomes of the Company.

28.1.3 Natural disasters

The Company and its facilities are exposed to natural hazards such as exceptional weather, floods, tsunamis, severe earthquake in the region (that may cause the materialization of other disasters such as explosion, fire and additional safety and security risks), other natural disasters and damage to the electricity system from electromagnetic waves, that may affect the Company's facilities and its business affairs.

The Company has a steering committee, headed by the Deputy CEO for Organization, Logistics, Security and Emergencies, on the subject of earthquakes and tsunamis (in this section: **"Steering Team"**), under which four subcommittees operate, which deal in the planning and execution of the preparations of the Company for these events in order to reduce and minimize the damage as a result of an earthquake event. The steering committee has established a multiannual work plan for coping with earthquakes, including execution of seismic studies at some of the sites of the Company and analyzing various scenarios which aided in identifying weak points that may be harmed. Based on the analysis of these scenarios, recommendations for executing reinforcements and anchoring of various components are delivered, and the implementation of these recommendations exists at various stages in the Company installations.

Within the preparations of the Company for winter (exceptional weather, snowstorms, strong winds etc.), preparations executed by the Generation and Energy Division and the Customer Division, including: preparations for peak demand, maintenance of substation units, transmission and distribution lines according to

the work plan, refreshing division procedures about activating headquarters in a stress crisis situation, and examinations were carried out for their operational preparedness. Additionally, a Company-wide exercise of preparedness for winter including the examination of supporting information systems was performed, headed by the CEO and the rest of the divisions that support the electricity chain units.

It is noted that “all risks” insurance of the Company covers the risk that is involved in natural disasters, except with respect to the electricity grid and subject to the deductible specified in the insurance policy of the Company.

28.1.4 Fires

The facilities of the Company are exposed to various types of fire risks. In view of the presence of fuels, hazardous materials, fire explosives (concentration of flammable materials), work with naked flame, high temperatures and pressures, the power stations have much greater fire risks than other facilities. The occurrence of a fire at a power station may lead to direct damages as a result of the cessation of the activity of generation units and may cause indirect damages as a result of the operation of the other stations using more expensive fuels. Fire events involve cleaning, repair, replacement of facilities, disposal of waste and so on.

The Company’s “all risks” insurance policy covers direct and indirect fire damages subject to the deductible by the Company, which the Company may be charged with in accordance with the insurance policy. The Company operates an array for coping with fire risks, which includes sophisticated fire detection and extinguishing systems that have been designed and installed in accordance with the requirements of strict Israeli and international standards, the Fire Brigade and site emergency teams, and conducts joint exercises with the firefighting services in order to examine the cooperation and practice the operational abilities that are required for extinguishing major blazes. For the prevention of fires, individual trees, forests and woods near strategic power lines are pruned and visually inspected for the proximity to power lines, while making sure that the required pruning distances are maintained. In addition, in the hazard reviews that are conducted by the engineers of the insurance companies and by the engineers of the insurance brokers within the framework of the “all risks” insurance policies for the Company’s assets, fire risks at the facilities for the Company are assessed, among other things, and recommendations are received for their reduction and elimination.

The Company has constructed a plan to comply with the instructions of the Chief Fire Commissioner and carries out numerous projects in the field of fire detection and extinguishing that will spread up to the end of 2017.

28.1.5 Market risks

For details with respect to the market risks of the Company see section B.2) of the Report of the Board of Directors.

28.1.6 Teleprocessing and cyber systems and information security

The Company, which is a strategic national infrastructure, and may be a target of cyber attacks, relies on teleprocessing systems and information security in its activity. Penetration of a malicious code or a hostile factor into a critical network in the Electric Company may harm the electricity production and supply process. Faults in information systems and failures in information security, including by hacking of the computer systems of the Company, may cause disruption and damage to the regular operation of the systems that support the business activity of the Company, the loss of business information and cause material costs for rehabilitation of the information systems of the Company. Deliberate damage to the information systems of the Company may cause damage to the administrative network of the Company, disruption of the normal activity of the Company that is mostly dependent on this infrastructure and of the integrity of the information that is in the possession of the Company. Additionally, cyber type hostile activity and information security may cause a leak of business information or personal information of customers, employees or suppliers. It should be noted that lately there is an increase in the volume of threats in Israel and overseas and also an increase in the severity level of these events.

The Company is operating to prevent failures in the information systems, *inter alia* through backup and security mechanisms and mechanisms for preventing failures in its computer systems, and by upgrading of the physical

infrastructure and the electricity system, and increasing the level of information security in several aspects: operating a national cyber center to monitor and handle a cyber event in all Company networks, increasing the level of information security of the critical networks, securing the link of the administrative network to external networks and compartmentalizing the data center and the administrative network, educational activities and constantly increasing awareness to the subject among the Company employees.

The computer equipment of the Company is still covered, like the rest of the operating property of the Company, by insurance coverage against “all risks”, including loss of profits / increased fuel expenses following damage to the computer equipment, but the deductible is high. The Company operates under regulation and supervision in the field of cyber and information security for the critical systems in the Company.

28.2 Industry level risks

28.2.1 Setting of the electricity charge rate

The revenues of the Company are based on the electricity charge rate that the Company collects from consumers. In accordance with the Electricity Sector Law, the electricity charge rates and manners of update are determined exclusively by the Electricity Authority. The financial status, revenues, profits and cash flow of the Company are affected materially by the level of the electricity charge rates. As a rule, the charge rate is determined in accordance with a mechanism of recognition of the costs that are required for fulfilling the duties of the Company as an essential service supplier, such as: fuels, operation and maintenance costs and capital costs (depreciation, financing and return on capital). See Section 7.11.1 for further information on the manner of setting and updating the electricity charge.

In some cases, the Electricity Authority does not recognize within the charge rate all of the costs and the expenses that the Company actually spends; in addition, although the charge rate includes an update mechanism that is intended to compensate the Company for the gap between the dates on which it incurs the costs and the time at which the charge rate is updated, this mechanism does not compensate in full, in the opinion of the Company, for the cash flow gaps that it sustains when its actual costs are materially higher than expected.

At present, the Company has no ability to unequivocally assess the time of setting the new charge rate bases for the transmission, distribution and generation segments, or the volumes of the property and costs that will be recognized for it, once set.

According to the decision of the Electricity Authority from January 21, 2015⁸⁹, the electricity rates are expected to be reduced at a rate of 10% for the domestic consumer and approximately 11.8% on average to the total consumers commencing on February 1, 2015.

See Section 7.11.1 for details on the applications of the Company to the Electricity Authority with respect to various issues that were related to the electricity charge rate.

28.2.2 Debt raising and management

The Company has needs of financing and debt raising to significant magnitudes, that inter alia serve for financing the development plans of the Company and recycling existing financial liabilities.

Debt raising by the Company is carried out through loans from Israeli and foreign financial institutions, as well as by public offerings and private placements of debt in Israel and private placements abroad.

The ability of the Company to raise the debt that it requires under terms that will benefit the Company depends on many factors, including: the conditions of the market in Israel and in the world, the interest rates, availability of credit (including credit exposure restrictions for a single borrower of banks in Israel and exposure restrictions of institutional bodies for a single borrower and the electricity economy in Israel), the trust of investors in the Company, the form and terms of the Structural Change in the Electricity Sector (as far as will be applied), the financial performance of the Company (including its leverage level), the economic, security, legal and political terms, the geopolitical situation in Israel and the privatization policy of the Government and accordingly there is no certainty as to the Company's ability to raise the complete debt it requires or that the debt raised by the Company will be under terms favorable to the Company.

In addition, insofar as the credit rating of the Company will be damaged, it may have a material negative impact on the availability of the financing sources of the Company in Israel and overseas. For details on changes in the credit rating of the Company see Note 20f.

⁸⁹ Resolution No. 4 of Meeting No. 452 of the Electricity Authority dated January 21, 2015, regarding "Summarizing resolution for electricity rates for Electric Company consumers in 2015".

28.2.3 Fuels

The increasing dependence of the Company on the generation of electricity using natural gas causes it risks both as a result of the limited number of the natural gas suppliers and due to restrictions that are related to the natural gas transmission system.

As of the date of the report, the sources of natural gas supply are the “Tamar” field and the liquid gas (LNG) supplied through the gasification ship (in this section: the “**Gas Suppliers**”). In the present reality, shortage in the supply of natural gas can be created as a result of one of the two gas suppliers not supplying the contractual quantities, from failure in the piping transmitting the natural gas from the “Tamar” field to the coastal system entry point at Ashdod and/or from the incapability of the national transmission system to supply the Company with the contractual gas quantities that are at its disposal.

Disruptions in the gas supply that stem from violations of the purchase contracts by the gas suppliers may cause the Company to power its generation system using more expensive and more pollutant alternative fuels, in order to satisfy its consumers’ demand for electricity. Disruptions in the transmission of the gas from the field to the coast and/or in the national gas conduction system whose repair may take a long time, are estimated to be of low probability by the Company, but the expected financial damage from the materialization of these events may be high, particularly if following the disruptions in the gas supply, the Company will not have sufficient generation ability using alternative fuels in order to satisfy the demands for electricity.

For details regarding the risk that results from the fact that most of the fuel purchased by the Company is imported from abroad and purchased by agreements whose effect is limited, mainly in times of war or other disruptions, see section 7.9.5.

For details of the position of the Company on the subject of the decision of the Natural Gas Authority of November 29, 2012, regarding the regulation of use of the capacity of the gas pipeline from the Tamar rig to the reception station at Ashdod, and the risks involved in it according to the opinion of the Company, see section 7.9.9.2 above and Note 34a1 to the Financial Statements.

In the absence of available supply of natural gas, the costs of fuels of the Company may be significantly higher than the recognized costs of fuels for the Company in the charge rate basis, although the Company believes that the high costs of fuels will be covered in the end in the charge rate, the time gap between the date on which the Company sustains the expenses for the purchase of the expensive fuels as stated and the time at which the charge rate is updated and the Company is compensated for these expenses, causes material impairment to the cash flow of the Company.

28.2.4 The Electricity Sector Law and the licenses of the Company

The Company is subject, in accordance with the above, to the provisions of the Electricity Sector Law, pursuant to which it has been granted licenses for its activity. In addition, the Company is also considered as an “essential service supplier” in accordance with the provisions of the Electricity Sector Law.

Pursuant to the provisions of the Electricity Sector Law and the licenses that have been given to it, the Company assumes various restrictions, which are extensively stipulated in Section 21.1.2. The costs of compliance with the provisions of the Electricity Sector Law and the licenses that have been given to the Company pursuant to it are material and have a material effect over the Company and its outcomes. Failure to comply with the provisions of the licenses and the provisions of the law applying to the Company, may lead to various sanctions against the Company and officers therein (including criminal sanctions), to the point of cancellation or suspension of the licenses, and may also constitute a material violation of stipulations in some of the financing agreements to which the Company is a party. As of the date of the report, besides that which has been stated in Section 21.1.3.6, the Company is materially complying with the conditions of the licenses that have been given to it.

In the past, pursuant to the provisions of the Electricity Sector Law and the orders issued pursuant to it, the licenses of the Company have been extended from time to time, for periods of up to one year each time. As

elaborated in Section 21.1.2, the licenses of the Company will remain in effect through to January 1, 2016, and an additional extension of the Company licenses to a date later than January 1, 2016 will require a legislation amendment.

Relying on past experience, the Company expects that its licenses will be extended for additional periods, but in view of the uncertainty with regard to the implementation of the structural change, and in view of the letter from the Deputy Commissioner of Wages of the Ministry of Finance of October 27, 2014 and the decision of the Electricity Authority of the same date (see Note 1e to the Financial Statements), there is no certainty if, for what length of periods and under what conditions the licenses of the Company will be extended, in full or in part, and under what conditions or which licenses will be granted to it after the implementation of the structural change, to the extent implemented.

The Company estimates that after the implementation of the structural change, the Company will receive new licenses in accordance with the outline of the structural change as will be determined.

The abstention from extension of the licenses of the Company or changes in the terms of the licenses or other provisions that are prescribed in the Electricity Sector Law may have a material adverse effect over its business activity and financial results.

28.2.5 Environmental protection

The activities of the Company are subject to laws and regulations on environmental protection issues, which relate to various issues, such as air pollution, soil and water pollution, prevention of noise, non-ionizing radiation (electrical and magnetic fields), dealing with hazardous materials and more. In recent years, the standards applying to the activity of the Company, the supervision of environmental protection and the enforcement of environmental standards have intensified. This trend, in the assessment of the Company, is expected to continue and even intensify in the upcoming years. Failure to comply with the provisions of the law and regulations in the field of environmental protection may expose the Company and its directors to various sanctions, including financial sanctions and criminal proceedings.

The Company is studying the consequences of the proposed laws and regulations in the environmental protection field, is acting to prevent or minimize the environmental risks that may occur during its activity, is preparing for economic, legal and operational consequences that stem from the laws and regulations, and is allocating money in its budgets for the purpose of compliance with the laws and regulations in the field of environmental protection that apply to it and that are expected to apply to it. However, there is no certainty that the costs that will be demanded of the Company with respect to the laws and regulations existing and expected in the field of environmental protection will not exceed the amounts that have been allocated by the Company for these purposes; however, the Company estimates, as of the time of this report, and based on the provisions of the Electricity Sector Law, that the material costs that will be imposed on it as a result of new regulatory requirements shall be covered within the electricity charge rate.

See Sections 7.12, 8.8, 9.10 and 20 for details on environmental protection instructions that apply to the Company and their consequences for it.

28.2.6 Human capital

Human capital risks affect the Company's managing and planning abilities. Difficulties in the ability to hire and preserve capable and suitable human resources and lack of adequate managerial flexibility may make it difficult for the operational and managerial capability of the Company. The Company handles this risk through medium and long term planning of human resources, ongoing human resources replacement, mobilization and rotation, plans and arrangements for preserving human resources for permanent and temporary employees (in professions that are in demand), implementing pooling plans and technological engineering and designated training, and preparing a managerial reserve.

28.2.7 Technical failures

A risk of technical failure means a risk of unexpected malfunction of the operating equipment in the electricity chain of the Company.

The reliability of existing equipment at power stations, substations, switching stations and transmission lines may have an effect over the reliability of the entire station and over the reliability of the electricity system. In the case of a failure in equipment, the station may have limited generation capacity, transmission ability and transformation ability, and worse more, depart from the generation and/or transmission cycle. The repair of large scale faults involves very high direct and indirect costs of equipment, spare parts, work of specialists, contractors and Corporation employees, alternative fuel costs and additional costs that stem from losses in the extension of the transmission lines. In case of damage to the transmission lines, there is a risk of loss of consumers and severe damage to the image of the Company.

In recent years, a large number of combined cycles have been incorporated into the generation array of the Company. Combined cycle stations feature higher, more rapid attribution compared with other generation units, and therefore need frequent maintenance actions; their number of severe faults is higher and their planned lifetime shorter. In addition, while the “all risks” insurance of the Company usually covers severe faults in equipment, the deductible in this insurance is high, and the processing of insurance claims, which in many cases reach legal proceedings, takes a long time.

Correct operation, continuous monitoring of data, attention to predicted maintenance and scheduled maintenance at the intervals recommended and the purchase of reliable equipment, which is based on recognized technologies are, according to the estimate of the Company, the most effective measures for reducing the risk for technical failures.

The Company is reducing the volume of planned renovations and spacing them for reasons of economizing. This policy may have adverse effect on the reliability of the equipment.

28.2.8 Suppliers and Contractual Engagements (without fuels)

An event of a collapse of a supplier of equipment or of a critical raw material could result in shortages and adversely affect the generation capacity and the current operation. Additionally, a low stock level due to budget restrictions, delays in supply and the supply of defective equipment could adversely affect the current operation and the meeting of project timetables. A service supplier who fails to meet requirements in the field of quality of the environment may lead to breach of laws, regulations and regulation in the field of quality of the environment and to negative media coverage that may cause severe damage to the image of the Company.

In addition, the manner of transport and storage of the equipment and raw materials that may be impaired as a result of various factors, including faults in transport, limited access to ports, natural hazards and so on. The Company stores the equipment in accordance with the instructions of suppliers and in conformity with procedures in order to avoid the storage of equipment and/or hazardous materials in an uncontrolled manner.

28.2.9 Safety

The occupation and activities of the Company at its various sites expose its employees to various safety hazards for which the Company may be exposed to claims due to physical injury or other damages. The Company takes all of the measures for reduction and elimination of these risks, in accordance with legislative and regulatory acts applying to it, and it is forming and acting according to safety instructions and procedures that reflect and are stricter than the requirements of the legislation and regulations on safety that apply to it, for the purpose of safeguarding the wellbeing and health of its employees. Despite the abovementioned, the Company cannot prevent completely this risk. It should be noted that the Company has insurance coverage for employees and for third parties, subject to the deductible fees that the Company may be obliged to bear, in accordance with the insurance policies of the Company.

28.2.10 Project risks

The Electric Company deals in the management of various projects. This activity involves exposure to risks such as:

Failure to comply with schedules, failure to meet quality requirements, failure to meet the budget, missing or excess preparations of inventory, shortage of resources (manpower, equipment, budget), non-optimal use of resources, human errors in decision making, failures in projects in new fields in which the Company has no previous experience, technical failure in equipment and machines that may have implications on project schedules and budget, safety events, effect of extreme weather conditions, an unstable security situation which may result in non-arrival of suppliers and resources from overseas, delays in project execution, delays in receiving statutory approvals and building permits for a project, unexpected faults or findings in soil examinations, erroneous decisions in determining the work plan and the required work stages, dependency on subcontractors for execution of the project, erroneous pricing of the project or parts of it, and more.

The realization of project risks for the Company may cause:

Damage to the reputation of the Company, constitute a cause to file actions against the Company, failure to meet schedule, budget, and quality of the projects, disruptions in the electricity supply chain, bodily injury or property damage due to safety events, and harm to the financial position of the Company.

28.3 Risks that are unique to the Company

28.3.1 Liquidity risks

Liquidity risk is a risk that is related to a situation in which the Company will not have enough available monetary resources in order to meet the current business requirements including its financial liabilities and the minimal cash requirements.

The Company may be exposed to liquidity risks due to various factors that are not necessarily under its control and, inter alia, as a result of employee sanctions that will affect the collection and/or as a result of disruptions in the supply of natural gas which may cause the Company to operate the generation system with alternative, more expensive fuels although the Company believes that the high fuels costs will eventually be covered in the rate, the time gap between the date on which the expenses with respect to purchase of the expensive fuels as stated will be caused to the Company and the date on which the rate will be updated and the Company will be compensated with respect to these expenses, causes material damage to the cash flow of the Company).

The management's approach to the management of its liquidity risks is to ensure, as far as possible, the liquidity amount that is adequate for it to meet its liabilities on time, under regular conditions and under stressful conditions, without incurring unwanted losses or damage to its reputation. The Company manages the liquidity risk through long term cash raising in the capital markets in Israel and/or abroad well ahead of the date required under the Company forecasts as well as by creating new credit lines in banks in Israel and abroad, while maintaining a "safety cushion" in accordance with the decision of the Board of Directors of the Company.

In accordance with the decision of the Board of Directors of February 27, 2014, the Company maintains a safety cushion with a monetary value of approximately NIS 3 billion (while the diesel oil and crude inventory surplus of the Company, in the amount of up to NIS 800 million, constitute part of the safety cushion of the Company and in addition, the Company has a cash balance which will not be less than NIS 2.2 billion), in order to adequately cope with risks which may adversely affect the liquidity of the Company.

As of the date of the report, the Company has surplus cash which according to its estimate will enable it to meet the expected liabilities of 2015 without additional raisings and without using the credit line in Banks in Israel. For details regarding the Company cash balance see section a.1 c)2)(d) to the Report of the Board of Directors.

28.3.2 Grounds for immediate repayment and cross violation clauses in existing financing contracts of the Company

Some of the financing agreements that the Company has executed include a clause for calling for immediate repayment in the case of a "material adverse change" (hereafter: "**MAC Stipulation**") as this event is defined in any such agreement. The enactment of the stipulation is subject to a test of reasonableness in some cases, and is down to the discretion of the lender in some of them, and this discretion is also subject to reasonableness in some of the agreements.

In some of the financing agreements, the existence of the right of a certain lender to demand immediate repayment of the debt (*that is*, even if it has not called the debt for immediate repayment) grants a right to another lender, whose agreement has not been violated, to demand immediate repayment (cross default).

In addition, some of the financing agreements that the Company has executed include clauses whereby if the Company violates its undertakings towards a certain lender and that lender demands immediate payment as a result of that violation, this will also grant another lender, whose contract has not been violated, the right to demand immediate repayment (cross acceleration).

In case one of the stated events occurs, it may have material negative effects on the business of the Company, its business results and its financial position.

See Note 20d) to the Financial Statements for details regarding the principal terms in the financing contracts of the Company that may cause immediate repayment, including the volume of the financing contracts that include MAC, Cross Default and Cross acceleration conditions.

28.3.3 Transition to reporting in accordance with the international financial reporting standards (IFRS)

As described in Notes 2.A.5) and 36 to the Financial Statements, from 2008, the Company has been implementing in its Financial Statements the international standards in accordance with the Government Companies Regulations (Rules for Preparing Financial Statements of Israel Electric Corporation Ltd.) (Provisional Order), 2004, including special exclusions that are included in these regulations with respect to the Company (retroactive from January 1, 2007). These regulations terminate on December 31, 2014, and with respect to the reporting period commencing on January 1, 2015, the Company will begin to fully report under the IFRS standards, and the transition date was set to January 1, 2014.

The transition to full reporting in accordance with the IFRS may have a very material effect over the Financial Statements of the Company, mainly in view of the fact that the charge rate is calculated according to index adjusted figures while the presentation in the Financial Statements will be carried out according to nominal data – which fact may cause attrition in the profitability and in the equity capital and as a result difficulties in raising funds. In light of the aforementioned, the Company is of the opinion that the complete transition to reporting under the IFRS should be accompanied by a determination of an appropriate rate or an appropriate accounting solution that will reflect the nominal financing costs and ensure an appropriate return on capital, as well as rate updates in order to prevent a significant delay between the amounts due to the Company or the electricity consumers and the collection date, that may negatively affect the Company, cause erosion of the Company's equity and harm its ability to raise money.

It is noted that although the full transition to reporting in accordance with the international standards may cause a major adverse effect over the outcomes and the financial status of the Company, this is not expected to have a direct effect over the current cash flow of the Company that is derived from the electricity charge rate.

28.3.4 Submission of audited Financial Statements to profit centers

The Company as an essential service supplier is required, in accordance with the Electricity Sector Law to submit Financial Statements in a form as prescribed by the Ministers in consultation with the Minister of Justice regarding the extent of their details, the accounting principles for their preparation, the declarations and the notes to be attached to them. Accordingly, under the Electricity Sector Regulations (Terms and Procedures for Granting Licenses and Obligations of the License Holder), 1997 ("**Electricity Sector Regulations**"), as well as under the licenses of the Company, the Company, as an essential service supplier, is obliged to submit Financial Statements separately for each area, for each activity and for each profit center, and submit consolidated statements with respect to its activities according to all of the licenses that are in its possession. A "profit center" is defined in these regulations as a unit with a closed income and expenses structure, without cross-subsidization with operations of another unit.

The Company manages its activities as separate profit centers but does not submit audited Financial Statements to profit centers as required in the Electricity Sector Regulations and in most of its licenses (including the new generation licenses received by the Company) and does not submit audited annual Financial Statements separately for each area, for each activity, but submits audited financial statements for the Company's operation in general.

The issue of the financial reporting and managing the Company's operation according to profit centers constitutes a component in the draft of recommendations of the Steering Committee which were formulated with regard to the structural change, and according to them the Company will act through profit centers that will provide for full transparency and assignment of costs in a model that will be determined by the character of activity of the Company.

The issue of profit centers is also addressed in the Yogev Letter, under which the various activity sectors of the Company will be managed as separate audited profit centers.

In view of the above-mentioned, the Company estimates that this issue is supposed to be regulated as part of the Structural Change that will be agreed upon. Notwithstanding, and despite sanctions not being imposed on the Company in this matter as of the date of the report, in the opinion of the management and the Board of Directors of the Company, as long as the issue of reporting by profit centers is not resolved, there is exposure

for the Company in the form of steps or proceedings that may be taken against the Company for failure to fulfill the provisions stipulated in its licenses.

According to the decision of the Electricity Authority of January 15, 2015⁹⁰, the Company has to submit to the Authority by the middle of March, 2015 a timetable on its behalf for completing the preparation of a profit centers report under the requirements of section 9.b of its licenses. As of the date of signing this report, a letter of response has not yet been sent to the Electricity Authority.

For details regarding the draft of the Steering Team and the Yogev Letter see Note 1 e to the Financial Statements.

28.3.5 Competition

As of the date of the report, the Company generates, transmits and distributes most of the electricity consumed in the State of Israel. However, as described in Section 6.5, the Government of Israel and the Electricity Authority take steps to encourage the entry of private electricity producers into the Electricity Sector, and in recent years have adopted a list of resolutions that have increased the share of private electricity producers in the Electricity Sector in Israel, while providing licenses to those producers to supply electricity to private consumers. The Company estimates that these resolutions are expected to continue to cause, in the short term, a significant increase in the installed generation volume of private producers, including generation using renewable energy.

The Company estimates that the increase in the generation volume of private consumers and transfer of private consumers to purchase electricity from private suppliers may have an effect over the activity of the Company in each of its activity segments, as stipulated in Section 7.4.4. The expected increase in the volume of activity of the private electricity producers and private transactions to purchase electricity creates uncertainty with respect to the volume of electricity that the Company will be required to generate in the future and to supply to consumers in the future, mainly to the big consumers.

The increase in generation in the national economy, whether by private electricity producers or by the Company, requires an enlargement of the distribution and transmission system, and accordingly, may cause additional operational and financial risks to the Company. In addition, the charge rate mechanism, as prescribed by the Electricity Authority, which is used for setting the charge rates of the Company today, include only a certain amount of consideration for the increase in the magnitude of electricity generated by private producers.

For details of the decision of the Electricity Authority within which arrangements and terms were determined for the transfer of distribution areas of historical distributors to other entities who will receive a license for distribution and supply of electricity, see section 9.4.1. For details of the draft recommendations of the Steering Committee and the Yogev Letter in this matter see Note 1 e to the Financial Statements.

28.3.6 Development and Advancement of the Development Plan in the Generation and Transmission Segments.

In accordance with the provisions of the Electricity Sector Law and its regulations and the licenses of the Company, and its classification as an "essential service supplier", the Company is required to submit for the approval of the Minister a Development Plan for the purpose of its activity and to fulfill them and their conditions. The failure of the Company to comply with the Development Plan may expose the Company and its managers to criminal sanctions and lead to the cancellation of some or all of the licenses that have been issued to it.

The future needs of the Electricity Sector in Israel may change in accordance with a great number of parameters, including future demand for electricity, climatic changes, developments of technologies and generation measures, different fuels that will be supplied to the Company, the geopolitical situation, the entry

⁹⁰ Decision no. 5 of meeting no. 451 of January 15, 2015, regarding "Decision of implementing reporting obligations on the Israel Electric Corporation Ltd. - generation, transmission, distribution, supply segments and general reports"

of private energy producers to the Electricity Sector and the Company's development budget cutback. Accordingly, the Company is required to predict future parameters at the time of processing and preparation of the Development Plan. To the extent that in actual fact, the parameters for prediction behave in a manner that differs materially from the manner in which they are predicted by the Company, the Development Plan of the Company may fail to match the needs of the Electricity Sector and impair the ability of the Company to supply the needs of the Electricity Sector, resulting from which they may impair the Company and its results and its ability to fulfill its undertakings as an "essential service supplier". In order to overcome the problem described above, the Company executes periodic updating of premises for the processing of the development plan, updates them if necessary and updates the development plan itself.

The execution of the Development Plan and the construction of new facilities by the Company require the Company to receive a large number of approvals, including construction permits, business licenses, environmental approvals and additional approvals – whose receipt is uncertain, and to the extent that they are received, there is no certainty that they will be received in time and without delays. In addition, there is no certainty that the Company will succeed in meeting the schedule or budget that have been prescribed for the execution of the Development Plan. Additionally, the budget cut increases the uncertainty of the required execution.

The execution of the Development Plan requires material capital investments, as stipulated in Section 7.7.7. In the past, and the Company expects this to be the case in the future too, the Development Plans were financed, partly or fully, by taking loans from domestic and foreign financial institutions and from raising of debt in public or private issues, in Israel or overseas. As of the date of publication of the report, there is no certainty with respect to the ability of the Company to execute the Development Plan, and this, inter alia, to the extent that the Company will not be able to raise debt from external sources and/or due to other budgetary considerations.

Obsolescence of the distribution grids makes it harder for the Company to meet the electricity supply reliability goals it has set. Additional delays in the renewal of the stated distribution grids may increase the damage to the reliability of supplying electricity to the Company customers.

For details of the draft recommendations of the Steering Team with regard to the investments plan see Note 1 e to the Financial Statements.

28.3.7 Structural change

The purpose of the Electricity Sector Law is to regulate the activity in the Electricity Sector to the benefit of the public, while ensuring reliability, availability, quality, efficiency, all while forming conditions for competition and minimization of costs.

As of the date of the report, the Company generates, transmits, distributes and supplies most of the electricity that is consumer in the Israeli economy, and therefore a structural change in the electricity sector in accordance with the Electricity Sector Law may weaken the status of the Company in the electricity sector in one or more of these activities, and decrease the monopolistic position of the Company in that activity.

The structure of the electricity sector, as set in the Electricity Sector Law, obliges execution of a structural change in the Company. As of the date of the report there is material uncertainty as to the manner in which the Electricity Sector Law will be implemented and the manner in which the Company and its activities, assets and liabilities will be reorganized in order to comply with the provisions of the Electricity Sector law.

If the provisions of the Electricity Sector Law are not changed (including the need to implement the recommendations draft of the steering team or the Yogev Letter) and/or the agreements required for the implementation of the recommendations draft of the steering team or the Yogev letter are not received, then it is possible that the Company will have to implement the Structural Change as it is laid down in the Electricity Sector Law, whether in the way in which the Company understands that the Electricity Sector Law can be implemented, as stated in Section 1.3, or in another outline.

Despite publication of the recommendations draft of the Steering Team and the Yogev Letter, as of the date of the report, there is yet no certainty with respect to the final format of the Structural Change, its time of

implementation or its consequences for the Company, its business affairs or outcomes, but the implementation of the Structural Change, including in accordance with the details of the Yogev Letter is expected to have a material effect on the Company, its business affairs, activity and financial outcomes.

For additional details regarding the provisions of the Electricity Sector Law in its current version and details regarding the recommendations draft of the Steering Committee (including the position of the Company regarding this draft of recommendations) and the Yogev Letter, see Note 1 e to the Financial Statements.

28.3.8 Asset arrangement

As described in Section 14.3, Section 62 of the Electricity Sector Law sets forth various provisions with respect to certain rights and assets which were held by the Company upon the expiry of the franchises which were granted to it by virtue of the Electricity Franchises Ordinance, with respect to part of which an arrangement is to be made between the State and the Company which shall govern the purchase thereof from the State according to the value of the assets on the date of conferral of the rights and the assets. As of the date of the report, no provisions have been established in the matter.

In February 2000, the Company received a letter from the Deputy Commissioner of Budgets in the Ministry of Finance, in which he states that within the framework of the Government team which has been appointed to handle the subject, the State has formulated an opinion, which includes an economic and accounting opinion and a legal opinion on behalf of the State with respect to the asset arrangement (the **"Opinion by the State"**). It was further noted in the Opinion by the State that some of the assets were held by the State on the date the Electricity Sector Law entered into force, with all the implications deriving from that. The letter stated that according to the content of the opinion by the State, it appears that the implementation of the asset arrangement pursuant to the Electricity Sector Law may have a material effect on the Company.

As detailed in Notes 1 e and Note 1 f to the Annual Financial Statements, on March 23, 2014, a draft of recommendations by the Steering Team was published, and included, *inter alia*, recommendations regarding the issue of asset arrangement. The Company delivered its reaction and initial position regarding this draft of recommendations, and its reservations regarding some of them, to the Steering Team. Additionally and as detailed in Note 1 f to the Annual Financial Statements, the issue of asset arrangement was also expressed in the Yogev letter which was received by the Company on September 8, 2014.

In the estimation of the Company, based on the opinion of its legal advisors, the asset arrangement should not have had and does not have, as of the date of this report, a material effect on the Company or on its monetary results or on its financial situation. At the same time, this point is open to determination by the Ministers. Accordingly, the Company has no possibility of estimating what the actual bottom line will be with respect to the asset arrangement, which opinion will be adopted – the opinion by the State or another interpretation, what the implications of the asset arrangement will be (if any) for the Company, which assets will be included in the asset arrangement, and which method will be used for calculating the value of the assets; furthermore, it is not in any way certain that the implementation of the asset arrangement, should it be implemented, and the manner and method in which it will be implemented, will not have a material effect on the Company's business, the results of its activity or its financial situation. Because the asset arrangement is subject, *inter alia*, to determination by the Ministers, it is possible that the Company will eventually be required to pay material amounts with respect to the assets to which it will apply. In addition, with respect to part of the assets, there is no certainty as to which monetary or other arrangement shall apply with respect thereto, or if they will remain in the possession of the Company or will be returned to the State. The Company further estimates that this issue will be arranged within the discussions of the structural change.

For additional details regarding the asset arrangement, including with regard to the recommendations draft of the Steering Team and the Yogev Letter, see sections 1.3 and 14.3 above as well as Note 1 e and Note 1 f to the Annual Financial Statements.

28.3.9 Legal

As of the time of this report, 11 petitions (one of which was submitted as an expansion of an existing claim) are pending against the Company for recognition of actions as class actions, 2 of which have been recognized as

class actions. The sum of 10 of the actions mentioned above amounts to a sum of approximately NIS 25.2 billion and another action has been assessed by the plaintiffs in the amount of several tens of millions of NIS. Additional claims are pending against the Company. For details of the actions see Section 23 above and Note 34(B) of the Financial Statements.

Based on the expert opinion of its legal counsel, the Company has not made for these class actions any provision in the Financial Statements, except for two actions in respect of which a negligible provision was recorded, but to the extent that these petitions are accepted in part or in full, this may have a material adverse effect over the Company.

28.3.10 Customers

The Company provides its customers credit and as a result of this, the Company is exposed to a risk of monetary loss as a result of insolvency or a decrease in the credit quality of debtors or parties to contracts or by unique characteristics of some of the customers of the Company (for details of the debt balance of the Palestinian Authority see Note 6 d to the Financial Statements). The Company is acting on the issue of collection enforcement using “red light” information⁹¹ with respect to deterioration in the business status of its strategic customers⁹², which is received on a regular basis from the business information companies and is transferred to the districts of the Company.

28.3.11 Labor relations

The labor relations in the Company are based mainly on the principles that are prescribed in the labor laws. The labor rules and the relevant procedures constitute the main normative source with regard to hiring at the Company, termination of employment, employment conditions and labor relations. The labor rules, whose legal status is a bilateral collective arrangement, are valid until December 31, 2015.

The Company acts to maintain good labor relations, while holding an ongoing dialog with the labor union and observing the implementation of the set of employment agreements at the Company. Changes in the field of labor relations, including due to relevant directions or decisions of the regulators that regulate the Company, including the Commissioner of Wages, may be expressed in labor disputes, which may lead to employee sanctions to the point of a long, all-out strike. The period of industrial peace (regarding the claims to increase the salary supplements cost and monetary benefits) under the last agreement of July 18, 2013 between the Company and the National federation of labor and the employee union was set until December 31, 2014 (this salary agreement exhausts the salary supplement updates of the company up to December 31, 2012).

Although in the past no material impairment in the supply of electricity has resulted, in the future, all out or protracted sanctions or strikes may impair the regular supply of electricity to the customers of the Company, the revenues, business outcomes, image and reputation of the Company.

The Company is holding a dialog with the New General Labor Federation and with the authorities of the State in order that changes in the labor relations in the Company, including within the Structural Change, organizational changes and cost saving plans will be conducted with the consent and approval of the relevant entities. To the extent that these changes are implemented without the consent of the labor union, this may lead to a labor dispute, which may affect the Company and its activity.

The Company estimates that the costs of employee retirement as part of the implementation of the Structural Change, insofar as will be implemented, may be material. For details regarding the estimates of the Company regarding the costs of the Structural Change in this mater, see Note 1 e to the Financial Statements.

For details regarding labor disputes see Note 34 c to the Financial Statements.

⁹¹ Red light [information] – the Company receives credit information – such as warnings about strategic customers on various financial issues, including bankruptcy and blocked accounts – on businesses, companies and entities from the information company BDI (Business Data Israel).

⁹² The Company defines a strategic customer as a customer that has a site that consumes more than 1 million kWh per year or a customer that has a number of sites that in total consume more than 5 million kWh per year.

28.3.12 Liabilities for pension fund

The deposits into the pension fund of the Company, for first generation and second generation employees who are insured by budgetary pension, are based on a forecast of the expected cash flows in the future and a number of actuarial assumptions (the pension of third generation employees is an accumulating pension). There is a risk that the actual pension liabilities of the Company will differ from those that are predicted by it, based on which the Company is making the deposits into the pension fund; therefore, to the extent that the deposits and their proceeds do not cover the liabilities, the Company may be required to make additional deposits for the pension period, to amounts that may be material for the Company. In addition, the actuarial model for the calculation of the deposits into the pension fund may change in the future, *inter alia* in accordance with changes in the life expectancy, on regulatory issues and in the economic climate and changes in the actuarial model as set forth above may require the Company to make additional deposits, in significant amounts, into the pension fund.

In addition, the investment policy of the pension fund, of money that is deposited in it by the Company, as well as differences between the lifetime and return of Government bonds in which most of the assets of the pension fund are invested and the lifetime and return of linked Government bonds by which the pension liabilities of the Company are calculated, may lead to the total assets of the fund being lower than the liabilities of the fund to the pensioners of the Company, in which case the Company will be required to make good the gap between the assets and the liabilities of the fund, to amounts that may be significant.

28.3.13 Generation Array Management

Non-optimal operation and/or maintenance of the generation units (such as under extreme operation regimes or not according to the manufacturer's instructions) may lead to non-fulfillment of the requirements of the system administration and regulatory requirements, damage in generation performance, increased wear of the generation units and shortening their life span, and malfunctions in the generation array. In order to reduce this risk, the Company executes maintenance and operation controls (such as: administering and planning maintenance, monitoring the condition of the equipment, analyzing sensitive events, improving skills of the operating team and management and control of the strategic parts inventory).

In circumstances where not meeting the full demand can be attributed to the Company not meeting its liabilities under its licenses or the provisions of the law, it may constitute a breach of these liabilities and adversely affect the Company, its outcomes and its image in the public eye.

28.3.14 Managing the life cycle of the transmission transformation and distribution array

Lack of optimal management throughout the lifecycle of the transmission, transformation and distribution array may cause harm to the reliability of the supply to the customers of the Company, lack of compliance with legislation and regulation requirements, increased exposure to risks of electrocution and fires, loss of income due to numerous technical failures, damage to the image of the Company, and possible damage to the environment.

28.3.15 Embezzlement and Fraud

The Company conducts extensive business operations of billions of Shekels a year, and is therefore exposed to a wide range of risks of embezzlements and fraud that may cause financial damage and harm its image.

Included in this risk are, *inter alia*, misuse of assets, means of payment, biased tenders, etc.

The central work processes of the Company are supported by, *inter alia*, several information systems. The risk of embezzlement or fraud may materialize within the work process or through the information systems that support it. The main exposures that have been identified may materialize in the following fields: Acquisition and contractual engagements with suppliers, tender management, revenues from collection and execution of special projects, storage and inventory management, wages, investment management and use of means of payment, information management and trade secrets.

As part of the handling of the risk, a survey of embezzlement and fraud was conducted in the past, and as a result a risk reducing program was written, and the internal audit is conducting an ongoing follow-up of its implementation. The Company has an inter-departmental team headed by an embezzlement and fraud risk controller, who from time to time monitors the implementation of the recommendations of the risk surveys in the various units of the Company, and prepares an annual work plan for the risk owner within which there are reviews of risks that in the opinion of the team contain exposure to the realization of embezzlement or fraud. The Company is currently completing a new embezzlement and fraud risk survey.

Furthermore, the Company determined several instructions in order to minimize the likelihood of materialization of the risk, such as: rotation of tender committee heads, executing audits and increasing stocktaking at the Company warehouses, orderly and strict management of all the authorizations system at the division of information systems and teleprocessing, encouraging reports of irregularities, etc.

Beyond that stated, as of December 31, 2012, the Company is undergoing a process of adopting and implementing an internal enforcement program in the field of prohibition of bribing a foreign public official. Within this, the Company is formulating an outline for a program in the field of prohibition of bribing a foreign public official according to guidelines of criteria that were set by the OECD organization. This process also continued in 2013 and 2014 and the Company estimates that it will be completed during 2015. In addition, the CEO of the Company has given his approval to the program outline.

29. Additional details in accordance with circular 2013-5-1 of the Government Companies Authority

29.1 Money that the Company has received from the State

See Section Regulation 22 in Chapter D of this annual statement for details on the loans that the Company has received from the state.

29.2 Disclosure with respect to investee corporations

Details with respect to held corporations follow:

Name of the Company	Country and place of incorporation	Rights of the Company in the Company (including means and control, asset rights, rights to distribution of profits and details, to the best of the Company's knowledge, with respect to other holders of the held corporation and their rights)	Names of the officers and other representatives who are serving or have served on behalf of the Company in the Company in 2014 and the compensation from the held corporation for this service	Material agreements between the Company and the held corporation, including guarantees to third parties for securing the liabilities of the Company	Dates of general meetings during the period of the Prospectus, the issues discussed in them and the resolutions adopted, manner of voting by the Company and the party that decided as to the manner of voting
Jordan Properties Company Ltd.	Israel	Fully owned (99.98%) subsidiary ⁹³ . The Company holds 100% of the rights that are attached to the shares, including rights to receive a dividend, voting rights and the right to appoint functionaries and directors by the Company, subject to the provisions of the Government Companies Law.	Until his termination of office as legal advisor and Company Secretary, on December 31, 2014, Adv. Dudu Yahav served as the legal adviser and secretary of the held corporation, without receiving additional compensation for this service. As of this date, no office holders or other representatives of the Company are serving in the held corporation ⁹⁴ .	None.	No general meetings were held during 2014.
Migrashei Hakablanim Ltd.	Israel	A fully owned (100%) subsidiary ⁹⁵ . The Company is held at 100% of rights attached to shares, including rights to receive a dividend, voting rights and the right to appoint functionaries and directors by the Company, subject to the provisions of the Government Companies Law.	Until his termination of office as legal advisor and Company Secretary, on December 31, 2014, Adv. Dudu Yahav served as the legal adviser and secretary of the held corporation, without receiving additional compensation for this service as stated. As of this date, no office holders or other representatives of the Company are serving in the held corporation ⁹⁶ .	There is no material agreement for the Company. Migrashei Hakablanim Ltd. has a right of lease from the Tel Aviv Municipal Council for a plot in Anielewicz Street, on which there is an office building that is being used by the Company. In exchange for a right of use of the property, the Corporation bears all of the costs related to the maintenance of the property, including taxes and fees.	No general meetings were held during 2014.

⁹³ 66 ordinary A shares are held by officers in trust for the Company, and an additional ordinary A share is held by the trustees of the estate of Pinchas Rothenberg.

⁹⁴ As of the date of the report, the Company is working on obtaining approval to appoint directors on the part of the held company.

⁹⁵ 630 deferred shares are held by officers in trust for the Company.

⁹⁶ As of the date of the Report, the Company is working to obtain approval for the appointment of directors on its part in the held company.

Name of the Company	Country and place of incorporation	Rights of the Company in the Company (including means and control, asset rights, rights to distribution of profits and details, to the best of the Company's knowledge, with respect to other holders of the held corporation and their rights)	Names of the officers and other representatives who are serving or have served on behalf of the Company in the Company in 2014 and the compensation from the held corporation for this service	Material agreements between the Company and the held corporation, including guarantees to third parties for securing the liabilities of the Company	Dates of general meetings during the period of the Prospectus, the issues discussed in them and the resolutions adopted, manner of voting by the Company and the party that decided as to the manner of voting
The National Coal Supply Company Ltd.	Israel	Fully (100%) owned subsidiary. The Company holds 100% of the rights attached to shares, including rights to receive a dividend, voting rights and the right to appoint functionaries and directors by the Company, subject to the provisions of the Government Companies Law and the articles of the Coal Company. According to the articles of the Coal Company, out of the nine members of the Board of Directors, six are representatives of the Company and three of the State.	Yaakov Hain, the Assistant CEO and Deputy Customers, until December 31, 2014 served as the chairman of the Board of Directors of the held company until expiry of his term on January 22, 2014. On March 13, 2014, Mr. Hain was reappointed as director of the Coal Company, and his term ended on December 31, 2014. He does not receive additional compensation for this service. Besides this, the acting directors from among the employees of the Company serve in the Coal Corporation, including: Shakib Gadban, Tali Danieli, Efraim Osher and Galit Globus ended their term in office on January 22, 2014. The directors mentioned above did not receive additional compensation for this service. On March 13, 2014, the Company appointed directors to represent it at The National Coal Supply Company Ltd.: Shakib Gadban, Efraim Osher, Oren Helman, Masha Hafiorski and Michal Yogev-Azulai. The directors mentioned above did not receive additional compensation for their term as stated. In addition, from January 2012, Adv. Shai Almalh, an employee of the Company, has been serving as a	The Company purchases all of the coal that it requires through the National Coal Supply Company Ltd., in accordance with an agreement that was signed between the parties in July 2004 for the purchase of coal and its supply to the power stations of the company consuming coal. See Section 7.9.6 for details on the agreement.	An ordinary general annual meeting was held on September 8, 2014, resolutions discussed and approved by majority of votes – approval of the Financial Statements for the year ended December 31, 2013, approval of appointment of the Haikin, Cohen, Rubin & Co. offices as the auditing accountant of the company, following the approval of the Government Companies Authority and according to section 44(a) to the Government Companies law - 1975; approval of the distribution of a dividend to shareholders with respect to profit of 2013.

Name of the Company	Country and place of incorporation	Rights of the Company in the Company (including means and control, asset rights, rights to distribution of profits and details, to the best of the Company's knowledge, with respect to other holders of the held corporation and their rights)	Names of the officers and other representatives who are serving or have served on behalf of the Company in the Company in 2014 and the compensation from the held corporation for this service	Material agreements between the Company and the held corporation, including guarantees to third parties for securing the liabilities of the Company	Dates of general meetings during the period of the Prospectus, the issues discussed in them and the resolutions adopted, manner of voting by the Company and the party that decided as to the manner of voting
The Managing Company of the Advanced Studies Fund of Israel Electric Corporation Ltd., Employees Ltd.	Israel	The Company holds 50% of the management shares and the rights to appoint directors, without rights for participation in profits. 50% remain held as follows: the Mutual Help Society of Israel Electric Corporation Employees in the Southern Region (Final Holder) (25%), the Society of Israel Electric Corporation Workers in the Northern Region (RA) (Final Holder) 16.667% and the Savings and Mutual Help Fund of Israel Electric Corporation Workers in Jerusalem Ltd. (Final Holder) (8.333%)	In the Advanced Study Fund, directors from among the employees of the Company serve on behalf of the Company: Dvir Yosef (pensioner), Eckstein Menashe, Waldman Mordechai Alexander Zayad and Israel Movshovitz. They receive no compensation for this service. Adv. Iris Joachims, an employee of the Company, serves as a legal adviser of the held company. She does not receive additional compensation for this service. Gur Achiezra, an employee of the Company, serves as the Internal Auditor of the held company. He does not receive additional compensation for this service.	None	On October 30, 2013, a general annual meeting convened and decided on the following subjects: approval of the Financial Statements of the Company for the years 2010-2012, approval of appointment of the Somekh Haikin, office as the auditing accountant of the company and the fund for 2012/13 and determining its fees, approval of the contractual engagement of the Company for insurance of office holders and professional liability for 2012/13, approval of extension of office of external directors. The Company voted by an authorized representative appointed by the Board of Directors of the Israel Electric Company.

Name of the Company	Country and place of incorporation	Rights of the Company in the Company (including means and control, asset rights, rights to distribution of profits and details, to the best of the Company's knowledge, with respect to other holders of the held corporation and their rights)	Names of the officers and other representatives who are serving or have served on behalf of the Company in the Company in 2014 and the compensation from the held corporation for this service	Material agreements between the Company and the held corporation, including guarantees to third parties for securing the liabilities of the Company	Dates of general meetings during the period of the Prospectus, the issues discussed in them and the resolutions adopted, manner of voting by the Company and the party that decided as to the manner of voting
The Energy Resource Development Company Ltd.	Israel	The Company holds 49.99% of the shares and capital rights and 30.77% of the rights to appoint directors. The remainder of the rights are held equally by Israel Chemicals Ltd. and Refineries Ltd. The State of Israel holds one foundation share, which grants it certain rights of management and appointment of directors	To the best of the Company's knowledge and as of the date of the report, the company is inactive.	To the best of the Company's knowledge and as of the date of the report, the company is inactive. During 2001, the activity of ERD was discontinued due to a decision of the shareholders to stop the transfer of money for its activity. In this context, an agreement was signed between the shareholders, defining the form of termination of the service of ERD and the sale of its assets.	No general meetings were held during 2014.

Eliyahu Glickman
Chief Executive Officer

Dr. Ziv Reich
Chairman, Committee for
Reviewing the Financial Statements

Yiftah Ron-Tal
Chairman of the
Board of Directors

Date of Approval: March 24, 2015



The Israel Electric Corporation Ltd.

Chapter B

Board of Directors' Report on the Status of the Company's Affairs

For the Year Ended
December 31, 2014

Prominent Disclaimer

This English translation of the "**Company's Board of Directors' Report on the Status of the Company's Affairs**" for the twelve months ended December 31, 2014 ("English Translation") is provided for informational purposes only.

In the event of any conflict or inconsistency between the terms of this English Translation and the original version prepared in Hebrew, the Hebrew version shall prevail and holders of the Notes should refer to the Hebrew version for any and all financial or other information relating to the Company.

The Company and its Directors make no representations as to the accuracy and reliability of the financial information in this English Translation, save that the Company and its Directors represent that reasonable care has been taken to correctly translate and reproduce such information, yet notwithstanding the above, the translation of any technical terms are, in the absence of generally agreed equivalent terms in English, approximations to convey the general sense intended in the Hebrew version.

The Company reserves the right to effect such amendments to this English Translation as may be necessary to remove such conflict or inconsistency.

THE ISRAEL ELECTRIC CORPORATION LIMITED
BOARD OF DIRECTORS' REPORT
ON THE STATUS OF THE COMPANY'S AFFAIRS
FOR THE YEAR ENDED DECEMBER 31, 2014

The Board of Directors of the Israel Electric Corporation (the "Company") hereby presents the Directors' Report on the status of the Company's affairs for the year ended on December 31, 2014, ("The Report Period") according to the directives of the Securities Regulations (Periodic and Immediate Reports) – 1970 ("The Securities Regulations") and the provisions of circulars of the Government Companies Authority ("The Companies Authority"), including the "Financial Statements Circular 2013-5-1" ("Financial Statements Circular").

a. Explanations of the Board of Directors on the Business Condition of the Company

1. Brief Description of the Company and its Business Environment

a) General

The Company acts as one combined and coordinated system that deals in supplying electricity to consumers, starting from the electricity generation stage through transmission, distribution and supply of and commerce in electricity, all in accordance with licenses granted to each type of activity, which are effective, as of the date of the signing of this report, up to January 1, 2016. The Company also deals in the construction of the infrastructure required for these activities. Company operations include three main fields: generation, transmission and transformation of electricity and its distribution, and it also operates as the Electricity Grid Administrator. The Company provides electricity to most of the State's consumers of electricity. The Company is owned by the State of Israel which holds about 99.85% of its share capital, therefore the Company and its operations are subject, inter alia, to the directives of the Government Companies Law – 1975 (the "Government Companies Law"). As of March 5, 1996, the Company operates according to the Electricity Sector Law – 1996 (the "Electricity Sector Law") and its regulations. The Electricity Sector Law replaced the Electricity Concessions Order and the Public Utilities Authority - Electricity (the "Electricity Authority") was founded according to this ordinance. The duties of the Electricity Authority are, among others, to set electricity rates and define rate update processes, to award licenses and to supervise fulfillment of instructions specified in the licenses. For additional details on the Electricity Sector Law, see Note 1b to the Financial Statements of December 31, 2014 (hereinafter: "Financial Statements").

b) Condensed Review of the Changes in the Business Environment

- 1) On July 22, 2013, the Ministers appointed a Steering Team for execution of a reform in the electricity sector and the Electric Company, headed by Mr. Uri Yogev. For additional details see Note 1 e to the Financial Statements.
- 2) For details of the rating of the Company see Note 20f to the Financial Statements.
- 3) Entry of private producers - on May 19, 2014, Dorad began its commercial operation, and its commercial framework comprises the sale of most of the electricity to private consumers and the sale of surplus electricity to the Company on a competitive basis, by the method of price bidding. For details of all the private producers see Note 34 a 4) to the Financial Statements.
- 4) For details of decisions and proceedings at the Labor Court concerning labor disputes and sanctions taken, see Note 34 c to the Financial Statements.
- 5) On October 5, 2014, the Ministerial Committee for Social and Economic Affairs (Socio-Economic Cabinet) (hereinafter: the "**Cabinet**") approved a "Multi-annual Plan to execute Issue of Minority Interests in Government Companies" (hereinafter; the "**Decision**").
In the Decision it was decided, inter alia, to approve a multi-annual plan to execute the issue of minority interests in government companies (hereinafter: the "**Plan**"), and to promote the creation of an appropriate legal infrastructure for executing the issue of minority stakes in government companies in order to implement the Plan.

THE ISRAEL ELECTRIC CORPORATION LIMITED
BOARD OF DIRECTORS' REPORT
ON THE STATUS OF THE COMPANY'S AFFAIRS
FOR THE YEAR ENDED DECEMBER 31, 2014

a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

1. Brief Description of the Company and its Business Environment (continued)

b) Condensed Review of the Changes in the Business Environment (continued)

5) (continued)

The Cabinet classified the Company as a company in which the State has an interest in maintaining long term government control. Accordingly, under the Plan outline, in 2017, subject to a Government decision to perform a structural change in the Company, as far as a decision will be reached, and considering the nature of the structural change that will be formulated, an issue of minority interests in the Company will be executed at a total amount of up to 25% of the share capital of the Company (fully diluted).

Additionally, in the Decision, the Cabinet instructed the Government Companies Authority to act so that the companies included in the Plan (including the Company) will distribute dividends to the State in a total amount of approximately NIS 500 million in each of the years 2015-2017, all subject to the progress of the privatization proceedings according to the timetables set and subject to the distribution analysis and permits required under the law, as amended, insofar as will be required. For details of the Company's dividend distribution policy and restrictions applying to it when distributing dividends see Note 26 to the Financial Statements.

- 6) In November, 2014, the Company completed the Issue of debentures to qualified institutional buyers in the U.S.A. according to Rule A144 of the U.S. Securities Act of 1933, as amended (hereinafter: the "U.S. Securities Act"), and outside the U.S.A., based on Regulation S of the U.S. Securities Act, in a total amount of USD 1.25 billion (the "Debentures").

The debentures issued as aforesaid under the plan were listed for trading in the "institutional continuous trading" system at the TASE as debentures of series Electric Dollar 2024. The debentures were issued at a price of 99.031% and the consideration of the issue (gross) was approximately USD 1,238 million. The nominal interest is 5% (effective yield to maturity 5.125%) and will be paid in semi-annual installments. The debenture principal will be paid in one payment on November 12, 2024.

The Debentures were issued as part of a comprehensive program in a total amount of USD 5 billion (Global Medium-Term Note Program) (the "Program"). As part of the Program, the Company has so far issued debentures in a total amount of approximately USD 3.4 billion, and the amount remaining to be used by the Company within the program will be USD 0.35 billion.

The debentures were listed for trading within the Institutional Continuous Trading system on the Tel Aviv Stock Exchange Ltd.

- 7) On November 5, 2014, the National Gas Authority of the Ministry of National Infrastructures, Energy and Water (the "Gas Authority") gave its approval for the Company to market and sell surplus natural gas.

For details of the approval of the Gas Authority, the terms included in it and the Company's reservations about it, see section 4.4 of Chapter A of the Periodic Report of the Business Affairs of the Company of December 31, 2014 (hereinafter: "Chapter A").

- 8) In November, 2014, the Securities Authority published a staff accounting bulletin number 21-1, regarding the existence of a high quality corporate debenture deep market in Israel. Accordingly, as of December 31, 2014, the Company is using the capitalization rate that corresponds to the market yields that are appropriate for the high quality corporate debentures. The impact is a decrease in the actuarial liability of approximately NIS 5.2 billion. For additional details of the impact on the Company due to publication of this bulletin by the Securities Authority see Note 12 h to the Financial Statements.

THE ISRAEL ELECTRIC CORPORATION LIMITED
BOARD OF DIRECTORS' REPORT
ON THE STATUS OF THE COMPANY'S AFFAIRS
FOR THE YEAR ENDED DECEMBER 31, 2014

a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

1. Brief Description of the Company and its Business Environment (continued)

b) Condensed Review of the Changes in the Business Environment (continued)

9) Transition to International Standards

- a) Starting January 1, 2015, the Company will fully implement the International Financial Reporting Standards (hereinafter: the "IFRS rules") in its financial statements.

On August 21, 2013, the reply of the Securities Authority to a preliminary application by the Company regarding the manner of transition to international standards was received, under it the Company received an exemption from the obligation to include comparative data for two years in its first financial statements that are prepared under the IFRS standards (the reports of 2015 only) and the Company will be permitted to include comparative figures for one year (2014) in these reports only. In addition, the date of transition to the IFRS standards was set at January 1, 2014.

- b) As stated in Note 2 z4 to the Financial Statements, in January, 2014, the International Financial Reporting Standard number 14 was published, regarding deferred regulatory accounts (hereinafter: the "Standard" or "IFRS 14"). The standard enables a Company that implements the IFRS standards for the first time to continue to implement the existing practice on the subject of recognition of regulatory assets and liabilities. Therefore, the Company will recognize regulatory deferred accounts, which are essentially similar to the regulatory assets and liabilities existing in these statements, in its financial statements that will be prepared in accordance with IFRS standards.

- c) According to the IFRS standards as of the date of transition, the Company will use the relief provided under IFRS 1 to determine the "deemed cost" of the fixed assets and the other assets as the described cost that was presented in the Financial Statements as of January 1, 2014.

Regarding the implications of the transition to the International Standards see Notes 2a and 36 to the Financial Statements.

- 10) On February 25, 2015, a special collective agreement was signed between the Company and the New National Labor Federation and the Employee union (hereinafter: the "Collective Agreement"). It was agreed in the Collective Agreement, inter alia, on early retirement of 400 to 440 permanent employees in 2015, granting tenure and conditions for eliminating permanent positions following the agreements, extending employment of temporary employees employed in projects, deducting salary due to participation of employees in sanctions and strikes, industrial peace and exhausting claims in issues arranged in the agreement. For additional details see Note 12 f to the Financial Statements.

- 11) The Centralization Law was published on December 11, 2013. Part B of the Centralization law deals with consideration of sectoral centralization considerations and competition considerations in the area when allocating rights. Within the law, a "Committee for Reducing Centralization" was appointed, and its members are the General Director of the Antitrust Authority (as Chairman of the Committee), the Director General of the Ministry of Finance or head of division of the Ministry of Finance, and the head of the National Council of Economics or one of his deputies.

For details of the significant impact of the law on the Company see section 39 n to the Financial Statements.

- 12) In 2014 and after the date of the statement of financial position, a number of senior office holders of the Company retired or announced their resignation, including the Company CEO, Deputy CEO, Senior Vice President - Customers, Senior Vice President - Finance and the General Counsel of the Company. As of the date of publication of the report, the Board of Directors of the Company appointed Mr. Itzhak Balmas as Senior Vice President - Customers, Advocate Yael Nevo as the General Counsel of the Company and Mr. Ofer Bloch as Company CEO. The appointment of Mr. Ofer Bloch requires the approval of the Minister of Finance and the Minister of National Infrastructures, Energy and Water, after consultation with the Committee for Reviewing Appointments of the Companies Authority.

**THE ISRAEL ELECTRIC CORPORATION LIMITED
BOARD OF DIRECTORS' REPORT
ON THE STATUS OF THE COMPANY'S AFFAIRS
FOR THE YEAR ENDED DECEMBER 31, 2014**

- a. **Explanations of the Board of Directors on the Business Condition of the Company (continued)**
- 1. **Brief Description of the Company and its Business Environment (continued)**
 - b) **Condensed Review of the Changes in the Business Environment (continued)**

13) On January 21, 2015, the Electricity Authority published decisions regarding the 2014 annual update. As part of the decision, the electricity rate will be reduced on average by 11.8% starting from February 1, 2015, regarding the rate that entered into force on May 16, 2013. For the other main points of the decisions see Note 3 a 3 to the Financial Statements.

THE ISRAEL ELECTRIC CORPORATION LIMITED
BOARD OF DIRECTORS' REPORT
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a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

1. Brief Description of the Company and its Business Environment (continued)

c) Information Required in Accordance with the Directives of the Government Companies Authority

1) Targets and Strategy

For general details of the Company's targets and strategies see section 25 of Chapter A.

In December, 2013, the Companies Authority, in collaboration with the Ministry of Environmental Protection, published a guidebook for sustainable development in Government Companies, in order to assist companies to implement principles of sustainable development and corporate responsibility. Following this, a Companies Authority circular on the subject of Sustainable Development in Government Companies - Implementation Instructions was sent in December 2013.

In June, 2014, the Company delivered its policy and strategy report for corporate sustainability on its behalf according to the instructions of the guidebook.

The report includes, inter alia, the sustainability vision and the sustainability policy of the Company in various fields.

The strategic policy for sustainable development was presented to the management of the Company and the Board of Directors and approved as required in the guidebook. In addition, office holders were appointed to synchronize the many activities that are carried out in the fields of the environmental and social sustainability. A steering committee was appointed for the process, headed by the Company CEO, and tracking and reporting modes were set.

As part of the work of the steering committee in the Company, processes of mapping and updating were carried out for the main areas of sustainable development processes in the Company, including defining targets for the multi-disciplinary environmental issues, office holders were appointed to synchronize the many activities executed in the field of environmental and social sustainability, approximately 20 inter-divisionary work teams were appointed (main and secondary) in the environmental and social fields. The work teams are working to realize annual and multi-annual work plans in diverse fields, such as: internal energetic efficiency, prevention of soil, air and water sources pollution, handling hazardous materials, biological diversity, landscape appearance of the Company's facilities, various types of waste, fuel infrastructures, wise use of paper, using water for operating and administrative needs, etc.

The annual work plans are discussed, budgeted within the annual development and operation budgets, and constantly monitored by the management's steering team for environmental sustainability.

In February 2015, a report of the activity to promote the issue in 2014, including targets and timetables, was submitted to the Government Companies Authority.

Additionally, various actions in the field of corporate sustainability in the Company are executed, such as:

Awarding the CEO Sustainability Prize, updating the Company's website on sustainability matters, integrating sustainability issues in various internal Company trainings, expanding the platform for dialogue with interested parties (inter alia, employees, investors, business partners and suppliers, customers and end users and the local community) etc.

At the same time, the Company voluntarily organized the formulation of the Corporate Sustainability Reports for 2012 and 2013 which were published on the Company's website.

2) The major financial targets of the Company

The long term targets are presented below:

- (a) Financial debt ratio to EBITDA of 6.5 (the EBITDA of 2014 in the amount of NIS 10,787 million after excluding regulatory assets and an amount of NIS 7,531 million including regulatory assets. The net financial debt of the Company as of December 31, 2014, is NIS 46,849 million. The net financial debt to EBITDA ratio as of December 31, 2014 is 4.3 after excluding regulatory assets and 6.2 including regulatory assets).

THE ISRAEL ELECTRIC CORPORATION LIMITED
BOARD OF DIRECTORS' REPORT
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a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

1. Brief Description of the Company and its Business Environment (continued)

c) Information Required in Accordance with the Directives of the Government Companies Authority (continued)

2) The major financial targets of the Company (continued)

(b) Total debt ratio to total balance will gradually decrease to 81% (as of December 31, 2014, the ratio stands at approximately 83%).

(c) Maintaining the 'BBB-' international rating (for additional details, see Note 20 of the Financial Statements).

(d) Cash in hand balance— not less than NIS 2.2 billion. In accordance with the decision of the Board of Directors that the fuels inventory up to a value of NIS 800 million constitutes completion of the safety cushion in the amount of NIS 3 billion. (As of December 31, 2014, the cash and cash equivalents balance is approximately NIS 4.5 billion, and the short-term investments balance is approximately NIS 2.6 billion).

(e) According to the five-year financial plan, decreasing financial debt by NIS 0.5 billion per year.

3) The Electric Company's strategic emergency awareness and readiness plan:

The Company's preparations for emergency and the main points of the "strategic emergency awareness and readiness plan" were presented and approved in a meeting of the Board of Directors of the Company of August 14, 2013.

The plan is based on directives of the Government Companies Authority, as detailed in the Companies Authority circular on the subject of July 11, 2012.

The plan includes the policy and targets of the Company for continued functional continuity and emergency electricity supply on the basis of priorities defined primarily for essential plants as well as for all the customers of the Company in times of emergency.

As part of the preparations of the Company, scenarios have been prepared for total/regional war, natural disasters, operating malfunctions, cyber, epidemic, and electro-magnetic-pulse (EMP).

The Company acts in cooperation with guiding entities in the State, prepares emergency plans and procedures, defines service levels for emergency, takes care to confine emergency manpower, operates an organizational and personal resilience array, conducts instructions, training and practice for employees and systems for various situations, and draws conclusions from actual events and drills and monitors their implementation.

The Company has established a risk management system subject to regulatory requirements, including risk identification programs and activities to minimize them.

The company purchased an insurance policy for damages and indirect expenses as a result of natural disasters, fire, explosion, contamination and mechanical damage.

The Company holds stocks of fuels, materials and equipment for emergency and operating failures.

The Company has established an array of headquarters, alternative headquarters that can change locations in times of need, and reporting rules and systems for emergency that are drilled every year.

The Company has a security, firefighting, search and rescue teams array for initial and immediate response, including the necessary emergency measures.

The Company has made preparations for business continuity in the computer, communication, spokespersonship and public information systems.

The Company conducts internal national drills on a regular annual basis, participates in national exercises, army headquarters exercises, exercises by government ministries, designated authorities, home front command, Israeli Police, at the national and district/local level.

THE ISRAEL ELECTRIC CORPORATION LIMITED
BOARD OF DIRECTORS' REPORT
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a. **Explanations of the Board of Directors on the Business Condition of the Company (continued)**

1. **Brief Description of the Company and its Business Environment (continued)**

c) **Information Required in Accordance with the Directives of the Government Companies Authority (continued)**

3) **The Electric Company's strategic emergency awareness and readiness plan (continued):**

During the "Tzuk Eitan" Operation in summer 2014, and in winter 2015 during which an "activation" condition was announced by the Company in three different events, the Company operated in emergency mode.

- 4) For additional details in accordance with the Government Companies Authority directives, see Note 39 to the Financial Statements.

d) **Estimate of the Financial Impact of the Difference between Financial Reporting Principles as Applied in the Financial Statements of the Company and the International Financial Reporting Standards (hereinafter: "IFRS" Standards)**

1) **General**

The Financial Statements of the Company are prepared in accordance with the Government Companies Regulations (The Principles for Preparing Financial Statements of the Israel Electric Corporation Ltd.) (Temporary Order), 2004 (hereinafter: "Government Companies Regulations"), as detailed in Note 2 a 1) to the Financial Statements.

As of January 1, 2015, the Company has to prepare its financial statements with full implementation of the IFRS.

- 2) The Company provided a qualitative disclosure with regard to the gaps between the IFRS and the financial reporting principles implemented in the Financial Statements. For details of the impact of the transition to IFRS see Note 36 to the Financial Statements.

THE ISRAEL ELECTRIC CORPORATION LIMITED
BOARD OF DIRECTORS' REPORT
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a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

1. Brief Description of the Company and its Business Environment (continued)

e) Electricity Rate

- 1) Comparison between Income of the Company according to the Rate Formula and the Expenses of the Company for the Period January – December 2014, In Millions NIS, at December 2014 NIS

	Income of the Company according to the formula of the rate	Expenses of the Company according to the Financial Statements	Gap	Return on equity approved by the Electricity Authority	Total profit before taxes on income
Fuel and electricity purchases	13,892	12,958	934		
Operation	3,475	4,690	(1,215)		
Depreciation and amortization	3,953	4,239	(286)		
Financing expenses	1,795	2,787	(992)		
Advance due to new rate base for transmission and distribution segments	386	-	386		
Expenses with respect to pensioners	24	2	22		
Miscellaneous and differences	(200)	(240)	40		
Total	23,325	24,436	(1,111)	1,335	224

- 2) Comparison between the Income of the Company according to the Rate Formula and the Expenses of the Company for the Period January – December 2013, In Millions NIS, at December 2014 NIS

	Income of the Company according to the formula of the rate	Expenses of the Company according to Financial Statements	Gap	Return on equity approved by the Electricity Authority	Total loss before taxes on income
Fuel and electricity purchases..	16,312	16,514	(202)		
Operation	3,770	4,847	(1,077)		
Depreciation and amortization	3,928	4,677	(749)		
Financing expenses	1,847	2,166	(319)		
Expenses with respect to pensioners	24	20	4		
Advance due to new rate bases for transmission and distribution segments	361	-	361		
Miscellaneous and differences	(314)	(196)	(118)		
Total	25,928	28,028	(2,100)	1,293	(807)

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a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

1. Brief Description of the Company and its Business Environment (continued)

e) Electricity Rate (continued)

Remarks:

1. In the transmission and distribution segments, the Authority applies reduction coefficients to all the income components and did not determine the specific component in which the Company has to improve efficiency.
For the purpose of calculation it was assumed that the depreciation coefficient is identical for all the income components of those segments.
2. In determining the rate, the Authority recognized some of the expense items not in accordance with the classifications listed in the Financial Statements. Adjustments were made in this table to both income and expenses of the same items that were recognized by the Authority in a different classification to that recorded in the Financial Statements, so as to obtain an appropriate comparison between the Company's income and its expenses.
3. The calculations of the Company's income in each segment were based on the average rate, according to the energy conveyed in that segment.

3) The Main Explanations for the Gaps according to Components:

a) Fuel

The gap in fuels is due to the addition of recognition by the Electricity Authority with respect to previous years within the 2014 annual update. Additionally, in 2014, profitability arising from the performance of the Company which differ from the normative recognition of the Electricity Authority and from consumption of fuels from inventory.

(b) Operation

Gap in the operational component derives mainly from non-recognition of the full renovation costs of power stations and from prolonged delay in updating the rates base in the transmission and distribution segments. In addition, provision to a reserve for doubtful debts with respect to debts that are difficult to collect.

c) Depreciation

The gap in the depreciation component derive mainly from the prolonged delay in updating the rates base for the transmission and distribution segments, amounting to hundreds of millions of NIS each year.

d) Financing Expenses

The gap in the financing expenses derives from non-recognition of part of the Company's fixed assets cost and from the Company's exposure to foreign currency and revaluation of hedging transactions to fair value.

THE ISRAEL ELECTRIC CORPORATION LIMITED
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a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

1. Brief Description of the Company and its Business Environment (continued)

f) Report of gaps between the recognized costs of the electricity rates and the actual costs for 2014 in accordance with the Electricity Authority's decision of February 9, 2015

This disclosure is provided commencing from this report in accordance with the decision of the Electricity Authority and in the format set by it. Its purpose is to compare sums recognized with respect to each component of the rate with the results in practice. However, the attribution to the various rate components was carried out on the basis of assumptions and estimates executed by the Company, on the basis of its understanding of the electricity rate. Regarding the allocation of costs and the assumptions this allocation is based on, see Note 38 to the Financial Statements regarding the activity segments of the Company. This disclosure does not relate to the financing expenses and the tax.

It should be noted that the Company had reservations regarding the structure of presentation set by the Authority for various reasons, but the Authority did not accept the Company's position in the matter.

Generation segment

Section	Rate component in NIS million, in December 2014 NIS					
	Fuels	Purchases of Electricity	Operation less efficiency (including expenses for pensioners)	Depreciation	Operating profit	Total income
Income according to actual rate/rate in force as calculated by the Company (1)						19,421
Deviation in actual income due to deviation in consumption distribution (2) ..						44
Movement in regulatory assets*						(4,504)
Adjustments**						365
Theoretical income from rates (3)	8,048	680	2,824	2,082	1,691	15,325
Classifications compared to the Financial Statements (4)	254	(187)	(704)	379	71	(187)
Total theoretical income from rates classified according to Financial Statements	<u>8,302</u>	<u>493</u>	<u>2,120</u>	<u>2,461</u>	<u>1,762</u>	<u>15,138</u>
Actual results according to segment Note (5)	11,476	498	2,234	2,356	2,699	19,263
Plus/less deducted/added regulatory assets (6)	(3,435)	(5)	433	60	-	(2,947)
Various income (7)	-	-	(78)	-	(246)	(324)
Classifications	-	-	281	(281)	-	-
Subtotal	<u>8,041</u>	<u>493</u>	<u>2,870</u>	<u>2,135</u>	<u>2,453</u>	<u>15,992</u>
Differences (8)	<u>261</u>	<u>-</u>	<u>(750)</u>	<u>326</u>	<u>(691)</u>	<u>(854)</u>
Regulatory assets with respect to previous years						<u>1,056</u>

* The regulatory assets do not include regulatory assets with respect to financing that were recorded in expenses.

** Adjustments executed for income such as: lack of rate cover for the consumption of the Company facilities.

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a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

1. Brief Description of the Company and its Business Environment (continued)

f) Report of gaps between the recognized costs of the electricity rates and the actual costs for 2014 in accordance with the Electricity Authority's decision of February 9, 2015 (continued)

Transmission segment

Section	Rate component in NIS million, in December 2014 NIS					
	Purchases of Electricity	Operation less efficiency (including expenses for pensioners)	Depreciation	Advances	Operating profit	Total income
Income according to actual rate/rate in force as calculated by the Company (1) ..						2,762
Deviation in actual income due to deviation in consumption distribution (2)						68
Movement in regulatory assets*						105
Adjustments**						(27)
Theoretical income from rates (3)	1,029	117	836	100	826	2,908
Classifications compared to the Financial Statements (4)	187	5	-	-	(5)	187
Total theoretical income from rates classified according to Financial Statements	1,216	122	836	100	821	3,095
Actual results according to segment Notes (5)	1,223	475	943	-	215	2,856
Plus/less deducted/added regulatory assets (6)	(7)	-	-	-	-	(7)
Various income (7)	-	(33)	-	-	12	(21)
Subtotal	1,216	442	943	-	227	2,828
Differences (8)	-	(320)	(107)	100	594	267
Regulatory assets with respect to previous years						(37)

* The regulatory assets do not include regulatory assets with respect to financing that were recorded in expenses.

** Adjustments executed for income such as: lack of rate cover for the consumption of the Company facilities.

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a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

1. Brief Description of the Company and its Business Environment (continued)

f) Report of gaps between the recognized costs of the electricity rates and the actual costs for 2014 in accordance with the Electricity Authority's decision of February 9, 2015 (continued)

Distribution segment

Item	Rate component in NIS million, in December 2014 NIS				
	Operation less efficiency (including expenses for pensioners)	Depreciation	Advances	Operating profit	Total income
Income according to actual rate/rate in force as calculated by the Company (1)					2,718
Deviation in actual income due to deviation in consumption distribution (2)					(28)
Movement in regulatory assets*					124
Adjustments**					128
Theoretical income from rates (3)	491	1,157	286	1,009	2,943
Classifications compared to the Financial Statements (4)	(49)	73	-	(24)	-
Total theoretical income from rates classified according to Financial Statements ...	442	1,230	286	985	2,943
Actual results according to segment Notes (5)	1,758	1,221	-	97	3,076
Plus/less deducted/added regulatory assets (6)	-	-	-	-	-
Various income (7)	(186)	-	-	(4)	(190)
Subtotal	1,572	1,221	-	93	2,886
Differences (8)	(1,130)	9	286	892	57
Regulatory assets with respect to previous years					59

* The regulatory assets do not include regulatory assets with respect to financing that were recorded in expenses.

** Adjustments executed for income such as: lack of rate cover for the consumption of the Company facilities.

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a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

1. Brief Description of the Company and its Business Environment (continued)

f) Report of gaps between the recognized costs of the electricity rates and the actual costs for 2014 in accordance with the Electricity Authority's decision of February 9, 2015 (continued)

Specific instructions:

- (1) Total consumer charges with respect to electricity consumption in the reporting year (including charges with respect to advances, spread, compensation for update delay and other consumer debts and charges that have not yet been invoiced at the end of the reporting period).
- (2) The sum reflects the deviation that is created as a result of the rates for a quantity unit being determined by a theoretical distribution, and the actual distribution is different.
- (3) The theoretical income with respect to the reporting period (meaning without return of consumer debt with respect to the past) if there had been no deviations in the consumption distribution and the rate had been continuously updated. The costs the Company deems should be approved for it with respect to the reporting period and have not yet been approved and has recorded regulatory assets with respect to them at the end of the period. Meaning, this income also includes profit that is defined as unrealized profit according to the accounting principles.
- (4) Sums included in the rate in a certain component and are included in the Financial Statements in a different component.
- (5) Columns 2 to 5 are identical to the total expenses of the segment, except for financing expense and tax.
- (6) Reduction/addition of deducted/added regulatory assets in the expenses items of the Profit and Loss Statement.
- (7) Income from unregulated operation is included in the segment's income. The segment's income includes non-material income that has not been attributed with costs and it is therefore completely offset from the costs, while assuming that the operating income with respect to it is negligible.
- (8) The differences between theoretical income classified according to Financial Statements and the subtotal.

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a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

2. Financial Position

Data on the Company's financial position on December 31, 2014 and December 31, 2013 are as follows:

	NIS in millions, in December 2014 NIS				
	December 31, 2014	December 31, 2013	Increase (decrease)	Percent %	Note No.
<u>CURRENT ASSETS</u>					
Cash and cash equivalents	4,504	3,394	1,110	33%	a.2.a)1)
Short term investments	2,559	492	2,067	420%	a.2.a)2)
Trade receivables for sales of electricity	4,546	4,383	163	4%	a.2.a)3)
Accounts receivable	537	328	209	64%	a.2.a)4)
Inventory – fuel.....	1,057	1,065	(8)	(1%)	a.2.a)5)
Inventory – stores	146	144	2	1%	
Regulatory assets, net	-	2,966	(2,966)	(100%)	a.2.a)6)
	13,349	12,772	577	5%	
<u>NON-CURRENT ASSETS</u>					
Inventory - fuel	1,539	1,733	(194)	(11%)	a.2.a)5)
Long-term receivables	1,833	1,176	657	56%	a.2.c)
Investment in associate	86	98	(12)	(12%)	
Long-term regulatory assets	-	695	(695)	(100%)	a.2.a.6)
Assets with respect to post-employment benefits:					
Surplus pension plan assets over pension liability	4,310	2,016	2,294	114%	a.2.d)
Funds in trust.....	1,909	1,725	184	11%	
	6,219	3,741	2,478	66%	
Fixed assets, net:					
Fixed assets in use, net	57,020	58,528	(1,508)	(3%)	a.2.e)
Fixed assets under construction	6,497	6,063	434	7%	
	63,517	64,591	(1,074)	(2%)	
Intangible assets, net	974	946	28	3%	
Total debit.....	87,517	85,752	1,765	2%	

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a. Explanations of the Board of Directors on the Business Condition of the Company (continued)
2. Financial Position (continued)

Data on the Company's financial condition on December 31, 2014 and December 31, 2013 are as follows:
(continued)

	NIS in millions, in December 2014 NIS				
	December 31, 2014	December 31, 2013	Increase (decrease)	Percent %	Note No.
<u>CURRENT LIABILITIES</u>					
Credit from banks and other credit providers	8,351	7,104	1,247	18%	a.2.f)1)
Trade payables	1,757	1,721	36	2%	
Accounts payable and accruals	1,799	1,739	60	3%	
Regulatory liabilities, net	400	-	400	-	a.2.a)6)
Customer advances, net of work in progress	453	397	56	14%	a.2.f)3)
Provisions	719	729	(10)	(1%)	
	13,479	11,690	1,789	15%	
<u>NON CURRENT LIABILITIES</u>					
Debentures	35,695	32,704	2,991	9%	a.2.f)2)
Liabilities to banks	4,737	8,555	(3,818)	(45%)	a.2.f)2)
Liabilities with respect to other post-employment benefits	2,930	2,918	12	0%	
Regulatory liabilities	261	1,395	(1,134)	(81%)	a.2.a)6)
Provision for refunding amounts due to restatement of the financial statements	2,675	2,560	115	4%	
Deferred taxes, net	5,537	5,078	459	9%	
Debentures to the State of Israel	2,534	2,531	3	0%	a.2.f)2)
Liabilities to the State of Israel	2,902	2,850	52	2%	a.2.f)2)
Other liabilities	683	690	(7)	(1%)	a.2.f)2)
	57,954	59,281	(1,327)	(2%)	
<u>SHAREHOLDERS' EQUITY</u>					
Share capital	1,135	1,135	-	0%	
Capital reserves	1,022	1,028	(6)	(1%)	
Capital pension reserve	135	(1,023)	1,158	(113%)	a.3.f)5)
Retained earnings	13,792	13,641	151	1%	
	16,084	14,781	1,303	9%	
Total credit	87,517	85,752	1,765	2%	

The following are explanations of the financial data of the Company, as detailed in the tables above, to December 31, 2014 compared to December 31, 2013 at Company level and according to segments of operation (for information of the sectorial reporting of the Company see Note 35 to the Financial Statements).

a) Current Assets

1) Cash and Cash Equivalents

The increase in cash and cash equivalents balance for the period mainly arises from the consideration from the issue of the debentures. For details of the issue see Note 20 c. 1)d) to the Financial Statements.

2) Short Term Investments

The increase in short term investments mainly arises from deposit of part of the consideration from the issue (see previous section) in short term deposits.

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a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

2. Financial Position (continued)

a) Current Assets (continued)

3) Customers

For details of the composition of the receivables balance and developments regarding the debts of the Palestinian Authority and the East Jerusalem Electricity Company see Note 6 to the Financial Statements.

4) Accounts Receivable

The increase mainly derives from an increase in the accounts receivables and the current maturities of the swap transactions and the security deposits with respect to them.

5) Inventory – Fuels

The decrease in fuels inventory (current and non-current) derives from impairment of the fuel oil inventory designated for sale due to the need to conduct renovations in the fuel oil tanks in 2015, and form a decrease in the coal and diesel oil inventory that is partially offset by an increase in liquid gas inventory.

The fuels inventory presented in the current assets reflects the Company forecast for fuels use for 2015 and the fuel oil inventory that is designated for sale. The remainder of the fuels inventory, which will serve the Company beyond this period, is presented in the non-current assets item.

6) Regulatory Assets / Liabilities

For details regarding regulatory assets/liabilities and the changes in them during the reporting period see note 9 to the Financial Statements.

(a) Background:

Compliance with Financial Accounting Standards 71 Directives (hereinafter: "FAS")

The Company applies the accounting principles of the US Financial Accounting Standards Board (hereinafter: the "FASB" standards) as listed in RE6 chapter (hereinafter "Chapter RE6") which permit, under certain conditions, an accounting treatment other than that acceptable with regard to the timing of expense/income attribution to operations, all for the purpose of reflecting and creating proper matching between expenses and income incurred by the Company on the dates when they are recognized for purposes of the electricity rates. One of the conditions for applying these standards states that regulated rates are built in a way that covers the specific costs (including the required return on capital) related to the delivery of the regulated service or product (see also Note 2 a 2 to the Financial Statements).

Under the financial reporting principles applied to the Company in accordance with the Government Companies Regulations for preparing financial statements, the Company applies the Standards of the Financial Accounting Standards Board in the U.S.A., included under ASC 980 – "Regulated Actions" ("RE6"), which deal with the effects of certain types of regulation on the accounting policies implemented by the Company.

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a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

2. Financial Position (continued)

a) Current Assets (continued)

6) Regulatory Assets / Liabilities (continued)

(a) Background (continued):

Compliance with Financial Accounting Standards 71 Directives (hereinafter: "FAS")(continued)

The standards noted in Chapter RE 6 apply to a company with regulated activities, when all three conditions listed below are met:

- (1) Rates of regulated products or services provided to customers are either established by an independent third party regulator or by a committee so empowered, or are subject to authorization by a third party independent regulator or by a supervising organization, authorized by a law or an agreement to establish rates that oblige the consumers.
- (2) The regulated rates are so constructed as to cover the specific costs of the entity associated with the provision of the regulated product or service.
- (3) In view of the demand for the regulated product or service and also of the level of competition, it would be reasonable to assume that the rates established so as to cover the costs are chargeable and collectible.

The Company implements the directives of the standard applied to regulated companies since it meets the aforementioned three cumulative conditions:

- Regulation of rates – electricity rates are determined by the Electricity Authority, established in accordance with the Electricity Sector Law, which is a separate, independent entity.
- Specific coverage of costs - regulated rates are designed to cover the specific costs of the Company associated with the provision of the regulated products or services. From March 4, 1996, the activity of the Electricity Sector has been regulated under the Electricity Sector Law and its regulations and the Company operates pursuant to them. According to section 31 of the law, the Electricity Authority will determine the electricity rates in accordance with the following principles:
 - (a) The charge rates shall be determined based on the principle of cost, considering, inter alia, the type and standard of services. Each price shall reflect the cost of the particular service without any price decreasing at the expense of increasing another.
 - (b) With respect to the cost, an adequate return on capital rate shall be taken into account, considering the rights and duties of a vital service provider license holder. The law does not define what an adequate return on capital rate is.

In accordance with these principles, the electricity charge rate is supposed to cover all of the costs sustained by the Company from the operation of its assets and required to fulfill its duties (except costs which are not required to fulfill the Company's duties as a vital service supplier). Costs required for fulfilling the duties of the Company as a vital service supplier consist mainly of costs of fuel, costs of operations and maintenance and costs of capital (depreciation, financing and return on capital). Accordingly, the structure of the electricity rates reflects the price of electricity in accordance with the processes of the electricity chain: generation, transmission, distribution, high voltage, distribution low voltage, connection and services. The rates of the transmission and distribution segments are based on historical costs of the Company as recorded in the Company's books, with certain adjustments, which are recognized pursuant to a costs audit, conducted by the Electricity Authority. In February 2010, the Electricity Authority published its decision on updating the new rate base for the generation segment, for 2010 – 2014.

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a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

2. Financial Position (continued)

a) Current Assets (continued)

6) Regulatory Assets / Liabilities (continued)

(a) Background (continued):

Compliance with Financial Accounting Standards 71 Directives (hereinafter: "FAS")(continued)

(3) (continued)

The recognized costs under this rate are based on normative costs, determined pursuant to a costs audit of Company costs as recorded in the Company's books over the years, conducted by the Electricity Authority. According to Chapter RE 6, these criteria were applied on the basis of the substance of the regulations/ regulation and not on the basis of their format. The rate for the generation segment does not provide immediate full coverage to all the costs of the Company, but is based on historical costs of the Company. Therefore, the Company estimates that this rate will provide full coverage of the costs in the long term. In addition, according to the decision of the Electricity Authority that in the event that costs incurred for units under construction are excessive in the opinion of the Company and are not included in the normative cost base, the Company is entitled to request that the Electricity Authority recognize the excessive costs, after the commissioning of the unit. Moreover, since the Electricity Sector Law is designed, as mentioned, to provide long term full coverage of the costs required by a "vital service supplier" to fulfill its duties, the Company expects that the rate will be updated to provide full coverage of all its costs, required to fulfill its duties as a vital service supplier. As specified in section (c) above, the electricity rate should cover all the costs incurred by the Company which are required to fulfill its duties as a vital service supplier, according to a cost audit, conducted by the Electricity Authority in accordance with the directives of the Electricity Sector law.

Based on past experience, work principles of the Electricity Authority and the directives of the law, the Company's Management assumes that the bases of the rate will be updated over time.

Pursuant to understanding the way in which the Electricity Authority determined rates in the recent past, the Company assumes that the future rate bases will also include normative components. These normative components are currently determined and will probably be determined in future on the basis of costs of the Company in the past or the economic environment in which it operates.

The Company believes that the normative components will be structured in a way that will allow the Company to gain profit from some of them by performance that exceeds the norms and will earn less or incur a loss from costs that are higher than the rate coverage, for some components.

The policy of the Company in recent years is to decrease actions and investments that do not have full costs coverage in the rate from the Electricity Authority, for the purpose of meeting the rate outline. Therefore, the Company estimates that after the update of the rates bases, it is anticipated that full coverage will be provided to all investment and operational costs incurred by the Company, in each of the segments, starting from the update date of the rate base for this segment.

However, the Company estimates that certain events may prevent it from meeting the rate outline during a certain period, and that in other periods it will meet the rate outline in a way that will yield a higher than required gain. On the average, and in view of the aforesaid, the Company expects that it will meet the rate outline in a way that will allow full costs coverage for its investment and operation costs.

Chargeable and collectible rates from consumers – this criterion requires consideration of expected changes in demand levels or competition during the coverage period of the capitalized costs. At present the electricity generation sector in Israel is characterized by an especially low competition level. In practice, the Company generates the major share of electricity in Israel and only private electricity producers are its competitors, who at this stage generate electricity in volume of approximately 14% of the total installed generation capacity in the sector.

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a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

2. Financial Position (continued)

a) Current Assets (continued)

6) Regulatory Assets / Liabilities (continued)

(a) Background (continued):

Compliance with Financial Accounting Standards 71 Directives (hereinafter: "FAS")(continued)

(3) (continued)

- (c) In order to determine the rates, the Electricity Authority will perform acts of controlling costs of an essential service provider license owner. The Electricity Authority is entitled not to take into account, for purposes of determining rates, expenses, in part or in full, that in its opinion are not required for fulfilling the obligations of an essential service provider license owner.

Moreover, the Company assumes that the Electricity Authority will determine a rate for backup services which the Company is required to provide to the private producers under the Electricity Sector Law. The backup rate is intended to compensate the vital service supplier for the decreased demand (also deriving from entry of competitors), which turns part of his generation means into a reserve for the segment. This backup rate will compensate the Company with respect to a decrease in its income from sale of electricity, at least partially.

Due to the fact that the Company acted according to the guidelines of the regulators who are authorized to act on the development of the electricity sector, it believes that all the costs required to construct assets after the costs audit of the Electricity Authority, will be recognized under the rate. This can be deduced from the current rate for the generation segment, which recognizes a specific list of power stations (based on the development plan of the Company) and the costs which will be recognized with respect to these units. The Company estimated that even if sales of electricity from these power stations will decrease due to entry of private producers to the electricity sector and prioritizing them, it will not affect the recognition of construction costs of power stations, the construction of which was approved by the Minister of Energy and Water. Therefore, the Company estimates that the Electricity Authority will recognize its full costs required to fulfill its duties as an essential service supplier in the next rates base.

"Chapter RE 6" provides examples of conditions under which this standard will not apply to the Company:

- (1) Termination of the regulation;
- (2) A change in the basis for determining the rate by the regulator from the cost principle to another basis;
- (3) Intensified competition, in a way that will limit the ability of the entity to sell services and products at rates which will cover its costs;
- (4) The rate determined by the regulator will limit full coverage of the costs of the entity, where the entity cannot appeal the decision of the regulator or chooses to refrain from appealing.

The aforementioned conditions do not reflect the current condition of the electricity sector. The electricity sector in Israel is currently subject to regulation that determines the electricity rates and also determines, as mentioned, that the rates will be determined according to the principle of cost, which states that the electricity rate should cover all the costs incurred by the Company arising from the operation of its assets and requirements to fulfill its duties as a vital service supplier.

Based on the aforesaid, the Company is of the opinion that it meets the conditions for applying FAS 71.

The Company examines the condition of the Israeli electricity sector and the decisions of the regulator periodically to determine if it continues to meet the conditions for applying "Chapter RE 6".

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a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

2. Financial Position (continued)

a) Current Assets (continued)

6) Regulatory Assets / Liabilities (continued)

(a) Background (continued):

Compliance with Financial Accounting Standards 71 Directives (hereinafter: "FAS")(continued)

(3) (continued)

(b) Regulatory assets

The decrease in the regulatory assets balance, net (presented in the current assets and non-current assets and in the current and non-current liabilities) in the amount of NIS 2,927 million is mainly due to:

- A decrease in the fuels regulatory asset in the amount of approximately NIS 5,357 million with respect to:
 - (1) end of collection of the 2012 fuels debt asset (the gas crisis that started in 2011 and caused high fuels costs in 2012) according to the decision of the Authority of January 21, 2015 regarding the 2014 annual update.
 - (2) excess collection with respect to fuels during the period of January - December 2014, since the collection in 2014 was based on the fuels basket determined in May 2013, which is higher than the final fuels basket expected to be recognized by the Authority for 2014.
- Partially offset by an increase in regulatory assets in the amount of approximately NIS 2,387 million as follows:
 - 1) An increase in regulatory assets compensation with respect to delay in consecutive update of the rate (without the fuel component) in the amount of approximately NIS 1,042 million, this component includes an increase of NIS 479 million with respect to cover for the fixed operating costs recognized in the generation segment following the entry of private producers.
 - 2) An increase in regulatory assets in the amount of approximately NIS 853 million deriving from the decrease of liability with respect to the hedging mechanism.
 - 3) An increase in regulatory assets in the amount of approximately NIS 421 million deriving from a reduction in liability for repayment of debt to consumers for financing Stage B of the Emergency Plan.
 - 4) An increase in regulatory assets in the amount of approximately NIS 71 million with respect to a social rate for needy populations.

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2. Financial Position (continued)

a) Current Assets (continued)

6) Regulatory Assets / Liabilities (continued)

(b) Regulatory assets (continued)

Following are details of the current assets according to electricity chain segments:

- **Generation segment** - NIS 8,132 million, mainly deriving from customer receivables with respect to electricity sales in the amount of approximately NIS 3,491 million (this section is attributed to segments according to income ratio), fuels inventory (attributed in full to the generation segment) in the amount of approximately NIS 1,057 million, and cash balance and cash equivalents in the amount of approximately NIS 3,189 million.
- **Transmission segment** - NIS 2,096 million, mainly deriving from customer receivables with respect to electricity sales and cash balance and cash equivalents.
- **Distribution segment** - NIS 3,121 million mainly deriving from customer receivables with respect to electricity sales and cash balance and cash equivalents.

b) Non-Current Assets (not including fixed assets)

The Long Term Liabilities according to the Electricity Segments are as follows (not including fixed assets):

Generation segment -	6,360	NIS million
Transmission segment -	846	NIS million
Distribution segment -	3,445	NIS million
	<u>10,651</u>	

c) Long-term Receivables:

The major increase derives from an increase in receivables with respect to electricity, hedge transactions, the designated deposit account for financing the investments in the electricity sector, and from the debt of the Israel Natural Gas Lines Company, with respect to the gas transmission project, which is linked to the Dollar rate.

d) Assets with Respect to Benefits after Termination of Employment:

During the report period, an increase occurred in the item of excess pension plan assets over the actuarial liability due to a decrease in the actuarial liability following a transition to use of the discount rate that is appropriate for the market yields for the high quality corporate debentures and salary reduction update. For additional details regarding the change in the discount rate see Note 12 h.1) to the Financial Statements.

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- a. **Explanations of the Board of Directors on the Business Condition of the Company (continued)**
2. **Financial Position (continued)**

e) **Investments in Fixed Assets**

The sum total of investments in fixed assets for the reporting period amounted to approximately NIS 3,620 million net compared to NIS 5,095 million net for the same period last year, a decrease of 29% or approximately NIS 1,475 million.

Company investments in Fixed Assets in the Reporting Period were as follows:

	<u>In NIS millions</u>
Power stations, CCGTs, structures	1,587
Sub-stations and high voltage lines	363
Switching stations and ultra high 400 Kilowatt voltage lines.....	153
Distribution grids and meters	732
Inventory – stores	507
Joint property and others	278
Total	<u>3,620</u>

For additional details see Note 14 I to the Financial Statements.

Detailed investments in fixed assets according to electricity chain segments are as follows:

Generation segment -	29,833	NIS million
Transmission segment -	14,012	NIS million
Distribution segment -	19,672	NIS million
	<u>63,517</u>	

The direct assets were attributed to the appropriate segments and the joint assets (some 3.21% of the Company's assets) were divided according to distribution keys that the Company assesses to be a reasonable estimate for attributing these assets. During the period covered by the report, the Company invested a total of approximately NIS 1,610 million, approximately NIS 549 million and approximately NIS 732 million in direct assets in the generation, transmission and distribution segments, respectively. In addition, a sum of approximately NIS 729 million was invested in joint property.

Detailed Current Liabilities according to Electricity Chain Segments are as follows:

Generation segment -	6,908	NIS million
Transmission segment -	2,425	NIS million
Distribution segment -	4,146	NIS million
	<u>13,479</u>	

f) **Non-Current Liabilities**

1) **Credit from Banking Corporations and Other Credit Providers**

The increase derives mainly from an increase in the short term loans and the current maturities of the liabilities of the Company.

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- a. **Explanations of the Board of Directors on the Business Condition of the Company (continued)**
2. **Financial Position (continued)**
f) **Non-Current Liabilities (continued)**

2) Debentures and Liabilities to Banking Corporations and other long term liabilities

The long term liabilities of the Company include debentures, liabilities to banking corporations, debentures to the State of Israel and liabilities to the State of Israel, hedging transactions and other long term liabilities amounting to NIS 46,551 million.

For details of the composition of the debentures and long term liabilities, see section a.6.b) below and Note 20 to the Financial Statements.

For details of the currency exposure, see linkage basis report in Note 27 f.

3) Advances from Work Orders less Work in Progress

An increase of approximately NIS 56 million deriving from new business initiation works and progress made in existing works.

Distribution of long term Loans, Debentures, Liabilities to Banks and Other Liabilities of the Company according to Electricity Chain Segments are as follows:

Generation segment -	24,433	NIS million
Transmission segment -	9,457	NIS million
Distribution segment -	12,661	NIS million
	<u>46,551</u>	

Long term loans and debentures were mainly attributed to the segments according to the distribution ratio of fixed assets and according to the manner of financing the Company's assets according to the rate principles.

The Distribution of liabilities with Respect to Post Employment Termination Benefits, according to Electricity Chain Segments is as follows:

Generation segment -	1,394	NIS million
Transmission segment -	238	NIS million
Distribution segment -	1,298	NIS million
	<u>2,930</u>	

The following is a breakdown of the regulatory liability by Electricity Chain Segments:

Generation segment -	118	NIS million
Transmission segment -	55	NIS million
Distribution segment -	88	NIS million
	<u>261</u>	

Distribution of the Provisions for Refunding Sums with respect to Restatement of the Financial Statements according to the Segments of the Electricity Chain:

Generation segment -	1,208	NIS million
Transmission segment -	564	NIS million
Distribution segment -	903	NIS million
	<u>2,675</u>	

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- a. Explanations of the Board of Directors on the Business Condition of the Company (continued)
3. Comparison and Analysis of Operating Results for the Reporting Period compared to the Corresponding Period in the Previous Year

a) Statements of Operations and Other Comprehensive Income in Millions NIS:

Statements of Operations	For the year ending on				Change		Explanatory Paragraph
	December 31, 2014		December 31, 2013				
	In NIS millions	%	In NIS millions	%	In NIS millions	%	No.
Revenues.....	25,195	100%	27,601	100%	(2,406)	(9%)	b)
Cost of operating the electricity system.....	20,144	80%	24,207	88%	(4,063)	(17%)	c)
Profit from operating the electricity system	5,051	20%	3,394	12%	1,657	49%	
Sales and marketing expenses	902	4%	903	3%	(1)	0%	
Administrative and general expenses	1,136	5%	1,111	4%	25	2%	
Expenses from liabilities to pensioners, net	2	0%	20	0%	(18)	(90%)	
Profit from current operations	3,011	12%	1,360	5%	1,651	121%	
Financial expenses, net.....	2,787	11%	2,167	8%	620	29%	e)
Profit (loss) before tax	224	1%	(807)	(3%)	1,031	(128%)	
Tax expenses (revenues) on income ..	61	0%	125	0%	(64)	(51%)	
Net profit (loss)	163	1%	(932)	(3%)	1,095	(117%)	
Loss due to included companies	(12)	0%	(2)	0%	(10)	500%	
Profit (loss) after included companies	151	1%	(934)	(3%)	1,085	(116%)	

Consolidated Reports of Other Comprehensive Income (Loss):

Sums that will Not be Attributed in the Future to statement of operations (Loss):

Remeasurements	1,158	5%	279	1%	879	315%
Hedge accounting	(6)	0%	-	0%	(6)	-
Other Comprehensive income	1,152	5%	279	1%	873	315%
Comprehensive Income (loss)	1,303	5%	(655)	(2%)	1,958	(299%)

b) Revenues

The total revenues for the reporting period are NIS 25,195 million compared to NIS 27,601 million for the corresponding period the previous year, resulting from:

- 1) Revenues from the sale of electricity for the reporting period amounted to approximately NIS 24,902 million, compared to approximately NIS 26,158 million for the corresponding period the previous year. This consists of an approximately NIS 1,256 million decrease in revenues from electricity sales, a decrease of approximately 5%.

The change in revenues from electricity sales noted above derives from two reasons, which are:
Mainly a decrease in Company sales in light of the entry of private electricity producers, including Dorad in May, 2014, and increased operation of the private electricity producers.

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BOARD OF DIRECTORS' REPORT
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- a. **Explanations of the Board of Directors on the Business Condition of the Company (continued)**
3. **Comparison and Analysis of Operating Results for the Reporting Period compared to the Corresponding Period in the Previous Year (continued)**

b) **Revenues (continued):**

- 2) Miscellaneous revenues - in the report period amounted to approximately NIS 535 million compared to approximately 379 in the same period the previous year. An increase of NIS 156 million deriving mainly from compensation of approximately NIS 87 million from the insurance company with respect to malfunction of Unit 40 of the Gezer power station and from an increase of work on account of others.
- 3) Transition from deduction in income in the report period in the amount of NIS 242 million compared to a collection supplement in the amount of approximately NIS 1,064 million in the same period the previous year, which constitutes a decrease of approximately NIS 1,306 million in Company revenues due to transaction in regulatory assets, net.

Peak electricity demand -

Regarding the peak in electricity demand during the period of the report, see section 7.5 in Chapter A - Description of the Business Affairs of the Company.

Details of Company Revenues according to Electricity Chain Segments are as follows:

- Generation Segment –** Net revenue deriving from sales of electricity in the generation segment in the cumulative period amounted to approximately NIS 18,939 million compared to approximately NIS 21,246 million in the same period last year, a decrease in revenue of approximately NIS 2,307 million.
- Transmission Segment –** Net revenue deriving from sales of electricity for the transmission period in the cumulative period amounted to approximately NIS 2,836 million compared to approximately NIS 3,076 million in the same period last year, a decrease in revenue of approximately NIS 240 million.
- Distribution Segment –** Net revenue deriving from sales of electricity for the distribution segment in the cumulative period amounted to approximately NIS 2,885 million compared to approximately NIS 2,900 million in the corresponding period last year, a decrease in revenue of approximately NIS 15 million.

c) **Cost of Operating the Electricity System**

The cost of operating the electricity system in the reported period amounted to NIS 20,144 million, as compared to NIS 24,207 million in the corresponding period last year, a decrease of NIS 4,063 million. The decrease was mainly due to a decrease in fuels expenses and by amortization of regulatory asset with respect to fuels as detailed below:

The cost of fuels consumed in the reporting period amounted to a sum of approximately 8,041 million, compared to approximately NIS 11,094 million for the same period the previous year, a decrease of approximately NIS 3,053 million, which constitutes a decrease of approximately 28%.

In the reporting period, expenses in an amount of approximately NIS 3,435 million were transferred from a regulatory asset with respect to fuels, compared to NIS 4,324 million during the same period in the previous year.

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3. Comparison and Analysis of Operating Results for the Reporting Period compared to the Corresponding Period in the Previous Year (continued)
c) Cost of Operating the Electricity System (continued)

The major part of the change to the cost of fuel consumption is explained by the following:

Details of the changes in NIS millions for the year ended on December 31, 2014

Fuel Type	Change in Consumption	Change in Prices	Total
Crude	(256)	34	(222)
Coal	(357)	(450)	(807)
Diesel oil	(1,231)	22	(1,209)
Natural gas*	(702)	(220)	(922)
Methanol	7	-	7
Total before impairment	(2,539)	(614)	(3,153)
Impairment with respect to crude.....			100
Total.....			(3,053)

* The natural gas data includes liquid gas data.

The following are the details of consumed quantities during the quarter ending:

Fuel Type	For the Year Ending December 31, 2014	For the Year Ending December 31, 2013	Increase (decrease) Tons	Change Rate in %
Crude (Ton)	4,495	84,134	(79,639)	(95%)
Coal (Standard Ton) ..	10,936,940	11,814,313	(877,373)	(7%)
Diesel oil (Ton)	16,571	307,646	(291,075)	(95%)
Natural gas (Ton)*	3,002,966	3,527,735	(524,769)	(15%)
Methanol	2,959	-	2,959	

* The natural gas data includes liquid gas data.

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- a. Explanations of the Board of Directors on the Business Condition of the Company (continued)
3. Comparison and Analysis of Operating Results for the Reporting Period compared to the Corresponding Period in the Previous Year (continued)

d) Depreciation and Amortization

Following are details of depreciation and amortization expenses presented in the profit and loss statement in the reporting period and in the same period the previous year:

	The year ended December 31, 2014	The year ended December 31, 2013
Depreciation and Amortization		
Electricity system operation cost	4,260	4,653
Sales and marketing expenses	142	141
Administrative and general expenses	118	123
Total depreciation expenses.....	4,520	4,917

Details of Depreciation and Amortization Expenses by Electricity Chain Segments:

- **Generation Segment** - The depreciation and amortization expenses presented in the generation segment profit and loss statement during the cumulative period amounted to approximately NIS 2,356 million compared to NIS 2,819 million during the same period of the previous year, a decrease of approximately NIS 463 million.
- **Transmission Segment** - The depreciation and amortization expenses presented in the transmission segment profit and loss statement during the cumulative period amounted to approximately NIS 943 million, compared with about NIS 927 million during the same period in the previous year, an increase of approximately NIS 16 million.
- **Distribution Segment** - The depreciation and amortization expenses presented in the distribution statement profit and loss statement during the cumulative period, amounted to approximately NIS 1,221 million, compared to NIS 1,171 million during the same period in the previous year, an increase of approximately NIS 50 million.

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- a. Explanations of the Board of Directors on the Business Condition of the Company (continued)
3. Comparison and Analysis of Operating Results for the Reporting Period compared to the Corresponding Period in the Previous Year (continued)

e) Financial Expenses

The decrease in financial expenses for the cumulative period compared to the same period in the previous year, are as follows:

<u>Sum Difference Analysis</u>	<u>Difference</u>	<u>For the year ending</u>	
		<u>31/12/2014</u>	<u>31/12/2013</u>
		<u>NIS in millions</u>	
<u>A. Erosion of Financial Liabilities</u>			
Transition from income to expenses from erosion of foreign currency financial liabilities, net, of NIS 4,597 million, deriving from a transition from real revaluation of 10.76% in the previous year, to a real devaluation of 9.59%	4,597	2,160	(2,437)
Transition from financing expenses to income from revaluation of hedging transactions to their fair value deriving from changes in the period of the exchange rates and CPI	(4,254)	(1,890)	2,364
Transition from financing income to expenses from revaluation of hedging transactions to their fair value that derives from changes in the credit risk and the curves of capitalization interest that occurred during the reporting period(*)	521	314	(207)
Transition from financing expenses to income from erosion transferred to regulatory liabilities in accordance with the Authority's decision on the subject of the Company's foreign currency exposure due to a transition from a revaluation to a real devaluation of the basket.	(477)	(147)	330
Total increase in financing expenses	387	437	50
Transition from financing income to expenses resulting from changes between the known CPI and the CPI in lieu of and the erosion of unlinked shekel loans.	109	28	(81)
Transition from financing expenses to income as a result of the erosion of working capital, loans and receivables items	(36)	(11)	25
Total increase in expenses from erosion of financial liabilities	460	454	(6)
<u>B. Other Financing Expenses</u>			
Decrease in interest expenses	(56)	2,610	2,666
Increase in expenses transferred to a regulatory asset due to normative interest differences from the actual interest expenses	(7)	(84)	(77)
Transfer from financing income to expenses, loans, receivables and regulatory assets	216	78	(138)
Total increase in other financing expenses:	153	2,604	2,451
Total increase in financing expenses before capitalization	613	3,058	2,445
<u>C. Capitalization of projects under construction</u>			
Decrease in financing expenses due to capitalization	(7)	271	278
Total increase in financing expenses in the reporting period, compared to the same period in the previous year, after the transfer to a regulatory asset and after capitalization of financing expenses	620	2,787	2,167

- (*) Against the foreign currency exposure (mainly Dollar), the Company implements a policy of hedging for the rate of exchange. Hedging transactions executed by the Company throughout the years carried out by the Company in foreign currency against linked NIS in substance replaced the foreign currency liabilities with fixed interest CPI linked NIS liabilities, and in this manner the raising is converted into the currency in which the Company's income is measured.

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e) **Financial Expenses (continued):**

Following are details of an accounting exposure with respect to measurement of hedging transactions at fair value:

According to the provisions of IAS 39, the Company is measuring its financial liabilities at amortized cost while using the effective interest method. On the other hand, the hedging transactions of these liabilities are measured at fair value through profit and loss. The gap between the measurement methods creates accounting exposure for the Company that might be affected by the changes that occurred in various market factors.

The credit risk of the parties to the transaction and relevant interest to capital curves are used when valuing the hedging transactions to their fair value. Accordingly, changes in these factors cause significant changes in the fair value between the measured periods. As a result, an accounting and not a cash flow entry was recorded in the reporting period, of approximately NIS 314 million. This expense in the Profit and Loss Statement of the Company derives, as stated, from the accounting gap between the different measurement methods and does not constitute a cash flow expense.

Presently the Company policy in managing its market risks is according to the financial exposure and not the accounting exposure. However, the Company has started implementing hedge accounting for new hedge transactions according to the provisions of the standard in order to minimize the above mentioned accounting exposure. For details see Note 27 h to the Financial Statements.

The following are the net financing details by electrical segments:

The net financing expenses are divided between the various segments, mainly by the ratio of operated fixed assets.

- **Generation Segment** - The financing expenses presented in the generation segment during the cumulative period amounted to approximately NIS 1,261 million, compared to NIS 981 million during the same period of the previous year, an increase of approximately NIS 280 million.
- **Transmission Segment** - The financing expenses in the transmission segment during the cumulative period amounted to approximately NIS 610 million, compared with about NIS 485 million during the same period in the previous year, an increase of approximately NIS 125 million.
- **Distribution Segment** - The financing expenses in the distribution segment during the cumulative period, amounted to approximately NIS 916 million, compared to NIS 701 million during the same period in the previous year, an increase of approximately NIS 215 million.

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- 3. Comparison and Analysis of Operating Results for the Reporting Period compared to the Corresponding Period in the Previous Year (continued)

f) Business Results during the Reporting Period:

- 1) A decrease in Company income in the amount of approximately NIS 2,406 million, (9%). For additional details see section b above.
- 2) A decrease in fuels costs in an amount of approximately NIS 3,053 million (27%), derived mainly from the decrease in fuel consumption and the use of a cheaper fuels mix, due to the entry of the natural gas from the Tamar reserve to a significant extent, a decline in the price of coal and less consumption of liquid gas. For additional details see section c above.
- 3) An increase in financing expenses of approximately NIS 620 million deriving mainly from an increase in erosion of foreign currency financial liabilities less the impact of hedging transactions and rate hedging and decrease in interest income from regulatory assets. For additional details see section e above.
- 4) The EBITDA (earnings before interest, taxes, depreciation and amortization and regulatory assets) during the reporting period was NIS 10,787 million compared to NIS 9,742 million in the same period the previous year, including the regulatory assets, the EBITDA for the report period is NIS 7,531 million compared to NIS 6,277 million in the same period the previous year.
- 5) An increase in other comprehensive income with respect to remeasurements of approximately NIS 879 million, deriving mainly from transition on December 31, 2014 to use of a capitalization rate appropriate for the market yields on high quality corporate debentures and offset by the impact of the decrease during the report period in the market yields on Government debentures (the capitalization rate implemented by the Company until the date of change) and by the impact of a change in actuarial assumptions: wages increases, electricity price discounts. For additional details regarding the update of the actuarial assumptions see Note 12 h and 12 k to the Financial Statements.

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4. Comparison and Analysis of Operating Results for the year 2013 Compared to the Year 2012

a) Statements of Operations and Other Comprehensive Income in Millions NIS:

Statements of Operations	For the year ending on				Change		Explanatory
	December 31, 2013		December 31, 2012		In NIS millions	%	Paragraph
	In NIS millions	%	In NIS millions	%			
Revenues.....	27,601	100%	28,263	100%	(662)	(2%)	b
Cost of operating the electricity system.....	24,207	88%	23,395	83%	812	3%	c
Profit from operating the electricity system	3,394	12%	4,868	17%	(1,474)	(30%)	
Sales and marketing expenses	903	3%	1,065	4%	(162)	(15%)	
Administrative and general expenses	1,111	4%	869	3%	242	28%	
Expenses from liabilities to pensioners, net	20	0%	1,544	5%	(1,524)	(99%)	
Profit from current operations	1,360	5%	1,390	5%	(30)	(2%)	
Financial expenses, net	2,167	8%	2,685	10%	(518)	(19%)	e
Loss before tax	(807)	(3%)	(1,295)	(5%)	488	(38%)	
Tax expenses (revenues) on income..	125	0%	(293)	(1%)	418	(143%)	
Net loss	(932)	(3%)	(1,002)	(4%)	70	(7%)	
Loss due to Included companies.....	(2)	0%	-	0%	(2)		
Loss after included companies.....	(934)	(3%)	(1,002)	(4%)	68	(7%)	

Consolidated Reports of Other Comprehensive Income (Loss):

Sums that will Not be Attributed in the Future to statement of operations (Loss):

Remeasurements	279	1%	(784)	(3%)	1,063	(136%)
Other comprehensive Income (Loss)	279	1%	(784)	(3%)	1,063	(136%)
Comprehensive loss	(655)	(2%)	(1,786)	(6%)	1,131	(63%)

b) Revenues

The total revenues for the year 2013 are NIS 27,601 million compared to NIS 28,263 million for the year 2012, deriving from:

- 1) The net revenues from the sale of electricity amounted to approximately NIS 26,158 million for 2013, compared to approximately NIS 26,869 million for 2012. An approximately NIS 711 million decrease in revenues from electricity sales, which constitutes a decrease of approximately 3%.
The change in revenues from electricity sales noted above partially derived from a decrease in Company sales in light of the entry of private electricity producers.
- 2) Miscellaneous income - amounted to approximately NIS 379 million in 2013 compared to approximately NIS 306 million in 2012, an increase of approximately NIS 73 million deriving mainly from an increase of works at the expense of others.

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4. **Comparison and Analysis of Operating Results for the Year 2013 compared to the Year 2012 (continued)**
b) **Revenues (continued):**

Peak electricity demand -

Regarding the peak in electricity demand during 2013 see section 7.5 of Chapter A - Description of the Business Affairs of the Company.

Details of Company Revenues according to Electricity Chain Segments are as follows:

Generation Segment -	Net revenue deriving from sales of electricity in the generation segment in the cumulative period amounted to approximately NIS 21,246 million compared to approximately NIS 22,443 million in the same period last year, a decrease in revenue of approximately NIS 1,197 million.
Transmission Segment -	Net revenue deriving from sales of electricity for the transmission period in the cumulative period amounted to approximately NIS 3,076 million compared to approximately NIS 2,642 million in the same period last year, an increase in revenue of approximately NIS 434 million.
Distribution Segment -	Net revenue deriving from sales of electricity for the distribution segment in the cumulative period amounted to approximately NIS 2,900 million compared to approximately NIS 2,872 million in the corresponding period last year, an increase in revenue of approximately NIS 28 million.

c) **Cost of Operating the Electricity System**

The cost of operating the electricity system in 2013 amounted to NIS 24,207 million, as compared to NIS 23,395 million in 2012, an increase of NIS 812 million. The increase was mainly due to transfer of expenses from regulatory asset with offset of the use of a cheaper fuels mix as detailed below:

The cost of fuels consumed in 2013 amounted to a sum of approximately NIS 11,094 million, compared to approximately NIS 20,037 million for 2012, a decrease of approximately NIS 8,943 million, which constitutes a decrease of approximately 45%.

In 2013, expenses in an amount of approximately NIS 4,324 million were transferred from a regulatory asset with respect to fuels, compared to NIS 5,258 million that were transferred to regulatory asset in 2012.

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4. **Comparison and Analysis of Operating Results for the Year 2013 compared to the Year 2012 (continued)**
c) **Cost of Operating the Electricity System (continued)**

The major part of the change the cost of fuel consumption is explained by the following:

Details of the changes in NIS millions for the year ended December 31, 2013

Fuel Type	Change in Consumption	Change in Prices	Total
Crude.....	(2,862)	7	(2,855)
Coal	(1,090)	(1,132)	(2,222)
Diesel oil.....	(7,003)	(10)	(7,013)
Natural gas*	2,724	423	3,147
Total.....	(8,231)	(712)	(8,943)

* Natural gas data include liquid gas data.

The following are the details of consumed quantities during the quarter ending:

Fuel Type	For the Year Ending December 31, 2013	For the Year Ending December 31, 2012	Increase (decrease) Tons	Change Rate in %
Crude (Ton)	84,134	996,372	(912,238)	(92%)
Coal (Standard Ton)	11,814,313	13,983,642	(2,169,329)	(16%)
Diesel oil (Ton)	307,646	1,951,001	(1,643,355)	(84%)
Natural gas (Ton)*	3,527,735	1,290,310	2,237,425	173%

* Natural gas data include liquid gas data.

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4. **Comparison and Analysis of Operating Results for the Year 2013 compared to the Year 2012 (continued)**

d) **Depreciation and Amortization**

Following are details of depreciation and amortization expenses presented in the profit and loss statement:

	The year ended December 31, 2013	The year ended December 31, 2012
Depreciation and Amortization		
Electricity system operation cost	4,653	4,399
Sales and marketing expenses	141	143
Administrative and general expenses	123	133
Total depreciation expenses.....	4,917	4,675

Details of Depreciation and Amortization Expenses by Electricity Chain Segments:

- **Generation Segment** – The depreciation and amortization expenses presented in the generation segment profit and loss statement during the cumulative period amounted to approximately NIS 2,819 million compared to NIS 2,660 million during the same period of the previous year, an increase of approximately NIS 159 million.
- **Transmission Segment** – The depreciation and amortization expenses presented in the transmission segment profit and loss statement during the cumulative period amounted to approximately NIS 927 million, compared with about NIS 853 million during the same period in the previous year, an increase of approximately NIS 74 million.
- **Distribution Segment** – The depreciation and amortization expenses presented in the distribution statement profit and loss statement during the cumulative period, amounted to approximately NIS 1,171 million, compared to NIS 1,162 million during the same period in the previous year, an increase of approximately NIS 9 million.

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4. Comparison and Analysis of Operating Results for the Year 2013 compared to the Year 2012 (continued)

e) Financial Expenses

The decrease in financial expenses is as follows:

<u>Sum Difference Analysis</u>	<u>Difference</u>	<u>For the year ending</u>	
		<u>31/12/2013</u>	<u>31/12/2012</u>
		<u>NIS in millions</u>	
<u>A. Erosion of Financial Liabilities</u>			
Increase in income from erosion of foreign currency financial liabilities, net, of approximately NIS 1,285 million, deriving from a transition from real revaluation of 5.2% in the previous year, to a real revaluation of 10.77%.....	(1,285)	(2,437)	(1,152)
Increase in financing expenses to income from revaluation of hedging transactions to their fair value.....	805	2,157	1,352
Increase in financing expenses to income from erosion during the report period transferred to regulatory liabilities in accordance with the Authority's decision on the subject of the Company's foreign currency exposure due to an increase in real revaluation of the rate basket that was partly offset by decrease of the hedged amount.....	55	330	275
Total decrease in financing expenses.....	(425)	50	475
Increase in financing income as a result of changes between the known CPI and the CPI in lieu	(11)	(81)	(70)
Decrease in financing expenses as a result of erosion of the working capital, loans and receivables items	(7)	25	32
Total decrease in financing expenses from erosion of financial liabilities	(442)	(6)	437
<u>B. Other Financing Expenses</u>			
Decrease in interest expenses	(55)	2,666	2,721
Decrease in expenses transferred to a regulatory asset due to normative interest differences from the actual interest expenses	13	(77)	(90)
Increase in income with respect to loans and receivables	(32)	(138)	(106)
Total decrease in other financing expenses	(74)	2,451	2,525
Total decrease in financing expenses before capitalization	(517)	2,445	2,962
<u>C. Capitalization of projects under construction</u>			
Total increase in capitalization of financing expenses	1	278	277
Total decrease in financing expenses.....	(518)	2,167	2,685

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4. **Comparison and Analysis of Operating Results for the Year 2013 compared to the Year 2012 (continued)**
e) **Financial Expenses (continued):**

The following are the net financing details by electrical segments:

The net financing expenses are divided between the various segments, mainly by the ratio of operated fixed assets.

- Generation Segment -** The financing expenses presented in the generation segment during the cumulative period amounted to approximately NIS 981 million compared to NIS 1,214 million during the same period of the previous year, a decrease of approximately NIS 233 million.
- Transmission Segment -** The financing expenses in the transmission segment during the cumulative period amounted to approximately NIS 485 million, compared with about NIS 601 million during the same period in the previous year, a decrease of approximately NIS 116 million.
- Distribution Segment -** The financing expenses in the distribution during the cumulative period, amounted to approximately NIS 701 million, compared to NIS 870 million during the same period in the previous year, a decrease of approximately NIS 169 million.

f) **Business Results during 2013:**

- 1) A decrease in Company income in the amount of approximately NIS 662 million, see section b above.
- 2) A decrease in fuels costs in an amount of approximately NIS 8,943 million. For additional details see section c above.
- 3) A decrease in financing expenses of approximately NIS 518 million (19%) deriving mainly from erosion of foreign currency financial liabilities less impact of hedging transactions and hedging rate and decrease in interest expenses.
- 4) The EBITDA (earnings before interest, taxes, depreciation and amortization and regulatory assets) during 2013 was NIS 9,742 million compared to NIS 1,611 million in 2012 including regulatory assets EBITDA for 2013 is NIS 6,277 million compared to NIS 7,984 million in 2012 (after excluding the one-time impact of the agreement of linking the pension to the CPI).

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a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

5. Comparison and Analysis of Operating Results in the Fourth Quarter of 2014 Compared with the Same Period the Previous Year:

	For the three months ended				Change		Explanatory section number
	December 31 2014		December 31 2013				
Profit and Loss Statements							
Revenues.....	5,905	100%	6,433	100%	(528)	(8%)	b
Cost of operating the electricity system.....	4,013	68%	6,112	95%	(2,099)	(34%)	c
Profit from operating the electricity system	1,892	32%	321	5%	1,571	489%	
Sales and marketing expenses	218	4%	236	4%	(18)	(8%)	
Administrative and general expenses	269	5%	512	8%	(243)	(47%)	d
Expenses from liabilities to pensioners, net	(2)	0%	4	-	(6)	(150%)	
Profit (loss) from current operations	1,407	24%	(431)	(7%)	1,838	(426%)	
Financial expenses, net	(36)	(1%)	335	5%	(371)	(111%)	f
Profit (loss) before tax	1,443	24%	(766)	(12%)	2,209	(288%)	
Expenses (income) from taxes on income	366	6%	(202)	(3%)	568	(281%)	
Profit (loss), net.....	1,077	18%	(564)	(9%)	1,641	(291%)	
Loss due to associate companies....	(5)	0%	(2)	-	(3)	150%	
Profit (loss) after associate companies	1,072	18%	(566)	(9%)	1,638	(289%)	

Consolidated Reports of Other Comprehensive Income (Loss):

Sums that will Not be Attributed in the Future to statement of operations (Loss):

Remeasurements.....	2,123	36%	(76)	(1%)	2,199	(2893%)
Cash flow hedging.....	(6)	0%	-	0%	(6)	
Other comprehensive income (loss)	2,117	36%	(76)	(1%)	2,193	(2893%)
Comprehensive income (loss)	3,189	54%	(642)	(10%)	3,831	(597%)

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- a. **Explanations of the Board of Directors on the Business Condition of the Company (continued)**
5. **Operating Results according to Quarterly Statements of Operations for 2014 (continued)**

The operating results for the fourth quarter of 2014:

a) Revenues

The total revenues in the fourth quarter of 2014 amounted to approximately NIS 5,905 million compared to approximately NIS 6,433 in the same period the previous year.

The total decrease of NIS 528 million deriving mainly from a collection supplement in the fourth quarter in the amount of approximately NIS 99 million compared with approximately NIS 426 million in the same period the previous year due to transaction in regulatory assets and an increase in non-recognition of revenue deriving from the Palestinian Authority and the East Jerusalem Electricity Company.

b) Fuel Cost

- The cost of fuel consumed in the fourth quarter amounted to a sum of approximately NIS 1,968 million compared to approximately NIS 2,143 million for the same period the previous year. A decrease of approximately NIS 175 million.
- In the fourth quarter, expenses in the amount of NIS 38 were transferred from a regulatory asset with respect to fuels compared to NIS 1,552 million in the same period the previous year.

The main changes in fuel consumption cost are explained as follows:

Details of the changes in NIS millions for the quarter ended on December 31, 2014

Fuel type	Change in consumption	Change in prices	Total
Crude.....	(11)	8	(3)
Coal	(272)	167	(105)
Diesel oil.....	(99)	(5)	(104)
Natural gas *	(337)	274	(63)
Total before impairment	(719)	444	(275)
Impairment with respect to crude.....			100
Total.....			(175)

Type of fuel	For the year ended December 31, 2013	For the year ended December 31, 2012	Increase (decrease) tons	Change in %
Crude (ton).....	292	1,542	(1,250)	(81%)
Coal (standard ton) ...	2,292,415	3,220,442	(928,027)	(29%)
Diesel oil (ton).....	2,821	13,971	(11,150)	(80%)
Natural gas (*).....	742,416	1,087,816	(345,400)	(32%)
Methanol	48	-	48	

c) Financing Expenses

The change in the financing expenses mainly derives from changes in the exchange rates and CPIs that affect the erosion of the financial liabilities and revaluation of the hedging transactions.

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a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

6. Liquidity for the Reporting Period

a) General for the Reporting Period:

In the reporting period, the cash flow of the Company amounted to a positive cash flow of approximately NIS 1,110 million as detailed below:

1) Cash Flow from Operating Activities:

The cash flow from Operating Activities for the reporting period amounted to a positive flow of approximately NIS 8,252 million, compared to a positive flow of approximately NIS 5,767 million in the corresponding period last year.

The change in the cash flow from current operations in the amount of approximately NIS 2,485 million derives mainly from the transition from loss to profit and termination of collection of the fuels debt from 2012 and excess collection with respect to fuels in 2014.

2) Cash Flow for Investment Activities:

Cash used for investment activities in the period reached a negative flow of approximately NIS 6,524 million, compared to a negative flow of approximately NIS 4,958 million in the corresponding period last year.

The change in the cash flow from investment activity in the amount of approximately NIS 1,566 million derives mainly from depositing deposits in banks and offsetting the decrease in investment in fixed assets during the current period compared to the corresponding period last year.

3) Cash Flow from Financing Activity:

Cash flow for financing activities in the report period amounted to a negative flow of approximately NIS 618 million, compared to a negative flow of approximately NIS 1,633 million in the corresponding period last year.

The change in the cash flow for financing activity in the amount of approximately NIS 1,015 million derives mainly from large repayments of debentures and loans during the same period the previous year.

For additional details regarding the cash flow of the Company see the statement of cash flow of the Company.

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6. Liquidity for the Reporting Period (continued)

b) Financing Sources

1) General

The Company finances its actions from its own sources, from offering debentures in Israel and abroad and from loans from banking corporations in Israel and abroad. The Company's recruitment of funds during the reporting year includes loans received from banks in the reporting period, see Note 20 c to the Financial Statements.

2) Long Term Loans

The balance of loans and long-term debentures of the Company on December 31, 2014 and December 31, 2013, is approximately NIS 46,551 million, and is approximately NIS 47,330 million, respectively, detailed as follows:

		As at December 31 2014	As at December 31 2013
		Millions of NIS	
Liabilities in Index-Linked NIS			
Index-linked debentures to the public.....		14,855	17,043
Debentures to the State of Israel		2,534	2,531
Other index-linked loans		397	1,502
Total Linked NIS Liabilities	(1)	17,786	21,076
Non-linked NIS Liabilities			
Non-linked NIS debentures in public offerings		657	656
Non-linked NIS loans	(3)	2,650	4,641
Total Non-Linked NIS		3,307	5,297
Dollar Linked Liabilities			
Money raised from a private offering for the sale of debentures in the US in US Dollars		8,069	7,188
Loans in US Dollars.....	(2)	4,366	4,178
Money raised from a private offering for the sale of debentures in Europe, in US Dollars		156	139
Offering debentures to institutional investors in Europe and the US, listed for trade on the Singapore stock exchange, in US Dollars		13,612	7,794
Total Liabilities Linked to US Dollars	(4)	26,203	19,299
Money raised from a private offering for the sale of debentures in Japan in Yen		2,441	2,474
Loans in Euros		2,101	2,354
Total		51,838	50,500
Less discounts/premiums on debentures, current maturities, issuance expenses and hedge contracts, net		(5,956)	(3,841)
Total debentures and liabilities to banks and others .		45,882	46,659
Long term accounts payable		669	671
Total		46,551	47,330

- (1) Including loans and debentures guaranteed by the State of Israel equaling NIS 3,152 million as of December 31, 2014, and NIS 3,222 million as of December 31, 2013.
(2) Including loans guaranteed by the State of Israel equaling NIS 607 million as of December 31, 2014, and NIS 592 million as of December 31, 2013.
(3) Including loans guaranteed by the State of Israel equaling NIS 2,400 million as of December 31, 2014, and NIS 4,391 million as of December 31, 2013.

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BOARD OF DIRECTORS' REPORT
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a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

6. Liquidity for the Reporting Period (continued)

b) Financing Sources (continued)

2) Long-Term Loans (continued)

Details of Loans Recorded in the Company's Books, Secured by a State Guarantee are as follows:

Contract Details	Source Currency	Balance in NIS in Millions as of December 31, 2014	Weighted Interest*	Date of final repayment
Loan from Bank Hapoalim	NIS	96	4.96	July 25, 2016
Loan from Citi Bank	\$	607	5.84	June 17, 2025
Debenture series 24	NIS	2,036	1.03	July 9, 2015
Debenture series 25	NIS	1,020	1.70	July 9, 2017
Loan from Bank Hapoalim	NIS	750	2.28	March 31, 2015
Loan from Bank Mizrahi	NIS	250	2.27	March 31, 2015
Loan from Discount Bank	NIS	200	2.42	March 31, 2015
Loan from Discount Bank	NIS	200	2.26	March 31, 2015
Loan from Bank Leumi Israel	NIS	700	2.38	March 31, 2015
Loan from Bank Leumi Israel	NIS	300	2.26	March 31, 2015
		<u>6,159</u>		

* Weighted interest, since the loan was received in several installments.
The Interest includes a guarantee commission.

3) Average Long Term Credit as of December 31, 2014

The credit is taken from banking corporations and others. The average credit for the reporting periods was NIS 51,909 million and is mainly long term loans and debentures (including hedging transactions, deferred, premium/discount of debentures).

4) Suppliers' and Customers' Credit

	As of December 31			
	2014		2013	
	Days	Amount	Days	Amount
Trade receivables	51	1,568	41	1,648
* Trade payables	42	2,794	35	2,546
* Trade receivables excluding the debts of the Palestinian Authority and the East Jerusalem Electricity Company (see Note 6 d to the Financial Statements)	26	1,591	29	1,904

* The calculation is without reference to provisions and income receivables

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b. Details about the Exposure to Market Risks and their Management

1. The Company's Market Risk Manager

The Company's person responsible for market risk management is the Senior Vice-President of Finance and Economics, Mr. Tamir Polikar, who announced on January 6, 2015 termination of his office at the end of March 2015. For details of his education, qualifications and business experience see Regulation 26a (Details of a Senior Position Holder in a Corporation), in Chapter D of the Annual Financial Statements of the Company for 2014.

2. Description of the Company's Market Risks

The Electric Company sells its products at a price set by an outside body - the Electricity Authority. Determination of the rate is based on the principle of cost as stated in Note 3 a to the Financial Statements. However, when determining the recognized cost for the Company, the Electricity Authority determined costs of the different components in the rate, which occasionally do not match the Company's actual costs. As a result, regarding the bulk of its activities, the Company is not exposed to market risks, with the exception of the following:

a) Currency Risks

1) Financial Liabilities:

The major part of the Company's revenues is nominally in NIS. At the same time, as of December 31, 2014, an amount of NIS 30,745 million and constituting 59% of the long term financial obligations of the Company (before entering into hedging transactions), is in foreign currency. Therefore, fluctuations in exchange rates cause changes in the financing expenses of the Company that may affect the financial results of the Company.

Due to the considerable volume of the long term obligations in foreign currency, the business results of the Company are expressed in profits or losses, affected by fluctuations in the NIS – foreign currency exchange rates.

When the Electricity Authority determined the electricity rate for the generation segment, it defined a hedging mechanism.

The sum hedged by the mechanism is linked to a "determining basket" defined by the Electricity Authority as linked to the U.S. Dollar and the Euro at the rate of 75% and 25%, respectively. The hedged sum is intended to reflect part of the financing expenses or income derived from the exposure of the Company to foreign currency and to transfer it to electricity consumers.

Regarding the balance of the exposure, in excess of the hedged amount in the rate, the Company took various steps intended to reduce the effect of fluctuations in exchange rates by decreasing the balance of the exposure to foreign currency, by entering into hedging transactions. Yet, the market capacity may be limited and cause a deviation in the Company's exposure to foreign currency in relation to the desired exposure rate according to the Company's policy.

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b. Details about the Exposure to Market Risks and their Management (continued)

2. Description of the Company's Market Risks (continued)

a) Currency Risks (continued)

2) Payments to Suppliers

The Company is exposed to exchange rates fluctuations deriving from part of the procurement agreements of goods and services for building generation units, as follows:

Purchase cost of generation units equipment was determined normatively according to the Gas Turbine Handbook (hereinafter: "GTH") price list, published in U.S. Dollars. The Electricity Authority recognizes the purchase cost in foreign currency translated into NIS at the known exchange rate on the normative purchase date. Therefore, the rate does not provide hedging against changes in index rates versus changes in foreign currency rates after the purchase date.

In addition, the Company is exposed to exchange rate fluctuations due to:

- Current payments to suppliers denominated in foreign currency and/or linked to foreign currency with respect to which there is no compensation in the electricity rate.
- Payments to gas suppliers with respect to the period from the date of recognition of the electricity rate until the actual payment date. The recognized price in the electricity rate is identical to the price paid by the Company. However, the recognized rate of exchange in the rate is a high checks rate determined by the Bank of Israel Ltd. on the third business day that precedes the end of the month for the gas consumption in the following month.

b) Interest Risks

The Company is exposed to changes in interest rates dictated by the market, regarding financial liabilities raised by the Company which bear variable interest. Moreover, an increase in interest rates of the market may considerably increase the costs of the debt raising which the Company is required to raise. This exposure may affect the financial results of the Company.

c) Input Price Change

The input basket for the other rate components, except for fuels costs, part of the operating costs and part of the capital costs was linked to changes in the CPI. Therefore, the Company is exposed to market risks deriving from a real increase in the prices of inputs, which the Company purchases.

d) Accounting Exposure Risk with Respect to Measurement of Hedging Transactions at Fair Value

According to the provisions of IAS39, the Company is measuring its financial liabilities at amortized cost and using the effective interest method, while the hedging transactions for these liabilities are measured at fair value through profit and loss. The gap between the measurement methods creates an accounting exposure for the Company that may be affected by changes that occurred in currency rates, CPI and interest rates.

Presently, the Company's policy in managing its market risks is according to financial exposure and not accounting exposure. However, in order to reduce this accounting exposure, the Company begun implementing hedge accounting for new hedge transactions according to the instructions of the standard. For details see Note 27 h to the Financial Statements.

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b. Details about the Exposure to Market Risks and their Management (continued)
2. Description of the Company's Market Risks (continued)

e) Capital Market Changes Affecting the Pension Funds and Pension Obligation

As a member of the Central Pension Fund, the Company is obliged to maintain a financial fund in the Central Pension Fund (the "Fund") that will enable pension payments to entitled pensioners and employees, according to the actuarial liability, calculated by the actuary of the Fund. The Fund calculates the actuarial liability of the Company for employees in the pension plan to determine the sum that the Company should deposit as a fund. For details of the payment arrangements between the Fund and the Company as detailed in the Articles of the Fund, see Note 12 I to the Financial Statements.

According to this liability, the Company will be responsible for making-up any deficit between the Fund and the liability. At the same time, there is a particular uncertainty regarding the volume of deposits that the Pension Fund will require.

The deposits in the pension fund of the Company are based on a forecast of cash flow expected in the future and several actuarial assumptions. The actual pension liabilities of the Company may differ from the forecasted liabilities. Moreover, the actuarial model for calculating the deposits in the pension fund may change in the future according to changes in life expectancy, regulatory issues, economic climate and other issues. These changes may cause a surplus or a deficit in the Company's liabilities to the pension fund. For additional details see Note 12 to the Financial Statements.

In this context, the main risks to which the Company is exposed are:

- 1) The investment policy of the Fund and its effect on the Fund – The fund held by the Fund includes various assets, comprised mostly of CPI linked bank deposits, Government debentures, corporate debentures and shares. Therefore, the yield of the Fund is affected by the inherent risks of markets behavior and its effect on the composition and value of the assets in the fund.
- 2) Average duration risks – the changes in yields of Government debentures have a higher effect on the financial value of the liabilities (the reserve) compared to the financial value of the assets (the fund) caused by the longer average duration of the reserve compared to that of the fund. Reduction of market risks requires therefore diversification of investments in terms of the mix of held financial assets, credit rating and adjusting the average duration to the average duration of the reserve, as far as possible.
- 3) Credit risks – failure of a third party to meet its obligations to the Fund may decrease the value of Fund assets.

f) Credit risks

The Company is at risk of facing difficulties in collecting from two customers - the East Jerusalem Company and the Palestinian Authority. Regarding details as to the risk as described above, see Note 6 d to the Financial Statements.

For additional details regarding the Company's policy pertaining to exposure to the various risks and the hedge policy implemented by the Company, see Note 27 c to the Financial Statements.

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b. Details about the Exposure to Market Risks and their Management (continued)

3. The Company's Policy for Managing Market Risks

As a rule, the Company acts in the matter of finances and investments, according to the procedure of the Company, so as to minimize financial risks, while spreading its investments in different banks. The policy of the Company is to manage the market risks arising from economic exposure of the Company to currency risks. The Company's policy for managing the market risks to which it is exposed is as follows:

a) The Company's policy for Managing Market Risks of Exposure to Currency Risks

The Company's policy is to manage market risks arising from the economic exposure of the Company. In order to minimize the Company's exposure to foreign currency fluctuations, the Board of Directors of the Company has reached decisions concerning the Company's exposure.

For details of the policy of handling the exposure to foreign currency and variable interest see Note 27 c. to the Financial Statements.

b) The Company's policy regarding interest risk

For details, see Note 27 c. to the Financial Statements.

c) The Policy of the Company to Contend with Market Risks Affecting the Pension Fund

The Company acts to deal with market risks affecting the ability of the Fund to effect payments to entitled employees out of its assets, as follows:

- 1) On all matters regarding the funds, the Company designates the market risks management for economic exposure.
- 2) A dedicated department is charged with the task of controlling the financial activity of the Fund and supervising the conformance to legal directives and the management services agreement between the Company and the management company of the Fund.
- 3) The Company has a representative on the Fund's Board of Directors and in its committees (in addition to a representative of Company employees).
These directors participate in defining the suitable policy for managing the funds, including providing a solution to the risk of average duration gaps between the assets and the liabilities by adjusting, as best as possible, the average duration of the assets to investments, with due consideration of the borrower's risks and investment volume and also investing the major share of Fund assets in NIS linked assets.
- 4) According to the Regulations of Supervision of Financial Services (Provident Fund) (Rules for Administering a Central Pension Fund), 2012, the Capital Market Division circular 2012-3-2 and the articles of the Fund that were approved by the Minister of Finance on March 31, 2014, have a spread mechanism of the actuarial deficit in a manner that facilitates the cash flow of the Company to the Fund, see section 5 below.
- 5) On March 31, 2014, the change in the articles of the Main Pension Fund was approved by the Supervisor of the Capital Market in the Ministry of Finance. For details see Note 12 I 1 e to the Financial Statements.
- 6) The Fund manages the pension funds according to its policy and not according to the Company's policy. It is known that the Fund is comprised of different assets, mainly Government debentures, corporate debentures, shares and index linked deposits in banks. Therefore, the yield of the Fund is affected by the inherent risks of markets behavior and its effect on the composition and value of the assets in the Fund.

d) The Scope of Authority in the Company's Management in Managing the Exposure to Market Risks

As per the Company's policy concerning the treatment of exposure deriving from market risks, as detailed above, the Head of the Finance Department is authorized to approve currency exchange transactions and interest swap transactions. The Head of the Finance Department is not limited to quantities in respect to authority to approve hedge transactions. In addition, the Board of Directors has determined that certain Company employees shall perform, on behalf of the Company, hedge transactions in accordance with its policy.

**THE ISRAEL ELECTRIC CORPORATION LIMITED
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- b. **Details about the Exposure to Market Risks and their Management (continued)**
- 3. **The Company's Policy for Managing Market Risks (continued)**

- e) **Supervising and Realizing the Risk Management Policy**

- 1) **General**

- The Company maintains a periodic monitoring for the management of financial market risks by carrying out monthly tracking of its financial liabilities and their hedges.

- The Company tracks its liabilities over the reporting period and will perform hedges based upon its needs and according to set policy.

- 2) **Supervision by the Board of Directors**

- Once a quarter, as part of the Committee of Examination of the Financial Statements, the Company will report on the linkage balance and the state of the comprehensive currency exposure of the Company to foreign currency, as of the balance date. With a material devaluation of 8% and upwards during each quarter, the Company will examine the state of the exposures and will report to the Committee of Budget, Financial Management and Risk Management of the Board of Directors.

- 3) **Company Control Mechanisms**

- The Company's Internal Audit occasionally tracks the performance of decisions made by the Board of Directors and its committees on the subject of exposure to currency risks, to prevent, inter alia, deviation from the Company's policy for managing market risks. The audit is conducted according to the accepted audit standards and to work plans approved by the Audit Committee of the Board of Directors.

- The Company has a team that is responsible for implementing the Company policy for handling the exposure to foreign currency and variable interest, which monitors the progression of the exposure once a month and recommends appropriate hedging transactions.

- f) **Linkage Base and Sensitivity Tests Report**

See Note 27 to the Financial Statements for information regarding linkage terms of the financial balances and sensitivity tests of the Company as of December 31, 2014 and the period last year.

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c. Aspects of Corporate Governance

1. Contributions

The Company is prevented from making contributions in light of Companies Authority directives.

2. Directors possessing accounting and financial expertise

According to the provisions of the Companies Law, the Board of Directors of the Company determined that the minimal number of directors in the Company possessing accounting and financial expertise will be 5 directors, taking into account, inter alia, the Company's size, type of activity, and number of members of its Board of Directors. The Company estimates that this number will enable the Board of Directors to meet the duties imposed on it according to law and the incorporation documents of the Company.

As of the date of the statement of financial position, the Company has five Directors possessing accounting and financial expertise:

Directors who possess accounting and financial skills are: Dr. Ziv Reich, Mr. Mordechai Ben-Ami, Accountant Arie Rapoport, Dr. Ophir Bashan and Accountant Raik Abu Reish. For additional details of the directors see Regulation 26 (the directors of the corporation) in Chapter D Additional Details of the Corporation as of December 31, 2014.

On February 20, 2015, Mr. Mordechai Ben-Ami ended his term in office.

Following the retirement of director Mordechai Ben-Ami, the number of directors with accounting and financial expertise became four, and was reduced from the minimal number set by the Board of Directors of the Company. The authority to appoint directors does not lie with the Company but with the Minister of Finance and the Minister of National Infrastructures, Energy and Water, after consultation with the Appointment Examination Committee. The Company applied to the Director of the Government Companies Authority on March 10, 2015 and warned him of the need to urgently appoint an additional director with accounting and financial expertise.

3. Independent directors

The Company has not adopted a provision in its articles of association regarding the number of independent directors, as detailed in section 219 (e) of the Companies Law.

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BOARD OF DIRECTORS' REPORT
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c. Aspects of Corporate Governance (continued)

4. The Company's Internal Auditor

a) Details of the Internal Auditor

- 1) Until April 27, 2014, Mr. Shmuel Shatz served as acting internal auditor of the Company. From that date, Ms. Nitza Rogozinski was appointed internal auditor.
- 2) The Internal Auditor meets the conditions set in section 146(b) to the Companies Law and the provisions of sections 3a and 8 to the Internal Audit law, 1992 (hereinafter: the "Internal Audit law").
- 3) The Internal Auditor is an employee of the Company and does not fulfill another function in the Company in addition to internal auditing, except for the function of Supervisor for Public Complaints and Supervisor for Employee Complaints. Fulfilling the additional function does not harm the fulfillment of her main function.
- 4) the Internal Auditor does not hold any securities of the Company or of anybody related to it and the Internal Auditor does not have material business relationships or other material relationships with the Company and does not fulfill any function outside the Company that creates or may create conflict of interests with her function as Internal Auditor.

b) Manner of Appointment of the Internal Auditor

On November 21, 2013, the Board of Directors of the Company, in accordance with a Companies Authority circular on the subject, approved the format of selection of the internal auditor as was presented by the Audit Committee. A search committee that was appointed for the process examined the candidates that participated in the process under the set format, ranked the candidates according to predetermined criteria, and recommended Ms. Nitza Rogozinski as the most suitable candidate for the function.

On February 6, 2014, the Board of Directors of the Company decided to adopt the decision of the Audit Committee and appoint Ms. Nitza Rogozinski as Internal Auditor of the Company.

On April 27, 2014, Ms. Nitza Rogozinski began her function as Internal Auditor of the Company.

c) Identity of the Supervisor of the Internal Auditor

- 1) The CEO and the Chairman of the Board of Directors of the Company supervise the Internal Auditor and Public Complaints Commissioner on behalf of the organization.
- 2) The identity of the supervisors conforms to the directives of section 148 and section 49 of the Government Companies Law.
- 3) The obligations and the authorities of the Internal Auditor are set in the procedure "The Internal Audit and Public Complaints Commissioner" of the Company. This Internal Audit procedure is approved by the Audit Committee.

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c. Aspects of Corporate Governance (continued)

4. The Company's Internal Auditor (continued)

d) Work Plan

- 1) The Internal Auditor submits a proposed annual work plan, in coordination with the Chairman of the Board of Directors, the Chairman of the Audit Committee and the CEO. The annual work plan is discussed and approved by the Audit Committee and by the Board of Directors. The work plan for 2014 was approved by the Audit Committee and approved by the Board of Directors in December 2013.
- 2) The duties and authorities of the internal auditor are determined in accordance with section 4(a) to the Internal Audit Law and by the Audit Committee, according to the authority delegated to it for this purpose in the past by the Company's Board of Directors. On May 24, 2012, the Board of Directors approved a motion to reconfirm its previous decision to delegate to the Audit Committee its authority to determine the duties and authorities of the Internal Auditor.
- 3) Demands to perform audit tasks and sometimes audits with higher priority than other tasks during the work year are initiated by the Chairman of the Board of Directors, the Chairman of the Audit Committee, the CEO, members of the Board of Directors and the Internal Auditor. In addition, the Internal Audit conducts additional audits that are not planned in advance during the year, pursuant to audit reports of the State Comptroller and pursuant to direct and anonymous complaints received by the Company. All these are integrated in the work plan within the approved scope of the plan.

The Internal Auditor annually submits a semi-annual report summarizing the Internal Audit reports completed during the months January – June of that year.

The Internal Auditor prepares an annual report every year, summarizing the Internal Audit reports completed during that year. The semi-annual report and the annual report of the Internal Audit are submitted to the Chairman of the Board of Directors, the Chairman of the Audit Committee of the Board of Directors and the CEO.

- 4) The Internal Auditor submitted an audit report in 2014 on the subject of material transactions (including transactions that require special approvals according to Section 270 of the Companies Law and exceptional transactions as defined in the Companies Law) which the Company entered into up to the end of December 2013.
- 5) The work plan for 2014 provides the Internal Auditor for unplanned tasks in the scope of 34 tasks.
- 6) During the period of January – December 2014, the Internal Audit submitted audit reports, including follow-up reports in the area of computerized information systems.
- 7) The preparation of a risk survey and a multi-year work plan for the internal audit for 2014-2016 was completed during 2013. The risk survey and the multi-year work plan (2014-2016) were approved by the audit committee and the board of directors.
In December 2013, the Audit Committee and the Board of Directors approved the internal audit work plan for 2014.
In October 2014, the Audit Committee approved the work plan for 2014.
In December, 2014, the Audit Committee and the Board of Directors approved the update of the multi-annual work plan and the internal audit work plan for 2015.

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c. Aspects of Corporate Governance (continued)

4. The Company's Internal Auditor (continued)

e) Audit of Held Companies

- 1) Work plans of the Internal Audit include, from time to time, audit of the subsidiaries.
- 2) An independent Internal Auditor was appointed for the National Coal Supply Corporation ("The Coal Company"). The supervision of the work of the internal auditor at the Coal Company is performed by the Audit Committee and the Board of Directors of the Coal Company. As agreed upon in June 2012 between the Internal Auditor and the Chairman of the Board of Directors of the Coal Company, the Internal Auditor of the Company receives all the material related to the internal audit in the Coal Company that he requires to perform his work.

f) Scope of Employment

- 1) The number of employment hours of the Audit Unit during the report year:

	Internal Audit	Public Complaints
Audit of activities in Israel	Approx 42,000	Approx 16,000

For 2014, the Internal Audit has 43 budgeted positions for employees who perform audits and handle public and employees complaints (including secretaries and administrators). The Internal Auditor clarifies complaints from the public, including employee complaints, assisted by employees of the Internal Audit. 10 employees out of the budgeted positions are designated to handle public complaints. In addition, the Internal Auditor engages outsourced audit services to assist fulfillment of the work plan and other audit tasks or on subjects requiring expertise that the internal audit lacks. The scope of the outsourced audit services is not material.

- 2) According to the multi-year work plan, as approved in November 2013, by the Audit Committee and approved by the Board of Directors in December 2013, the Company estimates that the work scope of the Internal Audit is required and sufficient to cover the material issues in the Company about once every three years.

g) Performance of the Audit

- (1) As stated by the Internal Auditor, audits are conducted according to accepted professional standards of Internal Auditing, in accordance with the applicable laws and in conformance to the Internal Audit Law and to the directives of the Government Companies Authority, furnished from time to time in circulars of the Government Companies Authority.
- (2) The Board of Directors and the Audit Committee assess that the Internal Auditor conformed to the requirements specified in the professional standards.

h) Access to Information

The Internal Auditor and her representatives are granted free, continuous and direct access to every hard copy or digital document, data, database, or information, including financial data, for performing their tasks. The Internal Auditor and her representatives are entitled to enter every asset and inspect it, in conformance with the contents of Section 9 of the Internal Audit Law.

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c. Aspects of Corporate Governance (continued)

4. The Company's Internal Auditor (continued)

(i) Reports of the Internal Auditor

- (1) Reports of the Internal Auditor are submitted in writing. Annually, the Internal Auditor submits an annual report that includes a summary of the work of the Internal Audit, a follow-up on implementation of decisions and recommendations as detailed in section d 3 above.
- (2) During the work year, the Internal Auditor submits final versions of audit reports to the Chairman of the Board of Directors, to the CEO and to the Chairman of the Audit Committee of the Board of Directors. Audit reports are submitted to the members of the Board of Directors, to members of Management and to the audited entities through the Secretary of the Board of Directors. The semi-annual reports submitted by the Chairman of the Board of Directors to the Finance and Energy and Water Ministers and to the Manager of the Companies Authority include a report on the performance of the Internal Audit in the Company.
- (3) During January – December 2014, the Internal Auditor presented 105 reports: 78 audit reports and 27 examination reports. During this period, the Audit Committee of the Board of Directors held 9 discussions on the Internal Auditor's findings and recommendations which took place on January 16, 2014, February 27, 2014, April 10, 2014, July 3, 2014, August 28, 2014, September 11, 2014, October 2, 2014, December 4, 2014 and December 25, 2014.

j) Evaluation of the Board of Directors of the Internal Auditor's Activities

According to the multi-annual plan, the Board of Directors estimates that the scope of the Internal Auditor's activities allows the auditing of material subjects once every 3 years or so. This scope, the character and continuity of the Internal Auditor's activities and her work plans are, in the Board of Director's estimate, reasonable and are capable of realizing the Company's Internal Auditing goals.

k) Remuneration

The Internal Auditor is an employee of the Company.

The Board of Directors estimates that her wages do not affect the ability of the Internal Auditor to exercise her professional consideration.

5. Internal Enforcement Plan in the Field of Securities

On June 14, 2012, the Board of Directors of the Company approved an outline of an internal enforcement plan that was formulated by the Company, according to criteria published by the Securities Authority on August 15, 2011, for recognizing an internal enforcement plan in the field of securities as an effective enforcement plan (hereinafter: the "Criteria").

As of the date of publication of the report, the Company has completed the milestones set by it for adoption of an internal enforcement plan by the Company, and the Board of Directors of the Company appointed a designated committee of the Board of directors - a Corporate Responsibility Committee, that deals, inter alia, with adoption and implementation of the internal enforcement plan in the Company according to the duties designated for it within the outline of the plan. Additionally, the Board of Directors appointed a supervisor in charge of the internal enforcement in the Company in the field of securities, and national enforcement and compliance team, unit enforcement and compliance teams and additional factors that constitute part of the internal enforcement array of the Company were also appointed. In addition, the Company completed the preparation and formulation of master procedures of the Company in the field of the internal enforcement and it is taking intensive enforcement actions for implementing and assimilating the internal enforcement plan in the Company, including by conducting tutorials to all the relevant enforcement factors of the Company.

Additionally, last year, the Company entered a contractual engagement with the firm of Ziv Haft Consultation and Management Ltd. for the execution of an external enforcement survey to locate potential gaps and failures in the operations of the Company and the exposure of the Company to the securities laws.

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c. Aspects of Corporate Governance (continued)

5. Internal Enforcement Plan (continued)

On December 16, 2014, an internal audit report dealing with "preparation and assimilation of an administrative enforcement plan" was distributed in the Company. According to the report, the preparation and implementation process of the internal enforcement plan in the Company was conducted appropriately and there were no findings that indicated exceptions from the provisions of the law. The Board of Directors and management of the Company allocated resources, held meetings and carried out follow-up and continuous monitoring in order to prepare an effective enforcement plan in accordance with the requirements of the Securities Authority.

According to the provisions of the administrative enforcement arrangement signed by the Company and the Securities Authority, which was approved by the administrative enforcement committee on November 28, 2013 (hereinafter in this section: the "Arrangement"), in February 2014, the Company appointed an external inspector whose duty is, inter alia, to ensure completion of the formulation and effective implementation of the enforcement plan and its procedures, and to quarterly submit a report to the Securities Authority on the findings of his inspection (hereinafter: the "External Inspector"). (For additional details regarding the enforcement Arrangement see immediate report of November 28, 2013, reference number: 2013-01-208542).

According to the provisions of the stated Arrangement, during 2014, the External Inspector delivered three quarterly supervision reports to the Securities Authority. The first and second quarterly reports delivered by the inspector were described in the Board of Directors' Report on the Status of the Company Affairs of June 30, 2014.

a) On November 20, 2014, the External Inspector delivered the third quarterly supervision report to the Securities Authority. Following are its main points:

- 1) The inspector included a number of comments that are being dealt with by the Company, and their main points are:
 - (a) The annual enforcement report, which summarizes the operation of the Company regarding the enforcement plan in the Company, constitutes an efficient and appropriate supervision tool. However, the inspector believes that the report can be improved and turned into a more efficient tool for those who study it and proposed a number of technical changes pertaining to the structure of the report. The changes are acceptable to the Company and will be implemented in the next annual report.
 - (b) The master procedures of the enforcement plan - The inspector is of the opinion that the master procedures should be accompanied by internal procedures and work papers of the various Company units and has therefore proposed to carry out a mapping of the existing internal procedures of the Company units in order to execute a complete arrangement of each of the master procedures of the Company. In addition, the inspector proposes that the Company consider setting specific controls for specific processes in the various procedures. The Company has taken the comments of the inspector into consideration and is dealing with them.
 - (c) The inspector found that many inputs were invested in the compliance survey project and that the findings of the survey reflect that an expansive and comprehensive examination of the relevant aspects has been conducted, and it appears that the enforcement plan is being satisfactorily implemented in the Company and the Company is acting according to law without significant exposures pertaining to securities law. However, the inspector is of the opinion that in certain cases, action should be taken to amend the wording in the findings of the compliance survey. Accordingly, the handlers of the compliance survey carried out an investigation and the wording of the remark in the survey findings was clarified.

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c. Aspects of Corporate Governance (continued)

5. Internal Enforcement Plan (continued)

a) (continued)

- 2) The inspector found that even during the third supervision report period, the Company continued in earnest to act towards implementing the internal enforcement plan.
- 3) The inspector notes that interviews with the key people constitute a very effective tool for controlling the effectiveness of the plan, which significantly contributes to the effective implementation of the plan, and the required resources should continue to be dedicated for it.
- 4) The scope of activity of the Company in the field of internal enforcement in this period has grown significantly compared with the period of the second report, and major objectives of the enforcement plan, such as delivery of the annual enforcement report and its approval, and publication of the compliance survey, have been achieved.
- 5) During the third report period, the extent of applications to the Supervisor of Internal Enforcement regarding issues of the enforcement plan rose significantly, and in the opinion of the inspector this indicates that the level of awareness and involvement of the employees to the enforcement plan is increasing.
- 6) In addition, the inspector notes that the implementation of the enforcement plan with the involvement of the management of the Company, the Board of Directors and the Regulation and Corporate Responsibility Committee has continued, and the Company has continued to use the tools it has developed for examining the effectiveness of the plan.

b) On February 22, 2015, the External Inspector delivered the fourth quarterly supervision report to the Securities Authority. Following are its main points:

- 1) The inspector found that even during the fourth supervision report period, the Company diligently continued to act in the area of the internal enforcement.
- 2) In this period, the process of implementing the enforcement plan continued in an orderly manner, with the involvement of the management of the Company, the Board of Directors and the Regulation and Corporate Responsibility Committee, and the Company has continued to use the diversified tools it has developed for examining the effectiveness of the plan.
- 3) The inspector notes that lessons and conclusions have been formulated from the manner of implementation of the plan in 2014, and these have been assimilated in an orderly manner in the 2015 annual plan, whose implementation has already begun during the fourth report period.
- 4) The national team continues to act methodically, handling the remarks and recommendations raised by the inspector in the third supervision report and in general. The inspector will again examine the progress of the various proceedings in the coming reports.

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c. Aspects of Corporate Governance (continued)

6. Financial Statements Approval Process

- a) For details of the Financial Statements Review Committee (hereinafter: the "Committee"), approval process of the Financial Statements as required by the Securities Regulations see the 2014 corporate governance questionnaire.

b) Procedure for Approval of Financial Statements

As part of the discussion on the subject of the Financial Statements as of December 31, 2014, the Financial Statements Review Committee held two meetings:

The following attended the meeting held March 12, 2015:

Dr. Ziv Reich Chairman of the Committee, Accountant Arie Rapoport Member of the Committee, Dr. Ophir Bashan, member of the Committee, Mr. Eliyahu Glickman CEO, Accountant Tamir Polikar Senior Vice President of Finance and Economics, Advocate Nissim Hilu acting General Counsel and Company Secretary, representatives of the internal audit, representatives of the Accounting and Economics Division, representatives of the Finance Division, representative of the office of the Auditor Brightman Almagor Zohar & Co., representatives of the law firm of Herzog Fox Neeman, representatives of the Companies Authority and the financial advisors of the Company and Mr. Emanuel Berzack Company actuary.

The following attended the meeting held March 16, 2015:

Dr. Ziv Reich Chairman of the Committee, Accountant Arie Rapoport Member of the Committee, Dr. Ophir Bashan, Member of the Committee, Mr. Eliyahu Glickman CEO, Accountant Tamir Polikar Senior Vice President of Finance and Economics, Advocate Nissim Hilu acting General Counsel and Company Secretary, representatives of the internal audit, representatives of the Accounting and Economics Division, representatives of the Finance Division, representative of the office of the Auditor Brightman Almagor Zohar & Co., representatives of the law firm of Herzog Fox Neeman and the financial advisors of the Company.

c) Other Steps taken in the Company to Ensure the Correctness of the Company Financial Statements and the Board of Directors' Report

The Company operates in accordance with the Government Companies Regulations (an additional Report on actions taken and presentations given to ensure the correctness of the Financial Statements and the Board of Directors' Report) – 2005, in which the Company is obliged to attach to its Annual and Quarterly Financial Statements an additional report on actions taken and presentations given to ensure the correctness of the periodic or quarterly report, as applicable, including signed statements from all of the Company officers signing those reports.

For the processes performed by the committee and the Board of Directors prior to the approval of the Financial Statements, see the 2014 corporate governance questionnaire.

There is a Disclosure Committee in the Company, headed by the CEO of the Company, Mr. Eliyahu Glickman, and the goal of the Committee is to ensure in an optimal manner that the financial statements of the Company include full presentations and disclosures as required.

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c. Aspects of Corporate Governance (continued)

6. Financial Statements Approval Process (continued)

c) Other Steps taken in the Company to Ensure the Correctness of the Company Financial Statements and the Board of Directors' Report (continued)

The duties of the committee:

The disclosure committee holds a discussion before the financial statements are presented for discussion at the committee for reviewing financial statements.

- 1) Reviewing periodic and annual reports and approving infrastructure and notes to the reports.
- 2) Discussing information relevant to the report being discussed.
- 3) Discussing relevant correspondence with the Securities Authority, Government Companies Authority, Electricity Authority and other regulators.
- 4) Discussing defects found as a result of the disclosure, information flow and solution providing processes.
- 5) Improving the disclosure processes.
- 6) Discussing the materialization of risks of accounting reports and financial statements.
- 7) Tracking and controlling reports of the division heads that require disclosure in the financial statements.

The members of the committee are: Company CEO - the chairman of the committee, deputy CEOs, acting General Counsel and Company Secretary, Head of Accounting and Economics Division, Head of Finances Division, Head of Accounting and Financial Statements Department, and the Head of the SOX Department. The committee convenes twice a quarter, in the beginning of the Financial Statement production process, and towards the end of the production of the Financial Statement, prior to its publication.

In addition, the Company has determined a "working Procedure for the approval of Financial Statements, critical accounting policy changes and changes in actuarial assumptions" which determined, inter alia, a mechanism for detecting, treating and reporting events and information that may influence the critical accounting policies and / or actuarial assumptions on which the Company operates, including the transfer of reports and discussions to the relevant parties in the Company, including the CEO, Senior Vice President of Finance and Economics, Head of Human Resources Division, the Chairman of the Committee examine the Financial Statements of the Board of Directors, members of the committee to examine the Financial Statements of the Board of Directors, the Chairman of the Board of Directors and Board members.

7. The Link between Rewards to Senior Position Holders and Interested Parties in the Company and Their Contribution to the Company

On March 24, 2015, the Board of Directors of the Company examined the terms of compensation for senior position holders and interested parties detailed in Chapter D against the remuneration policy of the Company, and reached the conclusion that the compensation paid to the five senior position holders receiving the highest compensation in the Company, as well as the interested parties of the Company, meet with the compensation policy, suit the complexity of their positions and are reasonable.

For additional details regarding the compensation policy in the Company see section 8 below.

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- c. Aspects of Corporate Governance (continued)
8. Policy for the Compensation of Officers under Amendment No. 20 to the Companies Law

Compensation Policy for Senior Office Holders

In accordance with the Companies Law (Amendment No. 20) – 2012, which regulates the structure of compensation for office holders in public companies and debenture companies, and determines a special proceeding for approval of the structure of the compensation, the compensation committee of the Board of Directors and the plenum of the Board of Directors approved on December 19, 2013 and December 26, 2013, respectively, the compensation policy for senior office holders of the Company ("**Compensation Policy**"). The abovementioned approval by the Board of Directors was given after the Board of Directors discussed and considered the recommendations of the Company's compensation committee on the matter, while considering the criteria set by the Companies Law and paying attention to the considerations and principles detailed below. The compensation package was adapted to the size of the Company, the nature of its activity, the aspiration of the Company to keep its office holders, and the Company being a Government Company subject to the provisions of the Government Companies Law and its various regulations, directives of the Government Companies Authority and section 29 to the Budget Foundations Law - 1985, that restrict the Company's abilities to act independently in matters of employment salary and benefits. The compensation policy was approved at the general meeting of January 9, 2014.

On September 16, 2014, and October 2, 2014, the compensation committee and the plenum of the Board of Directors (respectively) approved an amendment to the Compensation Policy, regarding the compensation and incentive bonus for senior office holders of the Company, according to the Government Companies Authority's circular of March 25, 2014. The amendment was approved in the general meeting on February 4, 2015. For additional details and the complete version of the compensation policy see the Immediate Report of the Company of January 9, 2014, ref. no.: 2014-01-011125, and February 4, 2015, ref. no.: 2015-01-024979.

In January 2015, an updated circular of the Companies Authority was published, regarding principles for a model for compensation and incentive for senior employees. The Company is studying its implications.

9. External Auditors of the Company

- a) The External Auditors of the Company are the Brightman Almagor Zohar & Co. auditing firm. On December 31, 2007, during the annual shareholders general meeting, Brightman Almagor Zohar & Co. auditing firm was appointed as the Company's external auditors for the 2008 fiscal year. Following this, the appointment of the Brightman Almagor Zohar & Co. was re-approved in each of the Company's annual general meetings for 2009, 2010 and 2011 (which were held on December 31, 2008, May 31, 2010 and August 2, 2011, respectively), and all the above detailed appointments were approved by the Government Companies Authority in accordance with the provisions of section 44(a) to the Government Companies Law of 1975.
- b) At the Annual General Meeting of November 22, 2012, and at the Annual General Meeting of January 9, 2014, the discussion regarding the appointment of an external auditor and determining the fees was deferred to a postponed annual general meeting according to the requirements of the Government Companies Authority, which announced that since the committee for appointment and pay of accountant for a government company (hereinafter: the "**Committee**") has yet to reach a decision in this matter, due to cessation of its activity and its conversion into a severed committee, the discussion of this matter should be postponed to a postponed annual meeting that will convene in accordance with the provisions of the law and the articles of the Company.

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c. Aspects of Corporate Governance (continued)
9. External Auditors of the Company (continued)

- c) As the committee has not yet convened, also during the last annual general meeting of the Company of February 4, 2015, it was decided to postpone the discussion of this matter to a postponed annual meeting that will be convened according to the provisions of the law and the articles of the Company. As a result, the firm of Brightman, Almagor, Zohar & Co continues its work as external auditor of the Company.

As stated in the decision of the General Meeting of February 4, 2015, the Company's Board of Directors implemented all the directives included in the circulars of the Government Companies Authority (published from time to time) related to procedures of employing external auditors and determining their fees and to financial statements, report of the Board of Directors and reports of internal and external audits. In addition, the Board of Directors will examine the work hours report and fees submitted by the auditor in light of the stated circulars of the Authority, emphasizing the level of the rates and the distribution among the professionals and will submit the conclusions of its examination for approval by the Government Companies Authority.

The total fees of the outside auditor in respect with audit services and other services relating to tax services audit and other related services for the years 2013 – 2014 are detailed below:

For the year ended on December 31				
2014		2013		
Brightman Almagor Zohar & Co.				
	Hours	NIS thousands	Hours	NIS thousands
a. Fees for audit services, for services related to audits and for tax services	20,133	4,228	21,917	4,603
b. Other fees - total fees for services provided by the outside auditor which are not included in paragraph (a) above .	2,950	620	3,250	682

Hours dedicated by the External Auditor in providing other related services in 2014:

Offering Circular abroad and a draft prospectus in Israel.....	1,900
Communication with the Government Companies Authority	100
Special tax work	650
Special confirmations.....	300
Total hours dedicated to accompanying services	2,950

Hours dedicated by the External Auditor in providing other related services in 2013:

Work related to a prospectus abroad and a draft prospectus abroad that was not published ...	2,150
Work related to the communication between the auditors and the Government Companies Authority	100
Special tax work	750
Work on providing special auditor confirmations	250
Total hours dedicated to other accompanying services	3,250

In the opinion of the Company, performances of the related services provided by the external auditor do not affect the independence of the external auditor.

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c. Aspects of Corporate Governance (continued)

9. External Auditors of the Company (continued)

d) Fees of the Outside Auditor

The fees of the external auditor, including the scope of hours and rate per hour are determined in accordance with the rules of the Government Companies Authority (Appointment of External Auditors and their Fees) – 1994 and according to its circulars, without the involvement of the Company. Current advance payments are paid to the external auditor during the audit year, according to the progress of the regular audit and review work, for services related to the audit and for tax services, up to the ceiling determined for these types of work. The balance of the fee (less advance payments paid) is paid at the end of the audit year, pursuant to the approval of the Companies Authority.

During the audit year, the external auditor also receives payment of fees related to providing additional services, which are not included in the aforementioned list, according to the progress of the work and subject to the approval of the Companies Authority.

On March 18, 2015, the Financial Statements Review Committee discussed and was satisfied that the scope of work of the external auditor relating to the financial statements of the reporting year are appropriate for executing proper auditing and review work.

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d. Instructions for Disclosure Related to the Financial Reporting of the Company

1. The Financial Reporting of the Company

The Consolidated Financial Statements of the Company comply with the provisions of the Government Companies Regulations (accounting principles for the preparation of Financial Statements of the Israel Electric Company Ltd.) (Temporary Order) – 2004 including their articles (hereinafter: the “Government Companies Regulations”) and the provisions of the Securities Regulations (Annual Financial Statements), 2010 and the Government Companies Regulations (accounting principles for the preparation of Financial Statements of the Israel Electric Company Ltd.) (Temporary Order) – 2004 including their amendments.

On January 1, 2015, the Company will fully implement the International Financial Reporting Standards (IFRS). See details in Note 2 a 4 to the Financial Statements.

The Company consolidates the Coal Company in its Financial Statements. The financial data in the Board of Directors’ Report are data from the Consolidated Financial Statements of the Company.

2. Events that Occurred after the Statement of Financial Position Date

See Note 37 to the Financial Statements.

3. Critical Accounting Estimates

a) Preparation of the Financial Statements in accordance with accepted accounting principles requires the Management of the Company to make evaluations and estimates which affect the reported values of the assets, liabilities, revenues and expenses and also the disclosure concerning contingent assets and liabilities. For details on the use of critical accounting estimates of the Company, see Note 2 aa to the Financial Statements.

b) Following are additional details regarding the critical accounting estimates of the Company:

1) Employee benefits:

For details of the critical accounting estimates related to employee benefits see Note 12 to the Financial Statements.

According to the staff accounting bulletin of the Securities Authority of November 25, 2014, regarding the existence of a corporate debenture deep market, starting December 31 2014 the Company is using the capitalization rate that is appropriate to the market yields for the high quality corporate debentures for capitalizing the liability with respect to employee benefits. For additional details see Note 12 h to the Financial Statements.

There is a difference of approximately NIS 6.5 billion between the actuarial liability according to the Financial Statements of the Fund as of December 31, 2014 and the actuarial liability according to the Financial Statements of the Company as of December 31, 2014, (with respect to the pension payments). The difference derives from a difference in calculation methodology between the bodies, which partly derives from different professional approaches, according to the rules that oblige each of the bodies: the Company calculates the actuarial liability in accordance with the accounting rules applied to the Company (in accordance with the International Financial Reporting Standards, including IAS 19 and the directives of the Securities Authority), while the Fund acts in accordance with the instructions of the Capital Market, Insurance and Savings Division Officer, where the Actuary of the Fund noted that the assumptions used to prepare the statement of financial position comply with the instructions of the Capital Market, Insurance and Savings Division Officer for preparing actuarial statements of financial position.

The main difference between the assumptions derives from the discount rate, used to calculate the actuarial liability, i.e. the Fund capitalizes the actuarial liability according to the discount rate of government debentures and the Company according to corporate debentures, (see Note 12 h to the Financial Statements), and the assumption of the real increase in salary assumption, rate of employee promotion, seniority increment, labor agreements, salary erosion, etc.

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d. Instructions for Disclosure Related to the Financial Reporting of the Company (continued)

3. Critical Accounting Estimates (continued)

b) (continued)

2) Asset impairment according to Accounting Standard 36.

Sensitivity according to the change in the weighted average cost of capital (WACC)

WACC	(1%)	(0.5%)	Set capital costs	0.5%	1%
Surplus of recoverable value over book value in NIS millions..	1,034	794	556	322	90

3) Fair value for financial instruments see Note 27 to the Financial Statements.

4. Material and Highly Material Valuations

a) In light of the update of Legal Position number 105-23 concerning parameters to examine the materiality of valuation, the Company policy in all that relates to materiality of valuations conforms to the position of the Securities Authority. Accordingly, a material valuation in the Company is a valuation that satisfies at least one of the following tests:

- (1) Statement of financial position test – examining the valuation in relation to the total assets of the Company constitutes at least 5% of the total assets of the Company, as presented in the consolidated statement of financial position as of the last date of the reported period.
- (2) Results test –the effect of the change in the value as a result of valuation of the net profit or comprehensive income, as the case may be, constitutes at least 5% of the net profit or comprehensive income of the Company, respectively, as well as constituting at least 2.5% of the Company's equity as of the end of the reporting period.

A highly material valuation is a valuation that fulfills a quantity threshold that is twice the material valuation according to the above detailed parameters (namely, 10% instead of 5% and 5% instead of 2.5%).

b) Disclosure with respect to a valuation that served as the basis to determine the value of data in the Financial Statements

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d. Instructions for Disclosure Related to the Financial Reporting of the Company (continued)

4. Material and Highly Material Valuations (continued)

b) Disclosure with respect to a valuation that served as the basis to determine the value of data in the Financial Statements

Highly Material Valuations

Details of valuations classified as highly material according to the above mentioned materiality tests, in accordance with regulation 8b(i) to the Securities Regulations are presented below:

- 1) The Company conducts very high materiality valuations of the actuarial liability with respect to benefits to employees in accordance with IAS 19.

Identification of Valuation subject	Actuarial obligation for employee benefits in accordance with International Accounting Standard 19 (IAS 19)
The timing of the evaluation:	December 31, 2014
Determined in accordance with the evaluation	NIS 26,359 million
Identifying the appraiser and his characteristics:	Assessment was carried out by Ernst & Young (Israel) Ltd. (hereinafter: Ernst & Young) by Emanuel Berzack and the Actuarial department staff supervised by him. Emanuel Berzack B.Econ.Sc. (Actuarial Statistics) University Witwatersrand, South Africa, is an authorized Actuary (full member of the Israel Association of Actuaries – FILAA, and the Institute of Actuaries in England – FIA). His professional experience - over the past 12 years includes actuarial estimates of employee benefits of similar types to that of the Company, pension liabilities of pension funds, insurance liabilities of insurance companies, duties of an actuary or an examining actuary examines or auditor.
Dependency on evaluation order	On March 29, 2011 the new actuary of the Company from Ernst & Young (Israel) Ltd., who provides actuarial services to the Company from the first quarter of 2010, received a letter of indemnification from the Company.
Evaluation model which the appraiser used	Discounted Cash Flow (hereinafter: "DCF")
Assumptions according to which the appraiser performed the valuation, depending on the model estimates:	Weighted grossed up interest rate in the current value of the liability is 2.56% Real update of salary during the work period - Individual salary development model of active employees and including salary increase between current salary agreements. Real update of post-employment pension amounts –pension development model since January 2012 the pension is linked to the actual linkage CPI of the pension to CPI of January 2013 (according to the annual change of the CPI in 2012) and so in future. Pensioners and survivors mortality including updating mortality rates – according to the Ministry of Finance circular of July 11, 2012. For additional actuarial assumptions, see the Actuary's Opinion in Annex A.
The body in the Company that decided to enter an agreement with the appraiser	Head of Accounting and Economics Section.

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d. Instructions for Disclosure Related to the Financial Reporting of the Company (continued)

4. Material and Highly Material Valuations (continued)

b) Disclosure with respect to a valuation that served as the basis to determine the value of data in the Financial Statements

- 2) Very high materiality valuations regarding assets impairment implementation of the provisions of IAS 36

Identification of Valuation subject	Asset impairment - examination of the Company's asset impairment as part of implementation of the provisions of IAS 36 - the assets of the three segments of operation of the Company.
The timing of the evaluation:	December 31, 2014
Value of the evaluation subject immediately before the date of the evaluation, had the accepted accounting principles, including depreciation and amortization, not required its change of value according to the valuation:	NIS 69,193 million (book value).
Net asset value of the object of the evaluation determined in accordance with the evaluation	NIS 69,749 million.
Identifying the appraiser and his characteristics:	Giza Singer Even is engaged in providing support and consultation services to many leading companies in the Israeli economy. The department is headed by Mr. Udi Rozenberg, senior partner of the firm and company CEO. Mr. Rozenberg has a B.A. in Economics from the Ben-Gurion University and MBA from the Ben-Gurion University. His experience includes valuations, financial advice, transaction support, management in a mezzanine fund and credit department
Dependency on evaluation order	No
Evaluation model which the appraiser used	Discounted Cash Flow method - DCF
Assumptions according to which the appraiser performed the valuation, depending on the model of estimates:	Forecast of future cash flows, expected to be caused by one cash yielding unit, was conducted on the basis of the present rate structure and on the basis of assumptions that represent, inter alia, the economic conditions that will exist during the useful lifespan of the units' assets, the major ones of which are: - When examining the cash yielding units, the Company identified the three segments of operation of the Company as one cash yielding unit. - The present rate structure in the generation segment, as determined in February 2010, will end at the end of 2014, and a new rate will enter into force in July 2016. The new rate base will provide full cover for the investment and operating costs of the Company, according to the Electricity Sector Law. - The new rate base for the transmission and distribution segments, when published, will apply from April 1, 2012. The new rate base for the transmission and distribution segments will provide full cover for the investment and operating costs of the Company as of January 1, 2015, according to the Electricity Sector Law. - The effect of the draft of the Navigant report on the new rate base for the transmission and distribution segments was not expressed in the cash flow forecast, but its impact was examined in the sensitivity tests.

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d. Instructions for Disclosure Related to the Financial Reporting of the Company (continued)

4. Material and Highly Material Valuations (continued)

b) Disclosure with respect to a valuation that served as the basis to determine the value of data in the Financial Statements (continued)

- 2) Very high materiality valuations regarding assets impairment implementation of the provisions of IAS 36 (continued)

	- The fuels expenses to be borne by the Company will be covered in the electricity rate throughout all the forecast periods. - The weighted capital cost 3.7% net of tax with respect to the periods regarding which it was assumed that full cover will apply - capitalization rate equal to the yield rate that will be granted by the Electricity Authority was assumed. - The debts of the Palestinian Authority and East Jerusalem with respect to past and future services will be collected in full but at a postponed date.
The body in the Company that decided to enter an agreement with the appraiser	Head of Accounting and Economics Section.

5. Disclosure of the Forecasted Cash Flow of the Company for Financing Repayment of Corporate Liabilities

- a) During 2014, the improvement in the cash flow position of the Company continued due to, inter alia, the supply of natural gas from the Tamar reserve and continued collection of the surplus fuels costs that derived in the past, inter alia as a result of the Egyptian gas supply crisis.
- b) According to the decision of the Board of Directors, the Company will hold a safety cushion with a financial value of not less than NIS 3 billion, while the cash balance will not be less than NIS 2.2 billion, and the diesel and crude surplus inventory will constitute a part of the safety cushion up to a value of NIS 0.8 billion. As of December 31, 2014, the Company is fulfilling that decision.
- c) In November 2014, the Company raised an amount of approximately NIS 4.8 billion, and raised a loan of NIS 1 billion after the balance sheet date. The Company is not required to raise additional significant amounts in 2015.
- d) As of the report date, the warning signs detailed in section 10(b)(14)(a)(3) of the Securities Regulations (Periodic and Immediate Reports), 1970 exist in the Company, in view of the fact that the Company has a deficit in the working capital. The Board of Directors of the Company, in its meeting of March 24, 2015, after hearing the estimates of the Management about the possibility of receiving financing and raising capital in the capital markets and/or the banking system in Israel and/or abroad, and considering the cash flow from current operations for the period adding up to approximately NIS 8,252 million, and the cash and short term investments balance as of December 31, 2014 of NIS 7,063, and noting the steps taken by the Company to raise the sums it requires, determined that the stated working capital deficit does not point to a liquidity problem in the Company and therefore in light of all the aforesaid the Company is not required to publish a future cash flow statement.

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d. Instructions for Disclosure Related to the Financial Reporting of the Company (continued)

6. Evaluations of the Effectiveness of Internal Controls and Disclosure Controls over the Financial Statement

- a) According to Government Companies Authority Regulations (Additional Report on Actions Taken and Presentations Made to Assure Correctness of the Financial Statements and the Board of Directors' Report - 2005) Government companies, including the Company, are required to attach to their yearly and quarterly Financial Statements an additional report concerning the activities taken and the presentations given so as to ensure full disclosure in the Financial Statements and the Directors' Report. So as to implement this directive, the Company set up a system the purpose of which is to confirm and assess disclosure controls, information gathering processes and information processing for the Financial Statements. This so as to permit functionaries signing the Financial Statements and the Directors' Report to declare in the additional report, that the Financial Statements and the Directors' Report do not contain incorrect presentations of material facts and that they properly reflect in all material aspects the Company's financial condition, operating results, changes in shareholders' equity and cash flows as of the dates and for the periods presented in the reports. The Company has set a procedure to confirm the lack of existence of weaknesses that may impact the report's integrity, to implement all existing disclosure controls, among them implementing a systematic mechanism to manage and monitor information, to gather information from executives and statements of middle managers concerning the implementation of disclosure controls in their fields of responsibility, as well as applying appropriate controls to any changed work procedures. In addition, a disclosure committee was established, headed by the Company CEO, and including senior management entities including Deputy CEOs, the legal advisor, Head of Accounting and Economics Division, Head of Accounting and Financial Statements Department, Head of Sox Department and advisors experienced in the field.

According to Government Companies Authority Regulations (Additional Report on Actions Taken and Presentations Made to Assure Correctness of Additional Reports on the Subject of the Effectiveness of Internal Controls on Financial Reporting) – 2007, Government companies, among them the Company, are required to attach to their annual Financial Statements, starting with the report published as of December 31, 2009, an additional report concerning actions taken to ensure the correctness of the financial reporting, among them, establishing a system of internal controls, with the main purposes of: to examine the processes affecting the Company's records which detail its transactions, to confirm the existence of controls and test their effectiveness and to ascertain with a reasonable level of certainty that Company receipts and expenditures are only made in accordance with the approval of properly authorized Company bodies. Therefore, the Company engaged the firm of Ziv Haft to act as an expert guide and ensure correct presentation of the financial reporting. The Company established administration, control and work units to implement the regulations. A steering committee, comprised of senior management functionaries and experienced consultants in the field was established and also a Control Committee and a work team. Roles of these committees and convening schedules were defined.

The Company completed preparations required to implement regulations, all according to the accepted standards, methodologies, updated models and COBIT, with the assistance of the expert and in full cooperation of the auditor of the Company. A dedicated computerized system was integrated in the project to implement the regulations in the Company, to manage the project and perform current on-going maintenance of the control upon completion of the project. The system allows documentation of risks and controls in any process, documentation of the performed tests and results thereof. The system also provided the ability to monitor faults corrections and to generate various control and administration reports.

In its additional report on the internal controls over the financial reporting in accordance with the Government Companies Regulations, attached to these financial statements, attached to the prospectus, the Board of Directors and the Management of the Company announced that the internal controls in the Company over the financial reporting of the Company for the period ending on December 31, 2014 are ineffective, due to a material weakness of the internal controls over financial reporting, detailed below:

The Company did not maintain effective controls to ensure that the rights and benefits, according to which payroll and pension payments are paid and actuarial obligations included, are authorized in conformity with the regulations of the law.

**THE ISRAEL ELECTRIC CORPORATION LIMITED
BOARD OF DIRECTORS' REPORT
ON THE STATUS OF THE COMPANY'S AFFAIRS
FOR THE YEAR ENDED DECEMBER 31, 2014**

d. Instructions for Disclosure Related to the Financial Reporting of the Company (continued)

6. Evaluations of the Effectiveness of Internal Controls and Disclosure Controls over the Financial Statement (continued)

a) (continued)

As for the material weakness, the Company strengthened the controls. In 2011, the Company established a procedure, which was approved by its Board of Directors, on the subject of rights and benefits according to which payroll and pension payments are paid and actuarial obligations and current obligations with respect to wages. The procedure is implemented in practice. Regarding salary rights deriving from the past, the Company received an opinion from its legal advisors, and in 2011 it applied to the Commissioner of Wages for his approval of the validity of salary rights that have not yet been approved. A comprehensive response or approval has not yet been received from the Commissioner.

The Company estimates that these corrective actions strengthened the material weakness in the internal controls over the financial reporting in subjects related to employees' salary rights item, from this date onwards. Regarding salary rights deriving from the past, the Company worked to obtain an opinion from its legal advisors on the validity of the Company's obligation to its employees.

Brightman, Almagor, Zohar & Co., the external auditors of the Company, which audited the Financial Statements of the Company for the period ending on December 31, 2014, issued an opinion on the effectiveness of the internal controls over the financial reporting of the Company.

In its opinion, the external auditor refers to the aforementioned material weakness.

- b) On November 24, 2009, the Finance Committee of the Knesset approved an amendment to the Securities Regulations (Periodic and Immediate Reports) - 1970 ("The Amendment"). This amendment requires all reporting corporations that have securities registered for trade in the Tel Aviv Stock Exchange to declare the effectiveness of their internal controls over financial reporting and disclosure.

On October 7, 2010, the Companies Authority published regulations (Additional Reporting on the Effectiveness of the Internal Controls over Financial Reporting) (Amendment) – 2010 and Regulations (Additional Report Regarding Actions Taken and Representations Made to Ensure the Accuracy of the Financial Statements and the Directors' Report) (Amendment) – 2010. Implementation of the aforementioned amendments in the regulations is intended to enable the Chairman of the Securities Authority to exercise his authority, according to section 9b(f) and 38c(f) to the Securities Regulations and determine that a Government Company that is also a reporting company according to the Securities Law – 1968, that implements the said regulations of the Companies Authority will report the effectiveness of the internal controls in the format stipulated in the Companies Authority Regulations.

The Company appealed to the Chairman of the Securities Authority, requesting him to exercise his authority to determine that the Company, under its definition as a Government Company that complies with all Government Authority Regulations, including the aforementioned, will report the effectiveness of the internal controls in the format specified by the Companies Authority Regulations.

In response to the request of the Company, the Chairman of the Securities Authority decided on January 4, 2011, to accept the Company's request to report the effectiveness of the internal controls in the format specified by the Companies Authority Regulations, as long as the Company fulfills these regulations. This arrangement is subject to the commitment of the Company to review the facts presented to the staff of the Securities Authority in the request on every report date and report any change to them. This includes a review of changes in the regulations or in Government Companies Regulations, changes in the status of the Company which affect the laws applied to it, changes in the implementation mode of Government Companies Regulations in the Company and any other change relevant to this subject. As at the date of the report, the Company fulfilled the requirements of the stipulations and found that there was no change in the regulations or any other relevant change.

**THE ISRAEL ELECTRIC CORPORATION LIMITED
BOARD OF DIRECTORS' REPORT
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FOR THE YEAR ENDED DECEMBER 31, 2014**

d. Instructions for Disclosure Related to the Financial Reporting of the Company (continued)

7. Disclosure with Respect to the Financial Reporting Required according to the Government Companies Circular on Financial statements

a) Registration of Rights and Assets

During the last few years, a focused and continuous procedure is taking place to gather and coordinate all of the information on all of the Company's assets, which were scattered among departments and districts, including the transformation stations, mobile/temporary/leased facilities, etc., and to organize them as to everything related to establishing an assets ledger, registration of rights (including caveats, insofar as is relevant), administration and oversight, including the evacuation of squatters from the Company's properties, or to arrange the status of those squatters on the Company's properties.

The Company has some 320 main sites, as well as a ledger of less important assets (about 13,076 sites, primarily transformation stations) which is currently being completed. In addition, the Company is acting to register its rights in its assets, both with regard to the principal assets and with regard to the less important assets.

During the reported period, the Company registered its rights with the Land Registry Office with respect to 18 sites, and with respect to 78 additional sites, caveats were recorded, 75 lease contracts were signed with the Israel Lands Administration, 320 contracts for purchasing transformation rooms were executed, 26 easements for access to a transformers room were registered and 342 others were identified.

b) Post-employment Employee Benefits

See Note 12 to the Financial Statements and also Annex A to the Interim Financial Statements – the opinion of the Company's Actuary as of December 31, 2014.

THE ISRAEL ELECTRIC CORPORATION LIMITED
BOARD OF DIRECTORS' REPORT
ON THE STATUS OF THE COMPANY'S AFFAIRS
FOR THE YEAR ENDED DECEMBER 31, 2014

e. Dedicated Disclosure to Debentures Holders

1. Details of the Bonds of the Corporation

a) Details of debentures (series 22) as at December 31, 2014, as required in the eighth addition to the Securities:

1) <u>Series</u>	<u>Debentures (Series 22)</u>
Issue date (initial)	May 29, 2002, according to the prospectus of the Company on May 21, 2002
Total nominal value on the issue date (initial)	NIS 500,000,000 nominal value.
Nominal value on December 31, 2014	NIS 500,000,000 nominal value
Revaluated nominal value in accordance with linkage conditions for the report date (December 31, 2014)	NIS 628,686,697
Accumulated interest (as of December 31, 2014)	NIS 4,540,515
Its fair value included in the last Financial Statements ¹	The fair value of the marketable series in the stock exchange value, see below
Stock exchange value of debenture series on December 31, 2014	NIS 632,700,000
Interest type (fixed or variable) and rate	Fixed annual interest at 6.5% rate
Principal payment dates	1/12 of the original principal, that was NIS 6 billion nominal value, every May 20, August 20, and November 20, of each of the years 2012 – 2014 and on February 20 of each of the years 2013-2015 from May 20, 2012 until the redemption date – February 20, 2015
Interest payment dates	Interest is paid in quarterly rates on August 20, November 20, February 20 and May 20 of every year, starting from the initial issue date and up to the redemption date
Linkage basis	Linked (principal and Interest) to the CPI published on May 15, 2002 of April 2002
It was determined that the debentures can be converted to another security	No
The entity is entitled to early redemption or enforced conversion of the debentures to other securities insofar that it exists and the conditions for exercising exist	No, but nevertheless, is should be indicated that the debentures will be available for early redemption if the stock exchange will decide on delisting debentures when the value of the public's holding in the debentures is lower than the amount determined by the delisting guidelines of the stock exchange.
A guarantee was issued for payment of the entity's liability, in accordance with a trust deed	No
Pledged Assets	No
Series rating	ilAA (Ma'alot, S&P) Aa3 (Midroog)
Is this debenture series considered material under regulation 10 (b)(13) of the Securities Regulations	No

2) Details of trustee for the liabilities - debentures (series 22):

Name of trustee company:	Hermetic Trust Services (1975) Ltd.
Name of responsible person:	Mr. Dan Avnon, Attorney
Address:	113, Hayarkon Street, Tel Aviv, 30835
Telephone:	03-5274867
Fax:	03-5271451
Website:	www.hermetic.co.il

3) The debentures cannot be converted.

¹Market value on the last trading day in December 2014, namely December 31, 2014.

**THE ISRAEL ELECTRIC CORPORATION LIMITED
BOARD OF DIRECTORS' REPORT
ON THE STATUS OF THE COMPANY'S AFFAIRS
FOR THE YEAR ENDED DECEMBER 31, 2014**

e. Dedicated Disclosure to Debentures Holders (continued)

1. Details of the Bonds of the Corporation (continued)

a) Details of debentures (series 22) as at December 31, 2014, as required in the eighth addition to the Securities: (continued)

4) Rating of Debentures (Series 22) by a Rating Company

The series is rated ilAA according to Ma'alot, S&P and Aa3 according to Midroog.
For details of the rating of the Company see Note 20 f to the Financial Statements.

5) Commitment to Fulfill the Conditions of the Debentures (Series 22)

As on the date of the report, the Company fulfilled all the conditions and commitments according to the deed of trust for the debentures (series 22) and there was no cause to place the debentures (series 22) for immediate repayment and the Company did not receive any notice from the trustee to the debentures (series 22) on its failure to fulfill the conditions and commitments according to the said deed of trust.

6) For details of repayments of the debentures (Series 22) in the reporting period and after the balance sheet date see Note 20 to the Financial Statements.

THE ISRAEL ELECTRIC CORPORATION LIMITED
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e. Dedicated Disclosure to Debentures Holders (continued)

1. Details of the Bonds of the Corporation (continued)

b) Following are details of debentures (series 24) issued by the Company, as of December 31, 2014, as required in the eighth addition to the Securities Regulations:

1) <u>Series</u>	<u>Debentures (Series 24)</u>
Issue date (initial)	July 8, 2012, according to the prospectus of the Company of June 26, 2012
Total nominal value on the issue date (initial)	NIS 996,525,000 nominal value.
Nominal value as of December 31, 2014	NIS 1,996,525,000 nominal value
Revaluated nominal value in accordance with linkage conditions for the report date December 31, 2014)	NIS 2,036,516,044
Accumulated interest (as of December 31, 2014)	NIS 6,287,743
Its fair value included in the last Financial Statements ²	The fair value of the marketable series is the stock exchange value, see below
Stock exchange value of debenture series on December 31, 2014	NIS 2,040,847,855
Interest type (fixed or variable) and rate	Fixed annual interest at 0.65% rate
Principal payment dates	One payment on July 9, 2015
Interest payment dates	On July 9 of each of the years 2013 to 2015
Linkage basis	Linked (principal and Interest) to the CPI published on June 15, 2012, of May 2012
It was determined that the debentures can be converted to another security	No
The entity is entitled to early redemption or enforced conversion of the debentures to other securities insofar that it exists and the conditions for exercising exist	The Company will be permitted, with the advance written agreement of the Comptroller General, to have the debentures available for early redemption (in full or in part), and in case the provisions detailed in the trust deed will apply, all subject to the guidelines of the Securities Authority and the provisions of the articles of the stock exchange and the guidelines thereof, as will be on the relevant date
A guarantee was issued for payment of the entity's liability, in accordance with a trust deed	A warranty by the State of Israel was issued
Pledged Assets	A floating charge was provided over all the Company's assets in favor of the guarantor – the State of Israel
Series rating	Aaa (Midroog)
Is this debenture series considered material under regulation 10 (b)(13) of the Securities Regulations	No

2) Details of trustee for the liabilities - debentures (series 24):

Name of trustee company:	Reznik Paz Nevo Trust Ltd.
Name of responsible person:	Yossi Reznik, CPA
Address:	14, Yad Harutzim Street, Tel Aviv
Telephone:	03-6389200
Fax:	03-6393316
Website:	www.rpn.co.il

3) The debentures cannot be converted.

² Market value on the last trading day in December 2014, namely December 31, 2014.

THE ISRAEL ELECTRIC CORPORATION LIMITED
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e. Dedicated Disclosure to Debentures Holders (continued)

1. Details of the Bonds of the Corporation (continued)

b) Following are details of debentures (series 24) issued by the Company, as of December 31, 2014, as required in the eighth addition to the Securities Regulations (continued):

4) Rating of Debentures (Series 24) by a Rating Company:

The series is rated Aaa according to Midroog.

For details of the rating of the Company see Note 20 f to the Financial Statements.

5) Commitment to Fulfill the Conditions of the Debentures (Series 24)

As on the date of the report, the Company fulfilled all the conditions and commitments according to the deed of trust for the debentures (series 24) and there was no cause to place the debentures (series 24) for immediate repayment, and the Company did not receive any notice from the trustee to the debentures (series 24) on its failure to fulfill the conditions and commitments according to the said deed of trust.

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e. Dedicated Disclosure to Debentures Holders (continued)

1. Details of the Bonds of the Corporation (continued)

c) Following are details of debentures (series 25) issued by the Company, as of December 31, 2014, as required in the eighth addition to the Securities Regulations:

1) <u>Series</u>	<u>Debentures (Series 25)</u>
Issue date (initial)	July 8, 2012, according to the prospectus of the Company of June 26, 2012
Total nominal value on the issue date (initial)	NIS 500,000,000 nominal value.
Nominal value as of December 31, 2014	NIS 1,000,000,000 nominal value
Revaluated nominal value in accordance with linkage conditions for the report date (December 31, 2014)	NIS 1,020,030,325
Accumulated interest (as of December 31, 2014)	NIS 5,814,173
Its fair value included in the last Financial Statements ³	The fair value of the marketable series is the stock exchange value, see below
Stock exchange value of debenture series on December 31, 2014	NIS 1,056,900,000
Interest type (fixed or variable) and rate	Fixed annual interest at 1.20% rate
Principal payment dates	One payment on July 9, 2017
Interest payment dates	On July 9 of each of the years 2013 to 2017
Linkage basis	Linked (principal and Interest) to the CPI published on June 15, 2012, of May 2012
It was determined that the debentures can be converted to another security	No
The entity is entitled to early redemption or enforced conversion of the debentures to other securities insofar that it exists and the conditions for exercising exist	The Company will be permitted, with the advance written agreement of the Comptroller General, to have the debentures available for early redemption (in full or in part), and in case the provisions detailed in the trust deed will apply, all subject to the guidelines of the Securities Authority and the provisions of the articles of the stock exchange and the guidelines thereof, as will be on the relevant date.
A guarantee was issued for payment of the entity's liability, in accordance with a trust deed	A warranty by the State of Israel was issued
Pledged Assets	A floating charge was provided over all the Company's assets in favor of the guarantor – the State of Israel
Series rating	Aaa (Midroog)
Is this debenture series considered material under regulation 10 (b)(13) of the Securities Regulations	No

2) Details of trustee for the liabilities - debentures (series 25):

Name of trustee company:	Reznik Paz Nevo Trust Ltd.
Name of responsible person:	Yossi Reznik, CPA
Address:	14, Yad Harutzim Street, Tel Aviv
Telephone:	03-6389200
Fax:	03-6393316
Website:	www.rpn.co.il

3) The debentures cannot be converted.

³ Market value on the last trading day in December 2014, namely December 31, 2014.

**THE ISRAEL ELECTRIC CORPORATION LIMITED
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e. Dedicated Disclosure to Debentures Holders (continued)

1. Details of the Bonds of the Corporation (continued)

c) Details of debentures (series 25) issued by the Company, as of December 31, 2014, as required in the eighth addition to the Securities Regulations (continued):

4) Rating of Debentures (Series 25) by a Rating Company:

The series is rated Aaa according to Midroog.

For details of the rating of the Company see Note 20 f to the Financial Statements.

5) Commitment to Fulfill the Conditions of the Debentures (Series 25)

As on the date of the report, the Company fulfilled all the conditions and commitments according to the deed of trust for the debentures (series 25) and there was no cause to place the debentures (series 25) for immediate repayment, and the Company did not receive any notice from the trustee to the debentures (series 25) on its failure to fulfill the conditions and commitments according to the said deed of trust.

THE ISRAEL ELECTRIC CORPORATION LIMITED
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f. Miscellaneous

1. Environmental Plan, Environmental Hazards and Management thereof

The Company generates and supplies electricity in Israel, while taking steps to protect the environment and reduce environmental hazards along the electricity chain (generation, transmission, transformation and distribution). The Electricity Sector is developed while perpetually balancing different considerations, including: electricity quality, reliability of the supply, cost to the economy and environmental considerations.

The activity of the Company is involved with different environmental aspects due to the emission of pollutants into the air, storage and use of hazardous and flammable materials, ground and water sources pollution, industrial sewage, asbestos, magnetic fields and more.

The environmental requirements applied to the activity of the Company became stricter in recent years, as well as the supervision and enforcement of these requirements.

The Company estimates that this trend is expected to continue and even become stricter in the coming years, according to international awareness and requirements and, inter alia, in accordance with that which is customary in Western countries.

The issue of air quality is a most relevant environmental issue for the activities of the Company. The general order signed in December 2010 and which applies to the Company's power plants determines, inter alia, the obligation to install emission reduction devices in the Company's coal fired power stations. The reduction devices include primary measures ("PM") and Selective Catalytic Reduction ("SCR"), to reduce emission of nitrogen and Flue Gas Desulphurization ("FGD") to reduce emission of sulfur dioxide. For additional details regarding the emission reduction project see section 7.12.16 in Chapter A.

2. Dividend Distribution and Appropriation of Income

According to the directives of the Accounting and Finance Circular of the Government Companies Authority "Financial Statements 2011-5-1" ("The Government Companies Authority Circular"), the Company is required to relate to the appropriation of its income in this report. See details on this subject in Section 4 in Chapter A and Note 26 to the Financial Statements.

3. Taxation

See Note 22 to the Financial Statements.

4. Legal Proceedings and Labor Disputes

See Note 34 b and 34 c to the Financial Statements.

5. Agreements including Agreements Requiring Government Approval

For details of the contractual engagements of the Company including those requiring Government approval see Note 34 a to the Financial Statements.

6. Limitations and Supervision on Activities of the Company

See Section 21 in the report Chapter A.

7. Transactions of the Company with Related Parties and Interest Holders, Including Indemnification Letters

See Note 33 to the Financial Statements.

8. Discussion of Risk Factors

See Section 28 in Chapter A.

THE ISRAEL ELECTRIC CORPORATION LIMITED
BOARD OF DIRECTORS' REPORT
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f. Miscellaneous (continued)

9. The State Comptroller's Report

For details of the State Comptroller's report see section 21.6.1 in Chapter A.

10. Corporate Sustainability Report

At the end of 2012, the Company decided to join the leading companies of the country and the world and establish a policy administration infrastructure on the subject of corporate responsibility and to present a corporate sustainability and responsibility report that transparently presents its operation in the field.

As part of the decision, a steering committee was appointed in the Company to teach the sustainability, a work plan was planned, to assimilate the social reporting process, corporate responsibility trustees were appointed, and special courses were held for the teams that carry out the report for writing reports according to the GRI universal reporting model.

In February, 2013, the Company published a corporate sustainability report, which extensively reviews its social and environmental performance. The report reflects the current activity of the Company in the fields of the environment. The report reviews the operation of the Company in 2012, and also presents its performance in preceding years for comparison.

The Company undertook the liability to increase the transparency of its activity and implement corporate sustainability and responsibility with regard to its interested parties, and this report is a continuation of this liability.

The Company is committed to an annual report from now on, and has appointed a senior entity at a rank of Company Deputy CEO who is in charge of managing the process.

Therefore, in accordance with a CEO decision in 2014, the Company published a second corporate sustainability report which describes the activity in 2013. This report complies with the fourth reporting standard (G4) that was set by the international organization GRI, which has not yet become compulsory in Israel, and after a profound process of due diligence was rated "as suitable for the maximum level of detailing".

The Electric Company is one of the pioneering companies in Israel that has chosen on its own initiative to meet the challenge in advance and report in accordance with the new directives. As opposed to the previous report, information regarding material environmental, social and financial issues, as arose from a survey carried out among interested parties of the Company, was published for the first time. The material issues selected received extensive exposure in this report, including details of the policy we base our activity on in these fields and providing extensive data concerning them. The concept of the Company's corporate sustainability is not only expressed in activities to protect the environment, assimilate an ethical code, formulate a corporate governance code, implementing the Freedom of Information Law, nurturing community ties, but also nurturing transparency and accountability norms because of understanding the needs of all the interested parties.

11. Appointments and Retirement of Directors and Position Holders during the Reporting Period:

- On January 19, 2014, Mr. Yigal Har'el ended his term as Internal Auditor of the Company.
- On January 23, 2014, Mr. Shmuel Shatz was appointed Acting Internal Auditor of the Company until the appointment of a permanent internal auditor.
- On March 13, 2014, Mr. Raik Abu Reish was appointed as Director of the Company.
- On March 14, 2014, Advocate Shlomit Barnea-Fargo ended her term as Director of the Company.
- On April 27, 2014, Ms. Nitza Rogozinski was appointed Internal Auditor of the Company.
- On April 27, 2014, Mr. Shmuel Shatz ended his term as Acting Internal Auditor.
- On May 2, 2014, Ms. Vered Itzhaki ended her term as Director of the Company.
- On May 11, 2014, Mr. Itzhak Lax ended his term as External Director of the Company.
- On June 1, 2014, Dr. Adrian Bianu was appointed Senior Vice President - Risk Management of the Company within his position as Senior Vice President - Corporate Sustainability.
- On June 30, 2014, Mr. Itzhak "Ika" Yakhin ended his term as Senior Vice President - Human Resources.
- On July 10, 2014, Mr. Amit Oberkowitz was appointed Head of Human Resources Division.

**THE ISRAEL ELECTRIC CORPORATION LIMITED
BOARD OF DIRECTORS' REPORT
ON THE STATUS OF THE COMPANY'S AFFAIRS
FOR THE YEAR ENDED DECEMBER 31, 2014**

f. Miscellaneous (continued)

11. Appointments and Retirement of Directors and Position Holders during the Reporting Period: (continued)

- On August 1, 2014, Mr. Arie Rapoport ended his term as Director of the Company and he was reappointed as a Director of the Company on August 14, 2014.
- On August 14, 2014, Ms. Vivi Ziv ended her term as Director of the Company.
- On September 14, 2014, Ms. Yafa Vigodski ended her term as Director of the Company and was reappointed as Director of the Company on October 29, 2014.
- On September 22, 2014, Mr. Eli Glickman, Company CEO, announced his intention to terminate his position.
- On December 31, 2014, Mr. Yakov (Yasha) Hain retired from his office as Deputy CEO and Senior Vice President - Customers.
- On December 31, 2014, Adv. David Yahav retired from his office as General Counsel and Company Secretary.

For details regarding the appointment and termination of services that occurred after the date of the Financial Statements, see Note 37 to the Financial Statements.

The Board of Directors and Management wish to express their appreciation to the Company's employees and its Managers.

Yiftah Ron-Tal
Chairman of the
Board of Directors

Dr. Ziv Reich
Chairman, Committee for
Reviewing the Financial
Statements

Eliyahu Glickman
Chief Executive Officer

Date of Approval: March 24, 2015.



The Israel Electric Corporation Ltd.

Supplement

Additional Report Regarding the Effectiveness of the
Internal Control Over Financial Reporting

For the Year Ended
December 31, 2014

Prominent Disclaimer

This English translation of the **“Additional Report Regarding the Effectiveness of the Internal Control Over Financial Reporting”** for the year ended December 31, 2014 ("English Translation") is provided for information purposes only.

In the event of any conflict or inconsistency between the terms of this English Translation and the original version prepared in Hebrew, the Hebrew version shall prevail and holders of the Notes should refer to the Hebrew version for any and all financial information relating to the Company.

The Company, its Directors and its Auditors make no representations as to the accuracy and reliability of the financial information in this English Translation, save that the Company and its Directors represent that reasonable care has been taken to correctly translate and reproduce such information, yet notwithstanding the above, the translation of any technical terms are, in the absence of generally agreed equivalent terms in English, approximations to convey the general sense intended in the Hebrew version.

The Company reserves the right to effect such amendments to this English Translation as may be necessary to remove such conflict or inconsistency.

**SECOND ADDENDUM
(REGULATION 2)**

A REPORT OF THE BOARD OF DIRECTORS AND THE MANAGEMENT ON THE INTERNAL CONTROLS OVER FINANCIAL REPORTING IN ACCORDANCE WITH GOVERNMENT COMPANIES REGULATIONS (ADDITIONAL REPORT REGARDING THE EFFECTIVENESS OF THE INTERNAL CONTROLS OVER FINANCIAL REPORTING), 2007

The Management, under supervision and upon approval of the Board of Directors of the Israel Electric Corporation Ltd., is responsible for establishing and maintaining adequate internal controls over financial reporting of the Company. The internal controls over financial reporting is a process designed to provide a reasonable measure of assurance regarding the reliability of the financial report and the preparation of the financial statements for external purposes, in accordance with generally acceptable accounting principles and the directives of the Government Companies Law. Due to its inherent limitations, the internal controls over financial reporting are not intended to provide an absolute assurance that a material misstatement will be prevented or discovered.

The Management and the Board of Directors conducted an assessment of effectiveness of the internal controls over financial reporting of the Company and its efficiency, based on criteria defined in a control model named "COSO Model".

Based on this evaluation, the Company's Management and Board of Directors concluded that the internal controls over financial reporting of the Company for the period ended on December 31, 2014, are not effective, due to a material weakness of the internal controls over financial reporting, as detailed below:

The Company did not maintain effective controls to ensure that the rights and benefits according to which payroll and pension payments are made and actuarial obligations are included, are authorized in conformity with requirements of the law.

Correction of the material weakness

The Company took actions to reinforce the controls pertaining to this matter and established a procedure, which was approved by the Company's Board of Directors, in 2011, concerning the rights and the benefits according to which payroll and pension payments are made and actuarial obligations are included. The procedure is implemented in practice. In relation to salary rights originating in the past, the Company has received an opinion from its legal counsel and in 2010 has applied to the Wages Commissioner for his approval of the effectiveness of salary rights for which an approval has not yet been issued. The Commissioner's comprehensive approval or reference has not yet been received.

The Company believes that these actions have strengthened the internal control over financial reporting in the matters pertaining to the prospective treatment of the employee salary rights balance. As to salary rights originating in the past, the deficiency will not be removed until the Commissioner's approval of the effectiveness of past salary rights is received.

The Opinion of the External Auditor

The external auditor of the Company, Brightman Almagor Zohar & Co., who audited the financial statements of the Company for the period ended on December 31, 2014, issued an opinion on the effectiveness of the Company's internal control over financial reporting.

In its opinion, the external auditor referred to the material weakness specified above.

Mr. Tamir Polikar
Acting Senior Vice-President
of Finances and Economics

Mr. Eliyahu Glickman
Chief Executive Officer

Dr. Ziv Reich
Chairman, Committee for
Reviewing the Financial
Statements

Mr. Yiftah Ron-Tal
Chairman, Board of Directors

March 24, 2015



Translated from the Hebrew language

Auditors' Report to the Shareholders of the Israel Electric Corporation Limited.

According to the Government Companies Regulations (Additional Reports on the Effectiveness of Internal Controls Over Financial Reporting), 2007

We have audited the internal controls over financial reporting of the Israel Electric Corporation Limited (hereafter- the "Company") as of December 31, 2014, based on criteria established in Internal Controls - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (hereafter- "COSO").

The Company's Board of Directors and Management are responsible for maintaining effective internal controls over financial reporting and for their assessment of the effectiveness of internal controls over financial reporting, included in the accompanying Board of Directors and Management's report on Internal Controls over Financial Reporting (hereafter- "the assessment of the Board of Directors and Management"). Our responsibility is to express an opinion on the Company's internal controls over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (PCAOB) in the United States of America with regard to an audit of internal controls over financial reporting as was adopted by the Institute of Certified Public Accountants in Israel. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal controls over financial reporting were maintained in all material respects. Our audit included obtaining an understanding of internal controls over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal controls based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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A Government corporation's internal controls over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the financial reporting principles applying to the Company (such principles applying to the Company are explained in note 2a to the financial statements as of December 31, 2014). A Government corporation's internal controls over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and transfers of the assets of the company (including removal from possession); (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with the financial reporting principles applying to the Company (as explained in note 2a to the financial statements as of December 31, 2014), and that receipts and expenditures of the company are being made only in accordance with proper authorizations of the Board of Directors and Management of the Company and subject to the approvals of the State authorities as required by law; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or transfer (including removal from possession) of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal controls over financial reporting may not prevent or detect misstatements. Also, concluding on the basis of a current evaluation of effectiveness as to future periods is exposed to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or a combination of deficiencies, in internal controls over financial reporting, so that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis.

The following material weakness has been identified and included in the assessment of the Board of Directors and Management:

1. The Company did not maintain effective controls to ensure that the rights and benefits according to which payroll and pension payments are paid and actuarial obligations included, are authorized in conformity with requirements of the law.

The aforementioned material weakness was considered in determining the substance, the timing and the scope of audit procedures applied in our audit of the Company's consolidated financial statements as of and for the year ended December 31, 2014, and this report does not affect our report on such financial statements.

In our opinion, because of the effect of the material weakness identified above on the achievement of the objectives of the controls criteria, the Company has not maintained effective internal controls over financial reporting as of December 31, 2014, based on the criteria established in Internal Controls — Integrated Framework issued by COSO.

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We have also audited, in accordance with Israeli generally accepted auditing standards, the consolidated financial statements of the Company as of December 31, 2014 and 2013 and for each of the three years in the period ended on December 31, 2014 and our report dated March 24, 2015 expressed an unqualified opinion on those financial statements and included explanatory paragraphs pertaining to a number of issues.

Brightman Almagor Zohar & Co.

Certified Public Accountants

A member firm of Deloitte Touche Tohmatsu Limited

Tel Aviv, March 24, 2015

TEL AVIV - MAIN OFFICE	RAMAT GAN	JERUSALEM	HAIFA	BEER SHEVA	EILAT
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The Israel Electric Corporation Ltd.

Chapter C

Consolidated Annual Financial Statements

For the Year Ended
December 31, 2014

Prominent Disclaimer

This English translation of the **“Consolidated Annual Financial Statements”** for the year ended December 31, 2014 ("English Translation") is provided for information purposes only.

In the event of any conflict or inconsistency between the terms of this English Translation and the original version prepared in Hebrew, the Hebrew version shall prevail and holders of the Notes should refer to the Hebrew version for any and all financial information relating to the Company.

The Company, its Directors and its Auditors make no representations as to the accuracy and reliability of the financial information in this English Translation, save that the Company and its Directors represent that reasonable care has been taken to correctly translate and reproduce such information, yet notwithstanding the above, the translation of any technical terms are, in the absence of generally agreed equivalent terms in English, approximations to convey the general sense intended in the Hebrew version.

The Company reserves the right to effect such amendments to this English Translation as may be necessary to remove such conflict or inconsistency.

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Translated from the Hebrew language

**Auditors' Report
To the Shareholders of the Israel Electric Corporation Limited**

We have audited the accompanying consolidated statements of financial position of the Israel Electric Corporation Limited (hereafter – the "Company") as of December 31, 2014 and 2013, and the related consolidated statements of operations and comprehensive income, changes in shareholders' equity and cash flows for each of the three years in the period ended on December 31, 2014. These financial statements are the responsibility of the Company's Board of Directors and its management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Israeli generally accepted auditing standards, including those prescribed by the Israeli Auditors' Regulations (Auditor's Mode of Performance), 1973. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Company's Board of Directors and its management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, based on our audit, the aforementioned financial statements present fairly, in all material respects, the financial position of the Company and its subsidiary as at December 31, 2014 and 2013 and their results of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended on December 31, 2014, in conformity with the Government Companies Regulations (as explained in Note 2a1) and the requirements of the Securities Regulations (Annual Financial Statements), 2010.

Without qualifying our above opinion, we draw attention to the following matters:

1. The contents of Note 1e regarding the structural change including the content of the draft of recommendations of the Steering Team and the letter of the Chairman of the Government Companies Authority on the subject of the reform in the Company and in the electricity sector. As stated in that Note, as of the date of the financial statements, the implementation of the structural change has not yet begun in any outline, and despite the publication of the draft recommendation of the Steering Team and the exchange of correspondence on this subject, there is still uncertainty regarding the final

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format of the structural change, the date of its implementation or its implications on the Company, its business and its results.

2. The contents of Note 1f regarding the "Assets Arrangement", particularly regarding significant uncertainty and highly material amounts that the Company may be obligated to pay under that arrangement.
3. The contents of Note 12g regarding the review performed by the Deputy Supervisor of Wages (the "Supervisor") on various salary components that are paid by the Company, regarding decisions made by the Supervisor in connection with alleged deviations, regarding the scope of the possible effect of the Supervisor decisions on the actuarial liability and salary expenses, regarding the Company's position which disputes the Supervisor opinion and regarding the court's decision in this case, which in light of the Company's position regarding its liability to continue paying the salary components in question, there weren't any changes made to the actuarial liability of the Company in these issues.
4. The contents of Note 34b (subsections 1, 6 and 9) regarding class action suits, a derivative suit and other material claims that were filed against the Company.
5. The contents of Note 36 regarding the aspects in which the financial reporting principles applied in the Company's financial statements, in conformity with the Governmental Companies Regulations, differ from International Financial Reporting Standards (IFRS).

Notes 38 and 39 and in other Notes in these financial statements include additional information pursuant to requirements of the Governmental Companies Authority (by virtue of section 33b to the Government Companies Law), excluding information regarding land rights as discussed in Note 14j.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (PCAOB) in the United States of America, as was adopted by the Institute of Certified Public Accountants in Israel, the Company's internal controls over financial reporting as of December 31, 2014, based on the criteria established in Internal Controls-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 24, 2015 expressed an adverse opinion on the Company's internal controls over financial reporting because of a material weakness .

Brightman Almagor Zohar & Co.

Certified Public Accountants

A member firm of Deloitte Touche Tohmatsu Limited

Tel Aviv, March 24, 2015

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**ADDENDUM
(REGULATION 2)
ADDITIONAL REPORT**

**IN ACCORDANCE WITH GOVERNMENT COMPANIES REGULATIONS
(ADDITIONAL REPORT REGARDING ACTIONS TAKEN AND REPRESENTATIONS MADE TO ENSURE THE ACCURACY OF THE
FINANCIAL STATEMENTS, AND THE REPORT OF THE BOARD OF DIRECTORS), – 2005**

I, Tamir Polikar, certify that:

1. I have reviewed the Periodic Report within the meaning of Chapter B of the Securities Regulations (Periodic and Immediate Reports) – 1970, of The Israel Electric Corporation Limited ("the Company" or the "Electric Corporation") for the year ended December 31, 2014 ("the reports").
2. To the best of my knowledge and after reviewing the reports, they do not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the reports.
3. To the best of my knowledge and after reviewing the reports, the Financial Statements and other financial information included in the Directors' Report fairly present, in all material respects, the financial condition, results of operations, changes in equity and cash flows of the Company as of, and for, the periods presented in the reports.
4. The Company's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures for the Company. Accordingly, we have designed such disclosure controls and procedures, or had established under our charge such disclosure controls and procedures, designed to ensure that material information relating to the Company is made known to us by others in the Company particularly during the period in which the reports were prepared.
5. The Company's other certifying officers and I have disclosed to the Company's auditors and to the Company's Board of Directors, based on our most recent evaluation:
 - a. All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information.
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal controls over financial reporting.

There is nothing in the aforesaid to derogate from my responsibility or the responsibility of anyone else, pursuant to any law.

March 24, 2015

Tamir Polikar
Senior Vice-President of Finance and Economics

**ADDENDUM
(REGULATION 2)
ADDITIONAL REPORT**

**IN ACCORDANCE WITH GOVERNMENT COMPANIES REGULATIONS
(ADDITIONAL REPORT REGARDING ACTIONS TAKEN AND REPRESENTATIONS MADE TO ENSURE THE ACCURACY OF THE
FINANCIAL STATEMENTS, AND THE REPORT OF THE BOARD OF DIRECTORS), – 2005**

I, Eliyahu Glickman, certify that:

1. I have reviewed the Periodic Report within the meaning of Chapter B of the Securities Regulations (Periodic and Immediate Reports) – 1970, of The Israel Electric Corporation Limited ("the Company" or the "Electric Corporation") for the year ended December 31, 2014 ("the reports").
2. To the best of my knowledge and after reviewing the reports, they do not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the reports.
3. To the best of my knowledge and after reviewing the reports, the Financial Statements and other financial information included in the Directors' Report fairly present, in all material respects, the financial condition, results of operations, changes in equity and cash flows of the Company as of, and for, the periods presented in the reports.
4. The Company's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures for the Company. Accordingly, we have designed such disclosure controls and procedures, or had established under our charge such disclosure controls and procedures, designed to ensure that material information relating to the Company is made known to us by others in the Company particularly during the period in which the reports were prepared.
5. The Company's other certifying officers and I have disclosed to the Company's auditors and to the Company's Board of Directors, based on our most recent evaluation:
 - a. All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information.
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal controls over financial reporting.

There is nothing in the aforesaid to derogate from my responsibility or the responsibility of anyone else, pursuant to any law.

March 24, 2015

Eliyahu Glickman
Chief Executive Officer

**ADDENDUM
(REGULATION 2)
ADDITIONAL REPORT**

**IN ACCORDANCE WITH GOVERNMENT COMPANIES REGULATIONS
(ADDITIONAL REPORT REGARDING ACTIONS TAKEN AND REPRESENTATIONS MADE TO ENSURE THE ACCURACY OF THE
FINANCIAL STATEMENTS, AND THE REPORT OF THE BOARD OF DIRECTORS), – 2005**

I, Dr. Ziv Reich, certify that:

1. I have reviewed the Periodic Report within the meaning of Chapter B of the Securities Regulations (Periodic and Immediate Reports) – 1970, of The Israel Electric Corporation Limited ("the Company" or the "Electric Corporation") for the year ended December 31, 2014 ("the reports").
2. To the best of my knowledge and after reviewing the reports, they do not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the reports.
3. To the best of my knowledge and after reviewing the reports, the Financial Statements and other financial information included in the Directors' Report fairly present, in all material respects, the financial condition, results of operations, changes in equity and cash flows of the Company as of, and for, the periods presented in the reports.
4. The Company's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures for the Company. Accordingly, we have designed such disclosure controls and procedures, or had established under our charge such disclosure controls and procedures, designed to ensure that material information relating to the Company is made known to us by others in the Company particularly during the period in which the reports were prepared.
5. The Company's other certifying officers and I have disclosed to the Company's auditors and to the Company's Board of Directors, based on our most recent evaluation:
 - a. All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information.
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal controls over financial reporting.

There is nothing in the aforesaid to derogate from my responsibility or the responsibility of anyone else, pursuant to any law.

March 24, 2015

Dr. Ziv Reich
Chairman, Committee for Reviewing
the Financial Statements

**ADDENDUM
(REGULATION 2)
ADDITIONAL REPORT**

**IN ACCORDANCE WITH GOVERNMENT COMPANIES REGULATIONS
(ADDITIONAL REPORT REGARDING ACTIONS TAKEN AND REPRESENTATIONS MADE TO ENSURE THE ACCURACY OF THE
FINANCIAL STATEMENTS, AND THE REPORT OF THE BOARD OF DIRECTORS), – 2005**

I, Yiftah Ron-Tal, certify that:

1. I have reviewed the Periodic Report within the meaning of Chapter B of the Securities Regulations (Periodic and Immediate Reports) – 1970, of The Israel Electric Corporation Limited ("the Company" or the "Electric Corporation") for the year ended December 31, 2014 ("the reports").
2. To the best of my knowledge and after reviewing the reports, they do not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the reports.
3. To the best of my knowledge and after reviewing the reports, the Financial Statements and other financial information included in the Directors' Report fairly present, in all material respects, the financial condition, results of operations, changes in equity and cash flows of the Company as of, and for, the periods presented in the reports.
4. The Company's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures for the Company. Accordingly, we have designed such disclosure controls and procedures, or had established under our charge such disclosure controls and procedures, designed to ensure that material information relating to the Company is made known to us by others in the Company particularly during the period in which the reports were prepared.
5. The Company's other certifying officers and I have disclosed to the Company's auditors and to the Company's Board of Directors, based on our most recent evaluation:
 - a. All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information.
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal controls over financial reporting.

There is nothing in the aforesaid to derogate from my responsibility or the responsibility of anyone else, pursuant to any law.

March 24, 2015

Yiftah Ron-Tal
Chairman of the
Board of Directors

THE ISRAEL ELECTRIC CORPORATION LIMITED
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(NEW ISRAELI SHEKELS, IN MILLIONS)
(Adjusted to NIS purchasing power of December 2014)

	Note	December 31 2014	December 31 2013
<u>CURRENT ASSETS</u>			
Cash and cash equivalents.....	4	4,504	3,394
Short term investments	5	2,559	492
Trade receivables for sales of electricity	6	4,546	4,383
Other current assets	7	537	328
Inventory- fuels	8	1,057	1,065
Inventory- stores		146	144
Regulatory assets, net	9	-	2,966
		13,349	12,772
<u>NON-CURRENT ASSETS</u>			
Inventory - fuels	8	1,539	1,733
Long-term receivables	10	1,833	1,176
Investment in associate.....	11	86	98
Regulatory assets	9	-	695
Assets with respect to post-employment benefits:			
Excess pension plan assets over pension liability.....	12	4,310	2,016
Funds in trust	13	1,909	1,725
		6,219	3,741
Fixed assets, net			
	14		
Fixed assets in use, net		57,020	58,528
Fixed assets under construction.....		6,497	6,063
		63,517	64,591
Intangible assets, net	15	974	946
		87,517	85,752

The accompanying notes are an integral part of the Financial Statements.

THE ISRAEL ELECTRIC CORPORATION LIMITED
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(NEW ISRAELI SHEKELS, IN MILLIONS)
(Adjusted to NIS purchasing power of December 2014)

	Note	December 31 2014	December 31 2013
<u>CURRENT LIABILITIES</u>			
Credit from banks and other credit providers	16	8,351	7,104
Trade payables	9	1,757	1,721
Other current liabilities	17	1,799	1,739
Short term regulatory liabilities.....	9	400	-
Customer advances, net of work in progress.....	18	453	397
Provisions	19	719	729
		13,479	11,690
<u>NON CURRENT LIABILITIES</u>			
Debentures	20	35,695	32,704
Liabilities to banks	20	4,737	8,555
Liabilities with respect to other post-employment benefits	12	2,930	2,918
Regulatory liabilities	9	261	1,395
Provision for refunding amounts to consumers.....	21	2,675	2,560
Deferred taxes, net.....	22	5,537	5,078
Debentures to the State of Israel	23	2,534	2,531
Liability to the State of Israel		2,902	2,850
Other liabilities.....		683	690
		57,954	59,281
<u>SHAREHOLDERS' EQUITY</u>			
Share capital	24	1,135	1,135
Capital reserves.....	25	1,022	1,028
Capital remeasurement reserve.....	25	135	(1,023)
Retained earnings.....	26	13,792	13,641
		16,084	14,781
		87,517	85,752

The accompanying notes are an integral part of the Financial Statements.

Mr. Tamir Polikar
Senior Vice-President of
Finances and Economics

Mr. Eliyahu Glickman
Chief Executive Officer

Dr. Ziv Reich
Chairman, Committee
for Reviewing the Financial
Statements

Yiftah Ron-Tal
Chairman of the
Board of Directors

March 24, 2015

Date of approval of the Financial Statements

THE ISRAEL ELECTRIC CORPORATION LIMITED
CONSOLIDATED STATEMENTS OF PROFIT AND LOSS
(NEW ISRAELI SHEKELS, IN MILLIONS)
(Adjusted to NIS purchasing power of December 2014)

	Note	For the Year ended December 31		
		2014	2013	2012
Revenues.....	28	25,195	27,601	28,263
Cost of operating the electricity system:				
Wages.....		1,718	1,887	2,361
Fuels		7,884	10,941	19,871
Transfer of regulatory asset to fuels (transfer of fuel to regulatory assets).....		3,435	4,324	(5,258)
Purchases of electricity		1,709	1,004	877
Transfer of regulatory asset to purchases of electricity.....		12	310	-
Operation of the generation system		732	754	839
Operation of the transmission and distribution system		394	334	306
Depreciation and amortization		4,260	4,653	4,399
		20,144	24,207	23,395
Profit from operating the electricity system		5,051	3,394	4,868
Sales and marketing expenses	29	902	903	1,065
Administrative and general expenses	30	1,136	1,111	869
Expenses for liabilities to pensioners, net.....		2	20	1,544
		2,040	2,034	3,478
Income from current operations.....		3,011	1,360	1,390
<u>Financial expenses, net:</u>	32			
Financial expenses		3,289	2,192	2,777
Capitalization of financial expenses		(271)	(278)	(277)
Transfer of financial income (expenses) to a regulatory asset/liability due to hedging		(231)	253	185
		2,787	2,167	2,685
Profit (loss) before income taxes		224	(807)	(1,295)
<u>Income taxes:</u>	22			
Other deferred taxes		61	(203)	(293)
Expenses from adjustment of deferred taxes balances due to a change in the future tax rate		-	328	-
		61	125	(293)
Profit (loss) after income tax		163	(932)	(1,002)
Company's share of the loss of associated companies, net		(12)	(2)	-
Net profit (loss) for the year.....		151	(934)	(1,002)

The accompanying notes are an integral part of the Financial Statements.

THE ISRAEL ELECTRIC CORPORATION LIMITED
CONSOLIDATED STATEMENTS OF OTHER COMPREHENSIVE INCOME
(NEW ISRAELI SHEKELS, IN MILLIONS)
(Adjusted to NIS purchasing power of December 2014)

	For the year ended December 31		
	2014	2013	2012
Net profit (loss) for the year	151	(934)	(1,002)
Amounts that will be attributed in future to the Statement of Profit and Loss.....			
Loss with respect to cash flow hedging, net of tax.....	(6)	-	-
Amounts that will not be attributed in future to the Statement of Profit and Loss:.....			
Remeasurement of a defined benefit plan, net of tax.....	1,158	279	(784)
Other comprehensive income (loss) for the period, after taxes	1,152	279	(784)
Comprehensive income (loss) for the year	1,303	(655)	(1,786)

The accompanying notes are an integral part of the Financial Statements.

THE ISRAEL ELECTRIC CORPORATION LIMITED
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(NEW ISRAELI SHEKELS, IN MILLIONS)
(Adjusted to NIS purchasing power of December 2014)

	Paid-up share capital	Capital reserves	Capital remeasurement reserves	Retained earnings	Total
	In NIS millions				
Balance as of January 1, 2012	1,135	1,028	(518)	15,577	17,222
Net loss for the year	-	-	-	(1,002)	(1,002)
Other comprehensive loss for the year.....	-	-	(784)	-	(784)
Balance as of December 31, 2012	1,135	1,028	(1,302)	14,575	15,436
Net loss for the year	-	-	-	(934)	(934)
Other comprehensive income for the year.....	-	-	279	-	279
Balance as of December 31, 2013	1,135	1,028	(1,023)	13,641	14,781
Net income for the year	-	-	-	151	151
Other comprehensive income (loss) for the year.....	-	(6)	1,158	-	1,152
Balance as of December 31, 2014	1,135	1,022	135	13,792	16,084

For details regarding assignment of profits and the dividend distribution policy see Note 26 below.

The accompanying notes are an integral part of the Financial Statements.

THE ISRAEL ELECTRIC CORPORATION LIMITED
CONSOLIDATED STATEMENTS OF CASH FLOWS
(NEW ISRAELI SHEKELS, IN MILLIONS)
(Adjusted to NIS purchasing power of December 2014)

	For the Year ended December 31		
	2014	2013	2012
Cash flows from operating activities:			
Net profit (loss) for the year according to the statement of profit and loss	151	(934)	(1,002)
Adjustments required to present cash flows from operating activities (Annex A)	8,101	6,701	(49)
Net cash provided by (used in) operating activities	8,252	5,767	(1,051)
Cash flows from investing activities:			
Investment in fixed assets	(4,041)	(4,693)	(5,393)
Investment in intangible assets	(172)	(172)	(195)
Transfer to Central Pension Fund (see Note 12)	-	253	355
Proceeds from sale of fixed assets	47	64	50
Collection of long-term receivables, net	(291)	82	68
Repayment (deposit) of bank deposits, net	(2,067)	(492)	765
Net cash used in investing activities	(6,524)	(4,958)	(4,350)
Cash flows from financing activities:			
Issuance (repayment) of short-term debentures, net	-	(4,704)	4,774
Issuance of long-term debentures	5,653	5,092	5,163
Other long-term loans received	197	3,371	2,032
Repayment of long-term debentures	(2,977)	(3,564)	(2,913)
Repayment of other long-term loans	(3,844)	(1,074)	(958)
Deposit/repayment of hedging transactions, net	82	(196)	269
Increase (decrease) of short-term credit from banks, net	271	(558)	62
Net cash provided by (used in) financing activities	(618)	(1,633)	8,429
Increase (decrease) in cash and cash equivalents	1,110	(824)	3,028
Balance of cash and cash equivalents at the beginning of the year	3,394	4,218	1,190
Balance of cash and cash equivalents at the end of the period	4,504	3,394	4,218
<u>Additional information about cash flows:</u>			
<u>Cash paid during the period for:</u>			
Interest	2,581	2,774	2,680
Income tax	4	4	8
	2,585	2,778	2,688
<u>Cash received during the period for:</u>			
Interest	4	5	5
Income tax	-	4	-
	4	9	5

The accompanying notes are an integral part of the Financial Statements.

THE ISRAEL ELECTRIC CORPORATION LIMITED
CONSOLIDATED STATEMENTS OF CASH FLOWS
(NEW ISRAELI SHEKELS, IN MILLIONS)
(Adjusted to NIS purchasing power of December 2014)

ANNEX A - ADJUSTMENTS REQUIRED TO PRESENT CASH FLOWS FROM OPERATING ACTIVITIES

	For the Year ended December 31		
	2014	2013	2012
Income and expenses not affecting cash flows:			
Loss from investment in an associate	9	2	-
Depreciation and amortization	4,579	4,775	4,816
(Decrease) increase in deferred taxes, net	58	122	(296)
Increase (decrease) in liabilities with respect to employee benefits, net	(444)	(516)	2,028
Revaluation (erosion) of loans, debentures and net hedging transactions	873	(435)	200
Increase in provision for refunding amounts to consumers	115	116	114
Decrease in exposure of the Company to changes in foreign currency transferred to consumers	(852)	(290)	(590)
Decrease (increase) in fuel regulatory liabilities	5,357	4,440	(5,670)
Decrease (increase) in regulatory assets with respect to compensation component	(1,182)	(203)	155
Decrease in other regulatory liabilities, net	(395)	(391)	(43)
Revaluation of debts collectible	(85)	38	39
Capital gain on sale of fixed assets	54	44	35
Loss from impairment of fuels inventory, long term	(100)	-	-
	7,987	7,702	788
Changes in assets and liabilities:			
Increase in trade receivables from sales of electricity (including those presented in long-term receivables)	(277)	(604)	(129)
Decrease (increase) in other current assets	(66)	97	(53)
Decrease (increase) in inventory – fuels (including noncurrent fuels inventory)	301	(130)	(652)
Decrease (increase) in long term receivables, net	(58)	86	81
Increase in customer advances for work ordered, net of work in progress	56	(70)	55
Increase (decrease) in trade payables (including long term)	35	(282)	(52)
Increase (decrease) in other current liabilities	123	(98)	(87)
	114	(1,001)	(837)
	8,101	6,701	(49)

The accompanying notes are an integral part of the Financial Statements.

THE ISRAEL ELECTRIC CORPORATION LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2014 (NEW ISRAELI SHEKELS)
(Adjusted to NIS purchasing power of December 2014)

NOTE 1:- GENERAL

a. Operation of the Company

- 1) The Israel Electric Corporation Limited ("The Company") is engaged in the generation, transmission, distribution and supply of and commerce in electricity pursuant to licenses granted to the Company by the State of Israel. The Company is classified as an Essential Service Provider in relation to these services. The Company was declared a monopoly by the General Director of the Israel Antitrust Authority. The directives of the Restrictive Trade Practices Law – 1988 (hereinafter: "Restrictive Trade Practices Law") apply to the Company. The Company also deals in the construction of the infrastructures required for these activities.
- 2) The Company is a Government Company (the State of Israel holds approximately 99.85% of its share capital) and it is subject to the provisions of the Government Companies Law – 1975 (hereinafter: "Government Companies Law") (see paragraph d below).
The Company is also a Public Company as defined by the Companies Law – 1999 (hereinafter: "Companies Law") and also a Reporting Corporation, as defined by the Securities Law – 1968.

b. The Electricity Sector Law

1) General

From March 4, 1996, the activity of the Electricity Sector has been regulated under the Electricity Sector Law and its regulations and the Company operates accordingly. The provisions of the Electricity Sector Law state that its purpose is to regulate the activity in the electricity sector for the benefit of the public, while securing reliability, availability, quality, efficiency and while creating conditions for competition and minimization of costs.

In accordance with the Electricity Sector Law, the Minister of National Infrastructures, Energy and Water ("The Minister") is the party in charge of execution of the law. In addition, in accordance with the Electricity Sector Law, the Public Utilities Authority - Electricity ("The Electricity Authority"), which was established pursuant to this law, shall act in accordance with its goals and the policy of the government, or the Minister and the Minister of Finance ("The Ministers") in accordance with their lawful authorities in the electricity sector field, and shall be responsible for giving the licenses in accordance with the law and supervision of fulfillment of the provisions of the law and the licenses. In addition, the Electricity Authority fulfills the functions that have been prescribed for it in the Electricity Sector Law (or that have been imposed upon it in accordance with any other law), including the setting of electricity charge rates and ways to update them, establishing of criteria for the standard and quality of the service that an essential service supplier license holder provides and supervision of fulfillment of its duties in accordance with these criteria.

As of this report, the Company generates, transmits, distributes and supplies most of the electricity that is consumed in the Israeli national economy pursuant to the licenses that have been granted to it for each such type of operation, in accordance with the Electricity Sector Law, which have been extended over the years, and it operates as an electricity system administrator. As of the date of this report, the licenses of the Company have been extended until January 1, 2016, in accordance with section 60 (d11) to the Electricity Sector law, by virtue of an order issued by the Ministers, after consultation with the Electricity Authority and the Government Companies Authority (hereinafter: the "Companies Authority"), and with the approval of the Economic Affairs Committee of the Knesset. In accordance with the Electricity Sector Law in its present version, an additional extension of the licenses of the Company to a date later than January 1, 2016 will require a legislative amendment. For details regarding the Company's application to the Ministers with regard to extension of the licenses and the letter of the Ministry of Finance and the decision of the Electricity Authority in this respect, see section e below.

THE ISRAEL ELECTRIC CORPORATION LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2014 (NEW ISRAELI SHEKELS)
(Adjusted to NIS purchasing power of December 2014)

NOTE 1:- GENERAL (continued)

b. The Electricity Sector Law (continued)

2) Presenting Separate Financial Statements as Required by the Implementation of the Electricity Sector Law

The Electricity Sector Law states that an essential service provider license holder shall prepare Financial Statements in a format as the Ministers prescribe, after consulting the Minister of Justice with respect to their extent of elaboration, the accounting principles to be used for their compilation, and the declarations and notes that are to be attached.

Accordingly, in accordance with the Electricity Sector Regulations (Conditions and Procedures for the Granting of a License) - 1997, and in accordance with the licenses of the Company, the Company, as an essential service provider, is required to submit Financial Statements separately for each area, for each activity and for each profit center, and to submit consolidated statements with respect to its activities in accordance with all of the licenses that are in its possession. A "profit center" is defined in these regulations as "a unit that has a closed income and expense structure, without cross subsidy with the operations of another unit.

Notwithstanding, the Company conducts its activities as separate profit centers, but does not submit audited Financial Statements for profit centers as required in the Electricity Sector Regulations and in most of its licenses (including the new generation licenses that the Company has received,) and it also does not submit audited Annual Financial Statements separately for each area, for each activity, for each generation unit or power station, but submits audited Financial Statements for the operations of the Company in its entirety.

According to the resolution of the Electricity Authority of January 15, 2015, according to section 9 b of the licenses, the Company has to submit to the Electricity Authority, by the middle of March, 2015, a schedule for completing the process of preparing a report by profit centers in accordance with the requirements of its licenses. As of the date of the report, the Company has yet to submit this schedule. (See note 34 c 3) below).

In light of the aforesaid, the Company estimates that this matter will be arranged within the structural change that will be agreed upon. Notwithstanding, and although sanctions regarding this matter have not been imposed on the Company as of the date of the report, the Management of the Company and the Board of Directors are of the opinion that as long as the issue of reporting according to profit centers is not resolved, the Company is exposed to the possibility of steps or proceedings taken against it with respect to non-compliance with the provisions stated in its licenses.

A possible outline was formulated within the discussions regarding the structural change of the electricity sector, that were held between representatives of the Ministry of Finance, the Ministry of National Infrastructures, Energy and Water, the Labor Federation, the employees' union and the management. According to the outline, the Company will operate through profit centers that will enable complete transparency and costs attribution in a model that will be determined according to the nature of the activity of the Company.

The issue of financial reporting and administering the activity of the Company according to profit centers constitutes a component in the draft of recommendations of the Steering Team that was formed with respect to the structural change, according to which the Company shall operate through audited profit centers that will enable complete transparency and attribution of costs in a model that will be agreed upon by the Ministry of National Infrastructures, Energy and Water, the Ministry of Finance, the Electricity Authority and the Company. The issue of the profit centers is also related to in the letter of Mr. Uri Yogev, addressed to Mr. Avi Nisenkorn, Chairman of the New National Labor Federation, regarding the "Position of the State regarding the Israel Electric Company Ltd." (hereinafter: the "Yogev Letter"), a copy of which was sent to the Company on September 8, 2014. According to the letter, the different activity sectors of the Company will be managed as separate audited profit centers. In light of the aforesaid, the Company estimates that this issue should be arranged within the framework of the structural change that will be agreed upon. Nonetheless, notwithstanding that as on the date of the report, no sanctions were applied to the Company on this subject. In the opinion of the Management of the Company and the Board of Directors, as long as the issue of reporting by profit centers is not resolved, there is exposure according to which there is the possibility of steps or proceedings being taken against the Company for failure to fulfill the provisions in its licenses.

Regarding the Steering Team's Recommendation Draft and the Yogev Letter, see section e below.

3) Reporting Costs of Electricity System Management Services as a Separate Segment

Regarding the decisions of the Electricity Authority on the subject, see Note 3 e to the Annual Financial Statements.

THE ISRAEL ELECTRIC CORPORATION LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2014 (NEW ISRAELI SHEKELS)
(Adjusted to NIS purchasing power of December 2014)

NOTE 1:- GENERAL (continued)

c. Decisions of the Government Regarding the Electricity Sector and Activities of the Company

Over the years, the Governments of Israel have made decisions that concern the electricity sector. Some of the decisions have not yet been implemented due to various considerations. The main subjects affected by material decisions of the Government are as follows:

- 1) Promotion and integration of independent power producers in electricity generation while using the Company's transmission system. A Government guideline target is increasing the generation capacity of private producers to 20% of the total generation capacity installed in Israel by 2020. For additional information see Note 34) a. 4) below.
- 2) Incorporating two Government Companies, held by the State of Israel, to operate in the electricity sector: System Management Company Ltd. and New Power Stations. To the best of the Company's knowledge, these companies are inactive.
- 3) A change to the structure of the electricity sector and the structure of the Company and, to the extent required, a change to the Electricity Sector Law (see paragraph e below).

4) Establishing a Communications Company

A Government resolution was published on July 15, 2010, regarding the increase in the quantity of broadband infrastructure suppliers by the Company. For additional details see Note 11 below.

- 5) On November 28, 2010, a Government decision was published on the formation of a national plan to reduce greenhouse gas emissions in Israel. Among other decisions, it was decided to require the Minister of Energy and Water to bring regulations to the approval of the Knesset on efficient electricity consumption in the household, commercial and public sectors. It was also decided to require the Electricity Authority to submit recommendations on different issues related to the electricity rate and require the Minister of the Environment to implement a comprehensive plan for supporting investments in reduction of greenhouse gas emissions (see section g below).

6) Government Policy on Energy Generation from Renewable Sources

On July 17, 2011, the Government decided to act to realize Government goals for electricity generation that combine renewable energies in the electricity generation system. This electricity generation goal is expected to be attained by installing renewable energies generation capacity of about 2,760 megawatts, which constitutes about 10% of the expected electricity energy requirements of the State up to 2020. Additionally, the interim goal of generating 5% of the electricity requirements for the end of 2014, by installed renewable energies electricity generation capacity is about 1,550 megawatts.

- 7) On October 5, 2014, the Ministerial Committee for Social and Economic Affairs (Socio-Economic Cabinet) (hereinafter: the "Cabinet") approved a "Multi-annual Plan to Execute Issue of Minority Stakes in Government Companies" (hereinafter; the "Decision").

Within the Decision it was decided, inter alia, to approve a multi-annual plan to execute issues of minority stakes in government companies (hereinafter: the "Plan"), and to promote the creation of an appropriate legal infrastructure for executing the issue of minority stakes in government companies in order to implement the Plan. The Cabinet classified the Company as a company in which the State has an interest in maintaining long term government control. Accordingly, under the Plan outline, in 2017, subject to a Government decision to perform a structural change in the Company, as far as a decision will be reached, and minding the nature of the structural change that will be formulated, an issue of minority stakes of the Company will be executed at a total amount of up to 25% of the share capital of the Company (fully diluted). Additionally, within the Decision, the Cabinet instructed the Government Companies Authority to act so that the companies included in the Plan (including the Company) will distribute dividends to the State in a total amount of approximately NIS 500 million in each of the years 2015-2017, all subject to the progress of the privatization proceedings according to the timetables set and subject to the distribution analysis and permits required under the law, as amended, insofar as will be required.

THE ISRAEL ELECTRIC CORPORATION LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2014 (NEW ISRAELI SHEKELS)
(Adjusted to NIS purchasing power of December 2014)

NOTE 1:- GENERAL (continued)

d. The Government Companies Law

The Company is a Government Company, and the arrangements set by the Government Companies Law and the regulations promulgated under it apply to it. Subject to the arrangements set under the Government Companies Law, the general company laws apply to the Company.

Additionally, additional laws apply to the Company as a Government Company, including certain provisions of the Budget Foundations Law (section 29, regarding the determination of employees' terms of employment), the State Comptroller Law (the Company is a controlled entity), the Internal Audit Law, the Mandatory Tenders Law and its regulations, the Freedom of Information Law, Women's Equal Rights Law, Equal Rights of Persons with Disabilities Law, Safety Arrangements for Public Entities Law, Antitrust Law and the Law for Increased Enforcement of Labor Law. For additional information required according to the Companies Authority, see Note 39 below.

e. Structural Change

The purpose of the Electricity Sector Law is to regulate the activity in the Electricity sector for the public's benefit, while ensuring reliability, availability, quality, efficiency, and while creating conditions for competition and minimizing costs. The Electricity Sector Law determines provisions by virtue of which it is obligatory to maintain separation between the electricity generation, transmission, distribution and supply activities and management of the system, under conditions prescribed by the Electricity Sector Law, through distributing the activities among several separate entities ("The Structural Change"), while specifying transition instructions and a timetable for implementing the instructions, which enable the Company to generate, transmit, distribute, supply, sell and trade in electricity, and also act as the electricity system's administrator, according to the licenses, granted to the Company in accordance with the Electricity Sector Law, up to January 1, 2016.

THE ISRAEL ELECTRIC CORPORATION LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2014 (NEW ISRAELI SHEKELS)
(Adjusted to NIS purchasing power of December 2014)

NOTE 1:- GENERAL (continued)

e. Structural Change (continued)

1. The major points of the Electricity Sector Law regarding the Structural Change

The Electricity Sector Law states that a person will not perform an act of generation (except generation of a certain output of electricity which is not sold to others), transmission, distribution or supply of electricity, commercial trade in electricity or management of an electricity system (hereinafter, jointly: "Activity in the Electricity Sector") except in accordance with a license granted to him for that purpose in accordance with the Electricity Sector Law (hereinafter: "License") by the Electricity Authority which will become effective upon approval by the Minister. The Electricity Sector Law sets conditions for granting licenses for activity in the electricity sector, including, inter alia, several restrictions. The main restrictions are detailed below.

- a) As a rule a license will not be granted to a person for more than one activity, however:
- (1) It is possible to grant a generation license together with a supply license to one person, with due attention to the development of competition in the electricity sector.
 - (2) No license is to be granted if after the receipt of the license, a person, with the exception of the State of Israel, would hold a license for the administration of the system or shall be a holder of means of control in a holder of such a license, and shall also be a holder of a license for the generation, distribution or supply of electricity, or if they would hold means of control in the holder of such a license. However, a holder of a license for the administration of the system or its subsidiary, may also, if so determined in his license and if crucial for the reliability of the supply of electricity, be granted licenses for generation, so long as these licenses are not granted for 5% or more of the generation capacity in the Electricity Sector, and, if the Minister finds that special circumstances exist – 10% or more of such magnitude.
- b) No generation license or distribution license shall be issued to a party holding means of control of a transmission license holder.
- c) No transmission license shall be issued to a holder of means of control of a generation license holder or a distribution license holder.
- d) No generation license shall be issued unless one of the following is fulfilled:
- (1) The license applicant holds means of control of a distribution license that holds 10% or more of the distribution volume in the Electricity Sector;
 - (2) The license applicant holds means of control of a distribution license holder, and after receipt of the requested license shall hold 10% or more of the volume of the generation capacity in the Electricity Sector;
 - (3) A person shall hold after the receipt of the requested license 30% or more of the volume of the generation capacity in the Electricity Sector;
 - (4) The license applicant is a holder of a transmission license.
- e) No distribution license shall be issued if one of the following is fulfilled:
- (1) The license applicant holds means of control of a generation license holder that holds 10% or more of the volume of the generation capacity in the Electricity Sector;
 - (2) The license applicant holds means of control of a generation license holder, and after receipt of the requested license shall hold 10% or more of the volume of the distribution in the Electricity Sector;
 - (3) A person will hold after the receipt of the requested license 25% or more of the distribution volume in the Electricity Sector.

The Ministers, upon consultation with the Electricity Authority and the Companies Authority, are entitled to establish rates that differ from those which have been stated in sections (d) and (e) above if they find this to be crucial for the promotion of the purposes of the Electricity Sector Law, and they are also entitled to establish additional restrictions on the granting of licenses.

THE ISRAEL ELECTRIC CORPORATION LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2014 (NEW ISRAELI SHEKELS)
(Adjusted to NIS purchasing power of December 2014)

NOTE 1:- GENERAL (continued)

e. Structural Change (continued)

2. Special transitional provisions and milestones for the Company in the Electricity Sector Law

- a) The licenses of the Company that have been issued to it pursuant to the Electricity Sector Law, and that were in effect prior to the end of the "transition period" as defined in the Law (10 years from the day of commencement of the law, i.e., March 4, 2006) (hereinafter: the "Transition Period"), shall remain in effect with respect to all of the activities that have been performed thereby through to the time prescribed in the Electricity Sector Law as extended from time to time, which is, on the date of the report, January 1, 2016.

It is the position of the Company that the extension applies to all of its licenses, including the new generation licenses that were granted to the Company in accordance with the transitory provisions of the Electricity Sector Law for power stations that were included in the development plan of the Company that was approved until January 1, 2009, (in this section the "New Generation Licenses"). It is the position of the Electricity Authority that the extension does not apply to the New Generation Licenses and that it was given the authority to extend these licenses.

On October 27, 2014, the Electricity Authority reached a decision, under which it does not object to the extension of the licenses as stated, but according to its position the continuing delay in completion of the reform materially harms the promotion of the electricity sector and the delay in implementation of the Electricity Sector Law has continued for an unreasonable length of time. Additionally, a letter from the deputy commissioner of budgets of the Ministry of Finance, of October 27, 2014 (hereinafter: the "Letter of the Ministry of Finance"), sent to the Company regarding the extension of the licenses until January 1, 2016, stated that beyond such an extension of licenses due to lack of a reasonable alternative, the State does not intend to change the policy of the Electricity Sector law.

On December 31, 2014, the Official Gazette published that the Minister of National Infrastructures, Energy and Water and the acting Minister of Finance, by virtue of their authority according to section 60 (d11) to the Electricity Sector law, extended the validity of the licenses of the Company until January 1, 2016, through an order issued by the ministers after consultation with the Electricity Authority and the Companies Authority, and with the approval of the Economic Committee of the Knesset. In accordance with the Electricity Sector Law in its present version, an additional extension of the licenses of the Company to a date later than January 1, 2016 will require a legislative amendment.

Furthermore, in view of the position of the Electricity Authority with regard to its authority to extend the new production licenses as explained above, and as a precaution, the Company applied to the Electricity Authority requesting an extension for the new production licenses. As part of the decision of the Electricity Authority of January 21, 2015, the validity of the new production licenses of the Company was extended until January 1, 2016. The Minister's approval for this extension has not yet been received.

Based on past experience, the Company expects its licenses to be extended for additional periods, but in view of the uncertainty as to the implementation of the structural change and in view of the letter of the Ministry of Finance of October 27, 2014 that is detailed above and the decision of the Electricity Authority of the same date, there is no certainty as to whether, for what periods and under what conditions some or all of the licenses of the Company will be extended, and under what conditions or which licenses shall be granted to it after the implementation of the Structural Change, to the extent implemented. The Company's assessment is that after the implementation of the Structural Change, the Company will receive new licenses in accordance with the outline of the organizational structure as will be determined.

- b) The granting of replacement licenses – the Electricity Authority is entitled, with the approval of the Minister, to grant replacement licenses for all or some of the licenses of the Company that were in effect prior to the end of the transaction period, (hereinafter: "The Replacement Licenses"), even if the conditions that have been stipulated by the Electricity Sector Law with respect to the granting of licenses for operations in the Electricity Sector are not fulfilled, so long as those Replacement Licenses for which these provisions of the law have not been fulfilled remain in force until the time that has been determined by the Law (as of the date of the report, January 1, 2016). An additional extension beyond this date requires an order to be issued by the Ministers as detailed above, and an additional extension beyond January 1, 2016 will entail a legislation amendment. If and

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NOTE 1:- GENERAL (continued)

e. Structural Change (continued)

2. Special transitional provisions and milestones for the Company in the Electricity Sector Law (continued)

to the extent that replacement licenses are granted, the other licenses of the Company will only apply to its operations for which replacement licenses have not been granted. As of the date of this report, no replacement licenses have been granted to the Company.

- c) Granting Generation Licenses to New Facilities – the Electricity Authority is entitled, upon approval of the Minister, to grant generation licenses, even when the recipients do not fulfill the limitations prescribed by the Electricity Sector Law for granting generation licenses to power stations included in the development plan of the Company, which was approved by the Minister, in consultation with the Electricity Authority (according to section 19 of the Electricity Sector Law) up to January 1, 2009, for a period in which the licenses of the Company that were effective on the eve of the end of the transition period, are still effective, meaning, January 1, 2016. An additional extension beyond January 1, 2016 will entail a legislative amendment. As described above, as part of the decision of the Electricity Authority of January 21, 2015, the validity of the new production licenses of the Company was extended until January 1, 2016. The Minister's approval for this extension has not yet been received.
- d) The granting of generation and distribution licenses to a government company or to a government subsidiary – the Electricity Authority is entitled, with the approval of the Minister, to grant a government company or a government subsidiary generation licenses and distribution licenses for an electricity system that has been operated in accordance with the licenses of the Company that were in effect at the end of the Transitional Period and the licenses that have been issued pursuant to section 2 c) above, even without the restrictions that have been stated in the Electricity Sector Law as described in the Chapter with respect to Provisions of the Electricity Sector Law with regard to the Structural Change, Sections 1 c 3) and 1 e 3) above, as long as the following conditions are met:
 - (1) Generation licenses shall only be granted if, subsequent to the receipt of a license, the license holder will possess power stations that operate based on a mixture of certain types of fuels that includes diesel oil, natural gas and coal; however, with respect to coal, the license applicant may not generate electricity through the use of coal itself, but it is to have rights to receive electricity that is generated at a coal powered power station.
 - (2) Distribution licenses shall be granted in such a manner that the costs of the license holders with respect to the electricity facilities that are used for their operations, at the time of the granting of the licenses, will be as similar as possible; however, the Ministers are entitled, after having consulted with the Electricity Authority and the Companies Authority, to determine otherwise, should they find this to be crucial for the advancement of the purposes of the Electricity Sector Law.
 - (3) After the receipt of the license, the license holder shall not hold, through another corporation, 30% or more of the volume of the generation capacity in the Electricity Sector, or 25% or more of the distribution capacity in the Electricity Sector.
 - (4) The validity of the license shall be contingent upon such that as from July 1, 2013, no government company or government subsidiary shall hold, jointly and severally, more than 51% of the means of control in a holder of a distribution or generation license that has been given pursuant to this section of the Law.
- e) The holding of means of control in a holder of a transmission license – the Ministers shall determine, in an order, by the time prescribed in the Law (as of the date of the report – January 1, 2016) upon consultation with the Electricity Authority and the Companies Authority, whether a government company or a government subsidiary, holding means of control of a holder of a generation or distribution license, will be also be able to hold means of control of a holder of a transmission license. An additional extension beyond January 1, 2016 will entail a legislation amendment.
- f) The granting of a supply license together with a distribution license – notwithstanding the provisions that have been stated in Section 1 above, a supply license may be given to a government company or to a government subsidiary that is a holder of a distribution license by law, until the time that has been prescribed by the Law (as of the date of the report - January 1, 2016). An additional extension beyond January 1, 2016 will entail a legislative amendment. In addition, a supply license may be given to a company that is a holder of a distribution license by law, that is not a government company or a government subsidiary, until the date set in the law (as of the date of the report, January 1, 2016).

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NOTE 1:- GENERAL (continued)

e. Structural Change (continued)

2. Special transitional provisions and milestones for the Company in the Electricity Sector Law: (continued)

- g) Prohibition on providing certain services in the electricity sector - a Government company or a subsidiary of a Government company that holds a controlling share in a license holder by force of the transition directives in the Electricity Sector Law will not act in the field of engineering planning of power stations, in building power stations, in the logistics, information technology and acquisition of all types of fuel and a Government company or a subsidiary of a Government company that holds a license by force of the transition directives in the Electricity Sector Law will not act in these fields for another corporation, that holds a license by force of the Electricity Sector Law.

3. The Position of the Company with respect to the implementation of the Structural Change in accordance with the provisions of the Electricity Sector Law

In the opinion of the Company, and subject to that stated at the end of this section, the provisions of the Electricity Sector Law, as currently worded, permit, subject to receipt of all of the approvals required by law, for a gradual process to be held within which the Company would be recognized as a holding company that would control a number of subsidiaries that would have generation licenses, a number of subsidiaries that would have distribution licenses, and a single subsidiary that would hold a transmission license, as stipulated below:

- a) A number of subsidiaries holding a generation license, each of which would hold licenses for 30% of the generation capacity of the Electricity Sector, at the most, and each of which generation companies would have power stations that would operate based on a mix of field of various types, including: diesel oil, natural gas and coal (subject to an exception with respect to generation using coal);
- b) At least four subsidiaries holding a distribution license, each of which would hold licenses for 25% of the distribution level in the Electricity Sector, at the most, the costs with respect to the electricity facilities used by each of the companies being as similar as possible;
- c) A company with a transmission license, if the Ministers determine, by January 1, 2016, that a government company or a government subsidiary holding means of control of a generation or distribution license holder would be able to hold means of control of a transmission license holder as well;
- d) The Company, as a parent company, would not be able to hold more than 51% of the means of control in the generation or distribution companies (this restriction would apply to the Company in the case of the Company receiving new generation or distribution licenses for its subsidiaries);
- e) The system administration activity would be carried out within a separate corporation in which the Company would have no holdings.
- f) The Company would be entitled to hold a subsidiary or subsidiaries for providing engineering design services for power stations, construction of power stations, logistics, information technologies and purchase of fuel of various types (which would not hold a license for carrying out activity in accordance with the Electricity Sector Law);
- g) The holding structure that has been described above is subject to the approval of the Minister.

Despite that stated at the head of this section, implementing the provisions of the Electricity Sector Law in the manner described above requires preparation in advance.

The provisions of the Electricity Sector Law are complex and the Company is of the opinion that they may be construed in different ways, including such that there is a possibility that the Structural Change will be carried out in a manner that is different from the aforesaid, such that the Company will also not operate in some of the activity segments listed in sub-section a)-d) and f) above.

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NOTE 1:- GENERAL (continued)

e. Structural Change (continued)

4. The Draft Report of the Steering Team

On July 22, 2013, the Ministers appointed a Steering Team for the execution of a reform in the electricity sector and the Electric Company, headed by Mr. Uri Yogev, who is at present the Director General of the Government Companies Authority, with the participation of senior members of the Ministry of National Infrastructures, Water and Energy Resources and the Ministry of Finance and others (hereinafter: “The **Steering Team**”). According to the letter of appointment delivered to the Steering Team, the assignments of the Steering Team are: to examine the optimal structure for the electricity sector and the Electric Company, and taking into account internationally accepted models and those discussed before the Steering team began working, including the model presented to the Company in recent years. The team will examine the various models, emphasizing implementation of competition in the competitive segments; to check the financial soundness of the Company thus far and to bring it to an appropriate financial position, as part of the reform: to examine a plan for increasing efficiency in the Company and to propose, in view of the aforesaid, a comprehensive reform in the Electricity Sector and in the Company.

On March 23, 2014, the draft of recommendations of the Steering Team (hereinafter: the “**Draft Report**”) was published for comments by the public until May 11, 2014. The Draft Report included recommendations regarding, inter alia, the following issues:

- (a) Electricity system management - establishing a separate government company to which the Electric Company will transfer the system management unit, the Planning, Development and Technologies Division, and the Statistics and market Research Department (hereinafter: the “System Management Company”), as well as its fields of business, its ownership and the assets that will be delivered to it and additional recommendations regarding manpower employed by the system management company and the organization required for its establishment and operation;
- (b) The electricity marketing model - arranging the electricity marketing model and a gradual transfer to an electricity marketing model based on the pool method, which is basically: (1) energy: all the plants in the market compete for the offer to sell energy (determined by relation to the marginal cost of each plant). Payment for energy using the clearing price – the price at the meeting point between demand and supply, paid uniformly to all the manufacturers; (2) availability: unless noted otherwise, all the plants receive identical availability payments for each available energy unit they place at the disposal of the system administration. Beyond that, the recommendations include combining the private plants under existing regulations, and operating the Company’s power stations under a unique regulation, and the manner of integrating private plants that are presently in the process of being established.
- (c) Trade in natural gas - recommendations regarding trade in natural gas, including allowing trade in surplus natural gas between all the natural gas users in the market – electricity manufacturers, industry and gas marketers, expediting the doubling of transmission segments in order to prevent deficits, improving the transmission system’s ability to support the volatility of the demand by consumers, and determining the that a team from the Ministry of Finance and the Ministry of National Infrastructures, Energy and Water will evaluate the development progress of the Leviathan reservoir in 2016. Insofar as it will appear that the Leviathan reservoir will not be connected to the natural gas conduction grid until 2018, the team will give guidance regarding the fair distribution of the natural gas between all the license-holding electricity producers.
- (d) The generation segment - selling certain Company sites (the Ramat Hovav site and the fourth combined cycle at Alon Tavor, as well as Eshkol C and Eshkol D) to private producers in a sale process managed by a joint team made up of personnel from the Companies Authority and the General Comptroller, and with the support of the Company, incorporating certain plants, scrapping certain plants, future development of plants and establishing a special purpose team headed by the Director General of the Ministry of National Infrastructures, Energy and Water and with the participation of the Finance and Environmental Protection Ministries, the Company and the System Management Company, which will reexamine certain topics;
- (e) The distribution segment - to allow the activities of private factors as sub-distributors up to a ceiling of 10% of the total consumption in the distribution system and regulating the manner of their operations, including the fact that the Electric Company will continue to be a distribution license holder as an essential service provider, and will sell the service at a supervised price;

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NOTE 1:- GENERAL (continued)

e. Structural Change (continued)

4. The Draft Report of the Steering Team (continued)

- (f) The supply segment - the supply segment will be opened to competition according to the rules determined and the fact that the Company will continue to be the supply license holder, and will sell the service at a supervised price. Additionally, granting supply licenses to private electricity producers that will meet threshold conditions as will be determined, and promoting the activities of companies operating in the field of demand response; free access to information produced from the analogical electricity meters and the smart metering of their customers.
- (g) Smart metering - promoting the smart metering project and its establishment by the Company;
- (h) Arrangement of the Electricity Company's assets - for details of the Draft Report regarding the assets arrangement see section f 5) below.
- (i) Structural change of the Company - within which: (1) the Company will undergo a significant process of efficiency planning and organizational change on the basis of principles that were formulated by the Company Management. In the framework of this process, organizational changes will take place that include, among others, reduction and optimization of the district structure, transition to regional power plants and regional maintenance, reorganization of the headquarters and services divisions, significant reduction in permanent human resource employment and reduction in the control and management roles; (2) the Electric Company will operate in the transmission and distribution segments and in the management branches via monitored profit centers that will permit full transparency and attribution of costs, in a model agreed upon between the Company, the Ministry of Finance, the Electricity Authority and the Ministry of Natural Infrastructures, Energy and Water by October 30, 2014
- (j) Reorganization and managerial flexibility - executing a comprehensive reorganization plan for reducing the Company's employee ranks, reinforcing the management capability of the Company management that will allow the necessary flexibility for the Company's activities as a commercial company, transition of certain employees to personal contracts and expanding employment through personal contracts in core expert positions in which there are gaps in knowledge or in salary compared to the labor market, adapting the salary structure to the modern labor market and competitive environment, cessation of payment for the electricity component to Company employees and evaluation of its conversion to a salary component at the level of the average consumption in the market, and recommendations regarding the transfer of sums from the trust account for non-budgetary components to the central pension fund;
- (k) The capital structure of the Company - executing public issues of shares in 2015 and 2018 according to a road map, after which the control of the Electric Company will remain in the hands of the State, and repayment of Company liabilities backed by State guarantee;
- (l) Business entrepreneurship - regulating the business initiative activity of the Company abroad through a wholly-owned subsidiary;
- (m) Rate outline - the Electricity Authority will examine a determination of a rate outline for salary costs for the period of the arrangement which will be based on the principles detailed in the Draft Report.

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NOTE 1:- GENERAL (continued)

e. Structural Change (continued)

5. The Position of the Company Regarding the Recommendations Draft of the Steering Team

On May 7, 2014, the Company presented the Steering Team with its initial reaction and position with regard to all the recommendations included in the recommendations Draft of the Steering Team regarding the reform in the Electric Company and the electricity sector. The Company's comments are focused on two major issues: the scope of the future development of the electricity sector (with emphasis on the generation segment) and ensuring long-term stable financial strength for the Company.

Following is a summary of the position of the Company, according to the issues discussed in the Draft Report:

- a) Electricity system management - setting a real schedule for implementing the recommendations and determining a transition period and regulation of the duties of the system management company.
- b) The electricity marketing model - supporting a gradual transition to a marketing model based on the pool method that will combine in an equal manner similar volumes of production from the private sector and the Company.
- c) The generation segment - comments regarding the possibility of establishment, exchange and upgrade of units; a demand to ensure a minimal market share for the essential service provider, and a demand to set real schedules regarding the incorporation and sale of plants and regarding scrapping plants and establishing a nuclear plant (or establishing an alternative generation capability).
- d) Natural gas - reservation about the recommendations concerning the redistribution of the gas capacity in case of delays in the Leviathan reserve, and a demand for the execution of suitable regulation of the commerce and operation in the natural gas sector, including the execution of a material update to the transmission agreement of the Company with the Natural Gas Lines Company Ltd. (hereinafter: the "Gas Lines Company").
- e) The distribution segment - comments regarding restricting customers that will use sub-distributors and a demand to stop the reduction provided to consumers of high voltage.
- f) The supply segment - a request for a gradual opening of the market to competition according to customer size, as is customary worldwide.
- g) Increasing efficiency, organizational change and managerial flexibility - the Company accepts the recommendations of the Draft report in principle, but notes that negotiations and signing collective agreements will be required, and in some cases a legislation process may even be required.
- h) Capital structure/financial strength - determining and achieving the goals of the financial strength are a necessary condition for the actual execution of reform, in the electricity sector and the Company has certain comments as to the manner of handling the issue of the financial strength and the goals for achieving it. Additionally, the position of the Company is that the Draft Report does not deal satisfactorily with the increase of the discretion of the Company in issues related to business entrepreneurship and establishing projects by Company subsidiaries.
- i) Assets arrangement - for details of the position of the Company regarding the assets arrangement see Note 1 f sections 2, 4 below.
- j) Rate outline - the proposed rate outline does not provide a stable business model and will not enable the Company to meet the goals set by the Steering Team or to stabilize the financial position of the Company.
- (k) Additional/general comments - Additionally, it is essential that certain issues be regulated under the reform, and they are not solved in the Draft Report, and they are, inter alia, as regards: (a) regulation and the relations of the Company with government entities that regulate it; (b) licenses of the Company, especially regarding the essentiality of granting long term licenses; (c) various restrictions that may apply to the Company by virtue of the Centralization Law.

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NOTE 1:- GENERAL (continued)

e. Structural Change (continued)

6. The Yogev Letter and correspondence regarding the structural change

A summary of the final proposal for the structural change of the Company, acceptable to the Minister of Finance and the Minister of National Infrastructures, Energy and Water, was attached to the Yogev Letter. Furthermore, it was noted that what is stated in the letter regarding the structure of the Electric Company and regarding changes in the electricity sector partially requires primary legislation amendments and partially requires other regulation.

On September 11, 2014, a copy of the letter of Mr. Uri Yogev and Mr. Kobi Amsalem, the Commissioner of Wages and Labor Agreements of the Ministry of Finance, addressed to Mr. Avi Nisenkorn, regarding the "Position of the State regarding the Israel Electric Company Ltd. as of September 8, 2014", was sent to the Company. It was clarified in the letter that a reaction is required from the New National Labor Federation to what is detailed in the Yogev Letter regarding the economic considerations that will be paid with respect to the implications of the planned changes in the Electric Company for the employees and the changes that will be required for the existing collective agreements and existing collective arrangements.

The summary of the State's position according to the Yogev Letter is as follows:

a) Part A - Implications of the Structural Change on the Rights of the Employees

1. Increasing efficiency:

- a. Reducing 1,700 permanent positions over the next decade, according to natural retirement, at an intake ratio of 1:3.
- b. Reducing 800 temporary positions during the first year of the agreement and increasing outsourcing by 300 employees.
- c. The Company's manpower strength as of 2025: 10,500 employees, of which permanent employees do not exceed 8,100.
- d. Voluntary retirement will be offered during the first year of the agreement, according to terms to be determined.

2. Remuneration with respect to the structural change:

- a. Structural change grant - every permanent employee will receive a grant in the amount of NIS 50,000, according to milestones:
 - (1) 1/3 of the grant upon the establishment of the System Management Company.
 - (2) 1/3 of the grant upon completion of incorporation of the subsidiary of gas turbine based power stations.
 - (3) 1/3 of the grant upon placing the Company power stations for sale.
- b. Pension supplements - all permanent Company employees employed by the Company on the date of signing the detailed agreements for implementation of the structural change will be entitled to a monthly pension supplement of NIS 1,000 from the age of 67, according to the following:
 - (1) Employees of generation A and B will receive a pension supplement of NIS 1,000 NIS.
 - (2) Generation C employees will receive a supplement to the pension salary of approximately 10%, as cumulative, without defined benefits.
 - (3) Employees whose pension exceeds double the average salary in the economy will receive a reduced pension supplement.
 - (4) The pension supplement will be given in two parts:
 - a. A permanent supplement.
 - b. A supplement contingent on meeting the milestones in an identical manner of the grant and ranked according to salary.
- c. Conversion of the free electricity bonus:
 - (1) No change for Company pensioners on the date of signing the agreement.
 - (2) New employees and temporary employees on the date of signing the agreement will not receive a bonus or compensation.
 - (3) Permanent employees on the date of signing the agreement - the free electricity component will be converted to a salary component at a consumption value of 7,500 kWh and grossing up the benefit at the present value. The component will be a pension component.

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NOTE 1:- GENERAL (continued)

e. Structural Change (continued)

6. The Yogev Letter and correspondence regarding the structural change (continued)

a) Part A - Implications of the Structural Change on the Rights of the Employees (continued)

3. Managerial flexibility:

- a. Cancelling the parity mechanism with respect to "incompatibility" to enable managerial flexibility.
- b. Establishing a new disciplinary mechanism.
- c. Full managerial flexibility in dismissal of temporary employees.
- d. Cancelling the parity in the tender committees for positions of section heads to department heads, management authority to set prerequisites for management positions from the level of section head and above.
- e. Management flexibility for employee mobility.
- f. Incentive salary - introducing incentive according to objectives and profitability.
- g. Work attendance and ensuring the completion of the work hours quota.

4. Salary agreements:

- a. New employees will be hired as generation D employees - in adjusted rank ranges according to occupation and without rank/salary automatic promotion.
- b. Managers and additional employees, up to 3% of the manpower strength, will be employed under personal contracts.
- c. Increasing the initial salary and decreasing the salary increase mechanisms, in a manner that will reduce total salary expenses.

b) Part B - The Structural Change in the Electric Company

1. Removing the System Management from the Company and operating it in a separate government company during the first year of the agreement.
2. The Company will sell the Ramat Hovav power stations, the land at Alon Tavor and the land at Eshkol C-D. Power stations will be erected by private electricity producers according to the needs of the sector instead of the Eshkol C-D stations that will be scrapped. A power station will be erected at Alon Tavor according to the needs of the sector, the Haifa C station will be scrapped.
3. After the Reading power plant ends its lifespan, the Company will erect a combined cycle F or H model generation unit with an installed capacity of approximately 440 megawatts at the Reading site, and an additional identical unit approximately one year later, according to the needs of the sector.
4. The Company will not erect or exchange additional power stations beyond the Reading station and the Ashkelon D station.
5. The Company will complete the emission reduction project: erecting scrubbers at the Orot Rabin units 5-6 and the Rutenberg units 1-4. Conversion of the Orot Rabin units 1-4 to operating with natural gas and coal backup.
6. Smart metering - the meter system will be converted to a digital system in an economic and graded manner decreasing according to consumer size, dependent on the results of the cost-benefit analysis.
7. The smart metering system, including control of the data, will be managed by an external company.
8. A Company subsidiary will be established for sites that include generation units based on F and E model gas turbines.
9. A subsidiary for business entrepreneurship abroad will be established ("Entrepreneurship Electricity").
10. The various activity sectors of the Company will be managed as separate audited profit centers.

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NOTE 1:- GENERAL (continued)

e. Structural Change (continued)

6. The Yogev Letter and correspondence regarding the structural change (continued)

b) Part B - The Structural Change in the Electric Company (continued)

11. Financial strength

- a. The equity capital objective in relation to the Balance Sheet will stand at 35% in 2022.
- b. The Company will be floated on the Stock Exchange in 2015 and 2018 at a scope of 15%, insofar as an appropriate decision will be reached by the Ministers' Committee for Privatization. The issue will be stipulated by the qualifications required so that the State will retain its right to execute a structural change in the Company in future and the activity of the Company as an essential service provider will not be prejudiced.
- c. The Company will pay its obligations that are backed by a State guarantee according to an original amortization schedule.
- d. Real estate assets that are unnecessary to the current operation of the Company will be transferred to the State according to an arrangement that will be determined.
- e. The State will pay for the power stations, system management assets and land and buildings, bought by the State or the system management company from the Company, by offsetting the Company's debt to the State.
- f. Real estate assets that are serving the Company and are expected to serve the Company in the future will remain in the arrangement existing at present.
- g. The Company will act to release funds from the trust account in the amount of at least NIS 1 billion, the balance will currently fund the non-pension components. The legal proceeding regarding the matter will continue.

c) Part C - General

1. Private entities will be added to the distribution segment in up to 10% of the electricity market share.
2. The supply segment will be opened for competition to private entities. Supply licenses will be granted to electricity producers and suppliers that will meet the prerequisites, including financial strength.

d) Part D - Miscellaneous

1. All supplements granted to the employees are stipulated by fulfillment of all the above mentioned objectives.
2. This offer is in effect for 30 days from the date of submission to the employees.

The position of the Company regarding the issues detailed in the Yogev Letter with respect to the structural change and that were discussed in the Draft Report is according to the position of the Company that is detailed above with respect to the recommendations that were included in the Draft Report.

On September 15, 2014, a copy of the letter of Mr. Avi Nisenkorn, addressed to Mr. Uri Yogev, whose heading is "Negotiation impasse and unilateral proceedings", was received by the Company. According to the letter, in view of the "unilateral position", as defined, which was presented in the Yogev Letter, and in view of the negotiations reaching an impasse, the National Labor Federation and employees' organization do not intend to stand aside and plan to take all measures in this matter.

At present there are material differences between the State's position and the position of the National Labor Federation, particularly with regard to employee rights relating to the structural change, and negotiations are not being conducted between the parties. The position of the Company is that the negotiations between the parties should be continued and the reform in the electricity sector should be promoted.

Within a letter sent by the Chairman of the Board of Directors of the Company to the Ministers and within a letter sent by the Commissioner of Wages of the Ministry of Finance to the Chairman of the Board of Directors of the Company, the Chairman of the Board of Directors of the Company on the one hand and the Commissioner of Wages of the Ministry of Finance on the other hand called for a return to the negotiating table in order to advance the reform in the Company and the electricity sector. The National Court of Labor also called on the parties to return to the negotiations.

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NOTE 1:- GENERAL (continued)

e. Structural Change (continued)

6. The Yogev Letter and correspondence regarding the structural change (continued)

The issues included in the Draft Report and the Yogev Letter may be of great importance to the Company, its financial position and the continued functioning of the Company as an essential service provider, but to the best of the Company's knowledge, as of the date of the report, the final report of the Steering Team has not been published, and the Company does not know if and when a final report as stated is intended to be published, and the Company also does not know if and when any structural change based on the Yogev letter will be implemented.

The Draft Report and the Yogev Letter have not yet been examined by all the authorized government entities and have not yet been approved by them, and they are not in line with the provisions of the Electricity Sector Law. Implementing a structural change in the electricity sector in accordance with the Draft Report and the Yogev Letter, if and insofar as an agreement will be reached regarding their implementation, fully or partially, and making the Draft Report or the Yogev Letter legally binding, will require approval of all the authorized entities in the State, including the approval of the government, execution of required legislation amendments, and execution of additional actions, none of which have been agreed upon or adopted as of the date of this report and it is not known if they will take place. As of the date of the report, there is uncertainty if and when the Draft Report or the Yogev Letter will be implemented, if at all, and if the Draft Report or the Yogev Letter will eventually be implemented, and it will be according to the discretion of the authorized entities and subject to the law. If all of these will not take place, then it is possible that the Company will be required to implement the structural change as it is outlined in the Electricity Sector Law, either in the manner in which the Company understands that the Electricity Sector Law can be implemented, as described in this Note, or in any other outline.

7. Estimated cost of the structural change insofar as will be implemented according to the outline set in the Yogev Letter

The implementation of the structural change is expected to have material implications on the financial position of the Company and its results, in the short, medium and long term, in accordance with the structural change outline that will be ultimately adopted. The Company estimates that the costs of the structural change, insofar as will be implemented according to the outline set in the Yogev Letter, can be divided into three major categories: (1) compensation for employees with respect to the implications of the structural change on their rights, (2) financial implications related to the arrangement of assets, and (3) residual costs related to the implementation of the structural change.

8. Employee compensation with respect to the implications of the structural change on their rights

According to the calculations of the Company, according to the Company's understanding of the State's proposal within the Yogev Letter, the compensation for employees with respect to the implications of the structural change on their rights is approximately NIS 2 billion. This cost could be significantly higher - insofar and according to the extent to which the employee demands regarding the implications of the structural change on their rights will be accepted. At this stage, the Company cannot accurately estimate which components will be those from which the compensation for employees with respect to the implications of the structural change on their rights will be derived, and these components are expected to be determined in accordance with the issues that will be raised and agreed upon within the negotiations between the parties. The Company estimates that these issues will include, inter alia, the number of employees that will actually retire as part of the structural change, the amount of the structural-change bonus that will be paid to the permanent employees of the Company and the pension supplements. It is noted that according to the estimate of the Company, over time, the Company will be saving as a result of this aspect of the structural change, mainly due to the employee retirement component, but at this stage the Company cannot estimate the extent of the stated savings or their timing.

It is further noted that insofar as there will be early retirement of permanent employees in 2015 as part of the Company's plan to increase efficiency (if and insofar as will be approved and implemented), the costs of implementing the efficiency plan as stated, insofar as they relate to early retirement of employees, may be offset from the cost of compensation for employees with respect to the implications of the structural change on their rights.

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NOTE 1:- GENERAL (continued)

e. Structural Change (continued)

9. Possible financial implications in connection with the structural change - the assets arrangement

In general, the arrangement proposed in the Yogev Letter is an arrangement according to which real estate assets that are serving the Company and are expected to serve the Company in future will remain in the proprietary arrangement existing at present and real estate assets that are not required by the Company as part of its current operations will be transferred to the State by an arrangement that will be determined, and the State will pay for the power stations, system management assets and the land and structures, that the State or the system management company will purchase from the Company, by offsetting the Company's debt to the State, and this is different from the arrangement existing in the Electricity Sector Law, under which, as part of the assets arrangement, the Company will purchase from the State some of the assets it is using.

The assets arrangement, insofar as will be implemented in accordance with the principles set in the Yogev Letter, may have financial implications for the Company in light of the fact that in accordance with the Draft Report and the Yogev letter, the Company will be required to sell and/or transfer certain assets to the State, as extensively detailed in section f below:

- a. According to the Draft Report and as extensively detailed in section f below, the assets that are not serving the Electric Company and that are not required by the Company for the development of the electricity chain will be sold by the Electric Company to the State. The value of these assets has been estimated in the Draft Report as at least NIS 1 billion.

Additionally, this issue has also been raised in the Yogev Letter, according to which the Company will be required to transfer to the State real estate assets that are not required by the Company as part of its current operation, and this will be done within an arrangement to be determined.

In this context it is noted that the Company had significant reservations regarding the contents of the Draft Report on this issue, as there is no complete certainty as to the list of assets that will be transferred or sold, as to the final value of those assets, and as to the question of if and how the Company will be compensated with respect to the transfer of these assets to the State.

- b. In addition, according to the Yogev Letter and as detailed above, the State will pay for the power stations, system management assets, land and structures, purchased by the State or the system management company from the Company, by offsetting the Company's debt to the State. A list of the assets detailed above was not included in the Draft Report or the Yogev Letter, but the Draft Report determined that the market value of the assets that will be purchased from the Company by the State by way of offsetting the Company's debt to the State will not exceed NIS 5.6 billion, and that their value for this purpose will be determined by valuation and in any case will not be less than their balance in the financial statements of the Company that will be agreed upon by the State and the Company by October 30, 2014. If the market value of the assets will exceed the total debt of the Company to the State (hereinafter: the "Surplus Assets"), all decisions regarding the assets that are detailed in the Draft Report will not apply to the Surplus Assets and the State will formulate its position with regard to the Surplus Assets by October 30, 2014.

It is noted that the Company had material reservations regarding the contents of the Draft Report on the sale of the Surplus Assets to the State, including the intention that the payment for the assets will be by way of offsetting a debt.

The financial implications of the implementation of the assets arrangement according to the Yogev Letter may change by paying attention, inter alia, to issues such as the sale value of the assets; rate regulation that will apply to power stations that will be established; possible tax implications; the nature of the assets that will be transferred; rate cover for the costs of clearing out the assets; and possible costs regarding the Company's existing financing agreements, and others. In view of the above, the Company cannot estimate the financial implications of the implementation of the assets arrangement in accordance with the Yogev Letter as stated, and their timing.

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NOTE 1:- GENERAL (continued)

e. Structural Change (continued)

10. Estimated cost of the structural change - residual costs

In addition, the Company estimates that if the structural change will be implemented on the basis of the Yogev Letter, additional costs are expected in connection with the implementation of the structural change, in the amount of approximately NIS 1 billion, inter alia in connection with the direct costs caused by the transfer of the system management activity, establishment of a control and transmission system and other expenses. This amount does not include certain aspects that the Company cannot estimate at this stage, including taxation aspects. These residual costs may materially change insofar as the outline of the structural change is changed.

It is clarified that the estimates of the costs of the structural change are only preliminary estimates, relating to a situation in which the structural change will be executed in accordance with the Yogev Letter, that these estimates may materially change, inter alia by paying attention to the structural change outline that will be agreed upon and implemented, and there is no certainty that additional costs regarding the structural change and its implementation will not be imposed on the Company, and/or that the structural change will not cause additional impacts on the results of the Company, inter alia in light of the rate of activity in the electricity sector that will be executed by private entities after and as a result of the structural change.

11. Resolutions of governmental bodies with respect to the structural change in the last three years

Over the course of the years since the date of the enactment of the Electricity Sector Law, the Government of Israel and the governmental bodies adopted a number of resolutions with respect to the structural change, some of which have been adopted as amendments to the Electricity Sector Law while others have not been adopted into the Law and have not even been implemented.

For details of the letter received by the Company from the Antitrust Authority, under which the General Director of the Israel Antitrust Authority is considering to use the authority vested in him and instruct the Company to refrain from increasing its electricity production capacity, and the Company actions in this matter, see Note 34 b 9) below.

Independently of this letter, in July, 2013, the General Director of the Israel Antitrust Authority presented the Ministers with the position of the Antitrust Authority with respect to the Structural Change, according to which, inter alia, the parallel activities of the Company of generating electricity, transmitting it, distributing it and supplying it to the consumers prevent the development of competition in electricity production, and the dominant position of the Company in each of the activity segments creates an inherent apprehension to operating a market force in a segment in which it is a single supplier, while forcing out competitors and reducing the competition in another segment, where it is exposed to attempts by others to compete with it.

12. The position of the Company with respect to the structural change

The Company regards the implementation of the structural change as a milestone in establishing and reinforcing the financial strength of the Company.

However, in the opinion of the Board of Directors and the Management of the Company, the Electricity Sector Law, in its current version, does not deal with all of the issues that the Structural Change causes to the Company, and does not regulate in detail the manner of its execution, as well as the ways to establish and reinforce the financial strength of the Company. In the opinion of the Company, a real structural change in the Company is vital to its ability to fulfill the functions that are imposed upon it by the Electricity Sector Law and it intends to continue to operate, to the extent possible, to advance a structural change in the real outline, with the consent of the Employees' Organization and the relevant State entities.

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NOTE 1:- GENERAL (continued)

e. Structural Change (continued)

13. The impact of the structural change on the creditors of the Company

In a letter to the Chairman of the Board of Directors of the Company, of February 28, 2007, regarding the legislation of amendment 5 to the Electricity Sector Law, the General Manager of the Companies Authority clarified that implementation of the reform in the Company in accordance with the Electricity Sector Law, including amendment 5 of the same date, will be executed while examining, inter alia, the implications of the structural change on the liabilities of the Company, in order, inter alia, not to prevent repayment of loans taken by the Company.

Furthermore, in the opinion of the Board of Directors and the Management of the Company, executing and implementing the structural change in the Company (in any format) involves addressing issues that pertain to creditors of the Company, in view of agreements with some of them, if they will be affected by the execution of the structural change, subject to the law. For details regarding restrictions applying to the Company by virtue of the loans taken see Note 20 d below.

As of the date of this report, the Company and the State have not yet completed dealing with the stated issues.

14. Labor Disputes

For details regarding the decisions and proceedings of the Courts of Labor concerning labor disputes and sanctions taken with regard to the structural change, see Note 34 c 9) below.

15. The Law to Promote Competition and Reduce Centralization - 2013 (hereinafter: the "Centralization Law")

For details regarding the Centralization Law and its possible impact on the Company see Note 39 n below.

It is noted that as of the date of this report, the actual implementation of the structural change has not yet began, in any outline, and despite the publication of the draft of recommendations of the Steering Team and following the Yogev Letter, there is still material uncertainty as to the final format of the structural change, the date of its implementation or its implications for the Company, its business and results, but implementation of the structural change in accordance with the Yogev Letter is expected to have a material impact on the Company, its business, operation and financial results.

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NOTE 1:- GENERAL (continued)

f. Assets Arrangement

1) Electricity Sector Law Stipulations

Section 62 of the Electricity Sector Law prescribes different directives with respect to certain rights and assets, which were held by the Company on the expiration date of the concessions granted to the Company by force of the Electricity Concession Ordinance (March 4, 1996), despite the provisions of section 46 of part a of the amendment to the Electricity Concession Ordinance ("section 46 to the concession").

According to section 46 of the Concession, at the end of the Concession period, the plant (as defined in the concession) with all its fixed facilities, instruments and materials was intended to be transferred to the holdings of the State (the High Commissioner at the time), free of charge, provided that the State will be appropriately compensated for the fuels, mechanisms, meters and instruments, either stored at the warehouse or transported to the Company or were ordered by the Company, which belong to the Company and for which the Company paid.

Section 62 of the Electricity Sector Law states the following:

- a) Despite the provisions of section 46 of the Concession, the liabilities of the Company, as well as the rights and assets which it held at the time that the concession expired, and for which it is entitled to compensation from the State pursuant to the aforesaid section, will remain with the Company (i.e., will not be transferred to the State) and no compensation will be paid for them ("Compensable Assets").
- b) The rights and assets for which the Company is not entitled to compensation, as stated above in sub-section (a), and which are used or were designated to be used, whether directly or indirectly, for its operations pursuant to the Electricity Sector law, will be purchased by the Company according to their value on the date the rights and assets were acquired, in accordance with an arrangement to be signed between the State and the Company ("The Assets Arrangement"); in this section "are used" or "were designated to be used", as will be determined by the Ministers ("Non-Compensable Assets in Use").

The Electricity Sector Law also states that until the assets arrangement referred to above in sub-section (b) is carried out, the assets and rights, as to which the arrangement is being prepared, will remain with the Company, as they were at the time that the concession expired. According to the Electricity Sector Law, in view of the fact that the parties did not arrive at an arrangement in this matter by March 1997, the Ministers will have to determine provisions as to the acquisition of the aforesaid rights and assets.

Moreover, similar to the Electricity Concessions Ordinance, the Electricity Sector Law does not specify which assets and rights are compensable assets with respect to which the Company is not required to pay the State, and also does not specify which assets and rights are assets in use that are non-compensable, for which an assets arrangement should be drawn. Moreover, the Electricity Sector Law does not define the manner and method for calculating the value of the assets and rights that will serve as the basis for determining the acquisition cost of these assets under the assets arrangement. Therefore, and in view of the time that elapsed, the Company cannot estimate when, if at all the ministers will issue instructions on the arrangement and its implementation.

Section 62(d) of the Electricity Sector Law also obliges the Company to indemnify the State with respect to any payment paid by the State for any of the Company's liabilities in force at the concession expiration date, arising from its expiration or from implementing the provisions specified in sub-sections (a) and (b) above.

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NOTE 1:- GENERAL (continued)

f. Assets Arrangement (continued)

2) The Position of the Company Regarding the Assets and Rights Classification

Based on the opinion of its legal advisors, the Company classified the rights and the assets into three groups: (a) rights and assets that are compensable assets, to which the assets arrangement will not apply; (b) rights and assets that are assets in use that are non-compensable to which the assets arrangement will apply; and (c) Non-compensable assets (attributed to the first group of assets) and are also not assets in use which are non-compensable (attributed to the second group of assets) for which section 62 of the Electricity Sector Law does not prescribe any arrangement, however, in the absence of use or designated use by the Company, they are not considered as assets in use that are non-compensable and therefore, the Company believes, based on the opinion of its legal advisers, that these assets were not intended to be transferred to the State at the end of the concession and would have remained the property of the Company, which the Company does not need to buy from the State ("Unused Non-Compensable Assets").

It should be noted that in the opinion of the State in 2000 ("the State's Opinion"), the State believes that the assets in this third category were transferred to the ownership of the State at the end of the concession. According to the opinion of the State, "all the remaining non compensable rights and assets, which were not expected to be bought from the State, are actually held by the State, from the effective date of the Electricity Sector Law and all the resulting implications".

3) The Opinion of the State

In February 2000, the Company received a letter from the Deputy Commissioner of Budgets at the Ministry of Finance in which he indicates that as part of the activities of the Governmental team that was appointed to deal with the issue, an economic, accounting and legal State opinion was prepared (and was attached to the letter to the Company), regarding the assets arrangement. The letter also stated, that according to the contents of the opinion of the State, it seems that implementation of the assets arrangement in accordance with the Electricity Sector Law might have a material effect on the Company.

According to the State's Opinion and in reference to the provisions of sections 44(c) and 46 to the concession, the Company is not entitled to compensation for investments already refunded through provisions for depreciation (namely, these assets are not included in the compensable assets group). Notwithstanding, based on the assets classification in the opinion of its legal advisers, the Company believes that the majority of its assets on the Concession expiration date (both fully depreciated depreciable assets on the concession expiration date and depreciable assets that were not fully depreciated on the concession expiration date, except assets in a marginal volume) are compensable assets.

The State's opinion included in its definition of the non-compensable assets to which the assets arrangement is supposed to apply, the assets (some of which could be defined as being "used" or "intended to be used" and some as "not used" or "not intended to be used") (the description of the assets is quoted from the economic opinion, written for the Chairman of the Governmental team for returning the assets of the Company arrangement): which at the time the Concession expired were fully depreciated, or partially depreciated, in the amount of what was depreciated (namely, with respect to each compensable facility, installation or repair, the compensation will be paid only with respect to the non-depreciated balance) and non-depreciable assets and rights of the Company, including land and companies held by the Company, except cash money and securities to money. The State also includes in its opinion as non-compensable assets, installations installed and repairs performed by the Company, if these were financed by share capital (profits that were not distributed, deriving from dividend and profits to which the "owners" were entitled according to section 34 to the supplement to the Electricity Concessions Ordinance) or by payment of a party interested in a connection (payment/ deposit paid by whoever requested the Company to connect any site to the electricity supply system, by building an electricity grid, including a load increment).

The economic opinion of the State includes a wider specification of the non-compensable assets to which the assets arrangement should apply and also of compensable assets. It also sets criteria and an economic model (including calculation formulas) for attributing and classifying these assets.

The adjusted cost of the fully depreciated assets, as detailed above, as it appears in the Company's Financial Statements as of March 31, 1996, is approximately NIS 4.46 billion (approximately NIS 7.5 billion of December 2014). The Company estimates that these assets include mainly power stations, transmission and distribution facilities, real estate properties and various assets such as equipment, machinery and various buildings.

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NOTE 1:- GENERAL (continued)

f. Assets Arrangement (continued)

3) The Opinion of the State (continued)

The net depreciated cost in the Company's books, of the partially depreciated assets, to the extent of the depreciated balance, net of the liabilities according to a certain rate, which depends on their financing sources (estimated by the Company to primarily include power plants, transmission and distribution facilities, certain real estate and additional equipment) and non-depreciable assets of the Company, estimated by the Company to include primarily intangible assets and shares of investee companies, but not cash and inventory, amount, as aforementioned as of March 31, 1996 to approximately NIS 4.5 billion (approximately NIS 7.5 billion in NIS of December 2014).

The aforementioned data are data as of March 31, 1996, yet the determining date is the end of the concession date, namely, March 4, 1996.

As calculated by the Company in accordance with the State's opinion, the cost in the books of non-compensable assets for which the assets arrangement will be applied, and for which the Company will be required to pay consideration to the State is approximately NIS 4.5 billion as of March 31, 1996 (approximately NIS 7.5 billion in NIS of December 2014).

Despite the abovementioned, most of the balance of the stated assets has been depreciated in the Company books since March 31, 1996.

In the Company's opinion, one should not infer the economic value of the assets from the amounts indicated above on the assets costs in the Company's books, where pursuant to this economic value, the amount which the Company is liable to be requested to pay will be determined according to the assets arrangement, even if the position presented in the State's Opinion is accepted and the value may be lower or higher.

In March 2000, just after the State's Opinion was received, the Director of the Electricity Authority in the Ministry of National Infrastructures, Energy and Water (The Ministry of National Infrastructures at the time) requested in a written letter to the Company, as instructed by the Minister, not to respond to the Ministry of Finance's communication with regard to the matter of the assets arrangement, as long as the matter had not been discussed in an orderly manner between the offices of the Ministers and between the Company and the Ministry of Energy and Water. Therefore, the Company did not respond at the time to the aforesaid communication of the Ministry of Finance. To the best knowledge of the Company, the subject was discussed in the past by a Government team, but no progress was made since then. The Company was notified that the need to address the issue of the assets arrangement was mentioned in the past, in discussions of different Government entities. Furthermore, in November, 2011, the Company received a draft of an interim report of recommendations by a team of regulators that was established in May 2009, by virtue of a Government Resolution, with the participation of the Director General of the Ministry of National Infrastructures, Energy and Water, the Budgets Commissioner of the Ministry of Finance, the Director General of the Government Companies Authority, the Manager of the Electricity Administration in the Ministry of National Infrastructures, Energy and Water, the Commissioner of Wages and Labor Agreements and the Comptroller General, or their representatives, under which, inter alia, it is proposed to reexamine the implications of the assets arrangement, according to section 62 to the Electricity Sector Law, 1996, including in view of the legal and economic opinions existing in this matter and its implications at the time of implementation of the structural change.

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NOTE 1:- GENERAL (continued)

f. Assets Arrangement (continued)

4) The Opinion of the Company

The opinion of the State does not match the opinion of the legal advisors of the Company. Based on the opinion of its legal advisors (in the absence of a specification regarding classification of the assets in section 62(a) of the Electricity Sector Law and in the absence of a ruling on the subject, and based on the purpose of the law and the intention of the legislator, as expressed in discussions held on the eve of legislating the Electricity Sector Law), the interpretation that all the assets which are depreciable, even if fully depreciated on the expiration date of the concession, should be included in the compensable assets group should be preferred over the interpretation of the State in its opinion, which states that all the assets of the Company which were fully depreciated on the concession expiration date and were recognized in the rate through a provision for depreciation constitute non compensable assets, whereas assets that were not fully depreciated constitute non compensable at the rate of the amount depreciated, net of a certain rate of the liabilities.

Based on the opinion of its legal advisors on the appropriate interpretation of the assets arrangement, including the classification of the assets to which it will apply, and taking into consideration the provisions of the Electricity Sector Law (including those mentioned above) and section 46 of the Concession, the Company classifies the majority of the assets it held on the Concession expiration date (both fully depreciated depreciable assets and depreciable assets which were not fully depreciated at the time the concession expired, and excluding assets in a marginal amount), are compensable assets, and as such, assets that will remain the property of the Company, for which no compensation will be paid by the State and will not be included in the assets arrangement, therefore, the Company will not be required to pay consideration to the State with respect to these assets. In the opinion of the Company, the assets arrangement will therefore apply to non-compensable assets in use only, which did not constitute the majority of the Company's assets on the Concession expiration date. Therefore, the Company estimates, that the implementation of the assets arrangement should not have and does not have a material effect on the Company or its financial results or financial position.

However, the matter is to be decided by the Ministers. As far as the Company knows, as of the date of the report, the Ministers did not conclude any recommendations on the subject of the assets arrangement as yet. Therefore, the Company cannot estimate the actual conclusions regarding the assets arrangement, its implications (if any) on the Company and there is no certainty that the implementation of the assets arrangement will not have a material effect on its financial condition.

Moreover, the Company is of the opinion, based on the opinion of its legal advisors, that the interpretation of section 62 to the Electricity Sector Law in a manner which will obligate the Company for the payment of the above amounts or any similar amount, in order to purchase the assets from the State, will be contrary to the declared purposes and objectives of the Electricity Sector Law, contrary to the principles of the correct and appropriate interpretation and will constitute an impairment of the proprietary rights of the Company. According to the legal opinion of the Company's legal advisors, the interpretations of section 62(a) to the Electricity Sector Law should be preferred so there is no significant impact on the Company's equity and its financial strength by the possible positioning of the loans taken by the Company (including debentures issued by the Company) for an early payoff and will cast a doubt as to its ability to repay its liabilities and to continue operating as a going concern, while the explicit intention of the legislator was that the Company will exist and fulfill the functions it was assigned and the tasks imposed upon it in the Electricity Sector Law and in the licenses granted to it by virtue of it.

Without derogating the position of the Company regarding the interpretation of section 62 to the Electricity Sector Law, based on the legal opinion it received, the Company will have a good argument, that the acquisition cost of the assets and rights applied to the Company, if and provided it will be obligated to pay for them according to the assets arrangement, should be recognized as part of the costs in the electricity rate, and therefore, accepting the opinion of the State means that the electricity consumers will be obliged to pay for the assets once again, after the acquisition by the Company was already paid for in the past by the consumers by means of the electricity rate. The opinion was also prepared on the basis of the assumption that the Electricity Authority will be reluctant to approve these costs through the rate (again), due to public reasons. The opinion of the State did not relate to this argument and did not confront it. The opinion of the State does not relate to the recognition of the assets and rights purchase cost within the framework of determining electricity rates by the Electricity Authority.

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NOTE 1:- GENERAL (continued)

f. Assets Arrangement (continued)

5) The draft of recommendations of the Steering Team

As detailed in section e above, on March 23, 2014, the draft of recommendations of the Steering Team was published for comments by the public, and it included, inter alia, recommendations by the team relating to the issue of the assets arrangement. In this framework, the Steering Team recommended that arrangements will be set with regard to implementation of the assets arrangement in accordance with the following principles:

- a. The Company will submit a complete list of all the assets in its possession (hereinafter: the "Assets List") to the Director General of the Government Companies Authority.
- b. Regarding assets that are serving the Company in the electricity chain - the ownership or lease arrangements in effect to date will be continued.
- c. Regarding assets required by the Company for future development of its activity segments or for populating units - a committee will be established with the participation of representatives of the Company, the Ministry of National Infrastructures, Energy and Water, the Ministry of Finance and the Government Companies Authority (hereinafter: the "Reserves Committee") and it will examine and determine the assets that fall under this definition. These assets will be leased by the Electric Company from the State for a period of 49 years, without consideration, or arrangements such as are presently practiced will be set with respect to them (according to the decision of the Reserves Committee).
- d. The assets that are not used by the Company and not required by it to develop the electricity chain in accordance with the Assets List or in accordance with the determination of the Reserves Committee will be sold by the Electric Company to the State.
- e. The rights, land and assets that the Company will be requested to transfer to the State will be transferred by the Company free of nuisances, soil pollution, etc, according to rules that will be determined.
- f. Regarding assets that are to be returned to the State according to unique arrangements, including assets whose lease period has terminated and is not supposed to be extended, or assets that are to be expropriated according to unique arrangements, the existing arrangements will apply to them and the rest of the decisions regarding assets that are detailed in the Committee's report will not apply.
- g. Financing the purchase of the power stations, system management assets, land and structures - the State will pay for the power stations, system management assets and land and structures that the State will purchase from the Company or that the system management company will purchase from the Company, by offsetting the Company's debt to the State, including debt secured by perpetual debentures, up to the market value of the assets, according to valuations, and in any case their value will not be less than their balance in the financial statements of the Company that will be agreed upon by the State and the Company by October 30, 2014. The debt balance as of June 30, 2013 is approximately NIS 3.1 billion, and the perpetual debenture balance is approximately NIS 2.5 billion. Insofar as the market value of the stated assets will exceed the total debt of the Company to the State (the "Surplus Assets"), then all the decisions detailed in the Committee's report regarding the assets will not apply to the Surplus Assets and the State will formulate its position regarding the Surplus Assets, by October 30, 2014. Assets that the State regards as assets it owns will be transferred to the State without consideration, as part of the implementation of the comprehensive settlement.
- h. Up to October 30, 2014, an umbrella agreement will be determined between the Israel Land Authority and the Company, arranging all the contractual engagements between the parties and including reference to the following issues, among others: planning for optimal residence and use of land that is not required for the needs of the Company, promoting subjects that are the responsibility of the Company in all that relates to residential and other plans of national importance and developing electricity infrastructure that will serve the realization of these national plans.
- i. By October 30, 2014, the State and the Company will examine the various taxation aspects of the steps included in this document.
- j. The Company will undertake not to claim ownership of rights, land and other assets that are not included in the Assets List and the State will be permitted to receive these assets without consideration on the date on which the Electric Company will notify the State about them.
- k. Implementation of all the asset arrangements detailed above by the State is conditional on the full implementation of the subjects requiring arrangement, as detailed above, by the Company.
- l. Every sale or transfer of assets or liability by the Company, including to a subsidiary, will be executed subject to the law and taking into account the restrictions included in the debt raising documents of the Company.

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NOTE 1:- GENERAL (continued)

f. Assets Arrangement (continued)

5) The draft of recommendations of the Steering Team (continued)

On May 7, 2014, the Company presented the Steering Team with its initial reaction and position with regard to all the recommendations Draft of the Steering Team. As part of this, the Company had reservations from part of the Team's draft of recommendations regarding the assets arrangement (in this context see also section e 13 above, under the heading "The impact of the structural change on the creditors of the Company"). Additionally, an arrangement should be made for the issue of selling the assets to the State (valuation mechanism, evacuation costs, taxation) and for the assets that are excluded from the assets arrangement for which various arrangements will apply.

As stated in section e above, on September 8, 2014, the Company received the Yogev Letter. Following is the referral to the issue of the assets arrangement in the stated letter:

- Real estate assets that are unnecessary to the current operation of the Company will be transferred to the State according to an arrangement that will be determined.
- The State will pay for the power stations, system management assets and assets sold by the Electric Company to the State or the system management company, by offsetting Electric the Company's debt to the State.
- Real estate assets that are serving the Company and are expected to serve the Company in the future will remain in the arrangement existing at present.

For details of the expected financial implications with respect to the implementation of the assets arrangement, if and insofar as will be implemented in accordance with the Yogev Letter, see section e 9 above under the heading "Estimated cost of the structural change - the assets arrangement". It is noted that insofar as the assets arrangement will not be implemented according to the Yogev Letter and will be implemented according to the provisions of section 62 of the Electricity Sector Law, the assets arrangement is expected to be executed in a materially different manner than that set in the Yogev Letter and there is no certainty as to its cost or implication on the financial position of the Company in this case.

For additional details of the structural change in the Electric Company and the Draft Recommendations of the Steering Team, including with regard to the letters from the Director of the Government Companies Authority and the Commissioner of Wages and Labor Agreements in the Ministry of Finance received by the Company, and the reaction of the Chairman of the New National Labor Federation in this matter, see section e above.

It is noted that the Draft Recommendations of the Steering Team and the Yogev Letter have not yet been examined by all the authorized government entities and have not yet been approved by them, and they are not in line with the provisions of the Electricity Sector Law. Implementing a structural change in the electricity sector in accordance with the Draft Report and the Yogev Letter, if and insofar as an agreement will be reached regarding their implementation, fully or partially, and making the Draft Report or the Yogev Letter legally binding, will require approval of the authorized entities in the State, including the approval of the government, execution of required legislation amendments, and execution of additional actions, none of which have been agreed upon or adopted as of the date of this report and it is not known if they will take place. As of the date of the report, there is uncertainty if and when the Draft Report or the Yogev Letter will be implemented, if at all, and if the Draft Report or the Yogev Letter will eventually be implemented, and it will be according to the discretion of the authorized entities and subject to the law. If all of these will not take place, then it is possible that the Company will be required to implement the structural change as it is outlined in the Electricity Sector Law, either in the manner in which the Company understands that the Electricity Sector Law can be implemented, as described in section e above, or in any other outline.

The Company estimates that as of the date of this report, the assets arrangement does not have a material impact on the Company or its financial results or its financial position. However, the Company cannot estimate what the actual conclusion will be with regard to the assets arrangement, what its implications (if any) will be for the Company, and it has no certainty that a future implementation of the assets arrangement will not materially impact its financial position.

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NOTE 1:- GENERAL (continued)

g. Environmental Protection Laws

- 1) The Company's activities are subject to different environmental protection laws and regulations on different issues, e.g., emission of pollutants into the air, soil and water pollution, noise abatement, non-ionizing radiation, storage and use of hazardous materials and fuels, asbestos and more. The Company believes that as on the date of this report it is in material compliance with the directives of the laws on environmental protection. The Company holds the environmental licenses required for its activity and acts to obtain any missing licenses. Non fulfillment of the environmental provisions of the law and the conditions of the licenses granted to the Company by virtue of them may impose a criminal and administrative exposure on the Company, including fines and sanctions and shut down injunctions for installations, and exposure to expenses of cleaning and rehabilitating environmental damage.
- 2) In December 2010 the lateral order was signed, within which the Company was required, inter alia, to act towards reducing the airborne emissions from the coal operated power stations. In the month of July 2011 the Ministry of Environmental Protection approved the plan, submitted by the Company, to reduce the emissions into the air, under which installations for reducing emissions will be gradually installed in the coal operated power stations of the Company, and some of the natural units will be converted. Installing the installations and converting the units involves massive investments. Following requests by the Company to postpone the project dates due to events outside the control of the Company, in February 2014, the approval of the Ministry for Environmental Protection for postponing the completion dates of the projects, so that the last project will end by June 30, 2018, was received, subject to terms. See also Note 3g below.

As of March 2014, the Company notified the Ministry for Environmental Protection that in the absence of a clear and suitable outline of rate recognition for the project, it will be difficult for the Company to complete the emission reduction project on their latest dates. In addition, the Company applied to the Deputy Attorney General and other relevant entities and requested their intervention in order to coordinate between requirements of the various government entities regarding the projects, and so that the date of the rate recognition and the manner of spread will suit projects of this kind. Furthermore, as of May 2014, the Company has notified the Ministry of additional events that are outside its control and may result in the Company's inability to meet the updated dates of the project, among others the Zuk Eitan Operation, restrictions in the field of labor law that prevent intake of new employees instead of those that ended their period of employment in the Company, and the impasse in negotiations regarding the structural change.

In October 2014, the Authority clarified that it recognizes the project in principle but the rate recognition will in any case be subject to principles to be determined, cost control and providing additional data of the Company.

In December 2014, a letter was received from the Ministry for Environmental Protection, under which the Ministry intends to assimilate obligating interim dates for executing the emission reduction project in the conditions of the business license and the emission permits of the Orot Rabin and Rutenberg power stations in order to comply with the schedules that were approved in the past. A draft of an amendment to the conditions of the business license of the Orot Rabin site was attached to the letter for comments by the Company. The draft of conditions anchors obligating interim dates for the advancement of the project. In February 2015, the Ministry sent a draft of an emission permit for the Rutenberg site in which, inter alia, milestones are anchored for implementation of the emission reduction project in this site. The Company applied to the Ministry for Environmental Protection and the Ministry of National Infrastructures and also held meetings with the relevant ministries in which the Company presented its position and requested that the target dates of the project will be postponed, interim dates will not be anchored and reexamination of the format of emission reduction from units 1-4 at Orot Rabin will be conducted in view of the events mentioned above.

These applications received the reaction of the Ministry for Environmental Protection which noted, inter alia, that they do not intend to refrain from specifying the milestones in the updated conditions of the business license and the emission permit and the Company is given the opportunity to relate to the proposed milestones themselves. In February, the Company's response was sent to the Ministry of Environmental Protection, requesting an extension for delivery of a detailed response to the terms of the Orot Rabin business license and the Rutenberg emission permit, after exhausting the present negotiations between government entities regarding integration of milestones into the projects and the suitable outline for emission reduction at the Orot Rabin units 1-4. The Company is continuing to hold meetings with the relevant ministries on this matter.

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NOTE 1:- GENERAL (continued)

g. Environmental Protection Laws

The position of the Ministry of Environmental Protection is that insofar as the Company will not receive an extension to the schedules, it will be against the law to operate the coal units after the dates set in the provisions without means to reduce emissions

- 3) As at the signing date of the financial statements, several proposed environmental bills and regulations are in various stages of enactment. Furthermore, the Ministry for Environmental Protection published guidelines for treating contaminated soil, and they may have material implication on the Company if they will be integrated into the obligating permits or documents received by the Company.
- 4) During recent years an increase has occurred in the environmental demands that apply (or that are undergoing legislation procedures) to the operation of the Company and in the supervision and enforcement of these demands. The Company is studying the material economic, legal, operational and technical implications for its activity which may arise from the directives, laws, regulations and environmental bills. The Company allocates funds in its budgets to fulfill the directives of the laws applied to it and those expected to be applied. As on the date of this report, and based on the directives of the Electricity Sector Law, the Company estimates that the material costs which will be applied as a result of new regulatory requirements related to environmental protection will be covered within the framework of the electricity rate. The decision on recognizing the costs is given to the Electricity Authority.

h. Definitions

Related Parties	–	As defined under International Accounting Standard 24
Dollar	–	US dollar.
Subsidiary Companies	–	Companies either directly or indirectly controlled (as defined under IAS 27) by the Company and whose financial reports are fully consolidated with those of the Company.
Held Companies	–	Subsidiary companies and investee companies.
Associate Companies	–	Companies in which the Company has material influence.
Total Electricity Consumers	-	All the electricity consumers in Israel that are customers of the Company and that are customers of private producers.
IFRS	-	International Financial Reporting Standards
SFAS	-	Statement of Financial Accounting Standards
IAS	-	International Accounting Standards

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES

a. The Basis of Financial Reporting

The Consolidated Financial Statements (hereinafter: "The Financial Statements") are prepared in compliance both with the provisions of the Securities Regulations (Annual Financial Statements), 2010 and of the Government Companies Regulations (Principles for the Preparation of Financial Statements of the Israel Electric Corporation Ltd.) (Ad Hoc Provision) - 2004, and all relevant amendments (hereinafter: "Government Companies Regulations") (as explained in section 1 below).

1) Government Companies Regulations

General

The Minister of Finance is entitled, in consultation with the Minister of Justice and, in the event of a public company, in consultation with the Securities Authority, to determine in accordance with a proposal of the Companies Authority, principles for preparing financial statements of a Government company, that was defined by him as a company that provides essential service to the public, including details contained in the statements, the accounting principles used in their preparation and statements and attached notes.

Should the Government Companies Authority feel that the public interest so requires, it is entitled to instruct a Government company as to the manner in which to present details in its financial statements, or in any other report that the Company is required to submit pursuant to any law, provided that the instructions covering this matter are not determined in the rules, laws or generally accepted accounting principles or generally accepted reporting principles.

If the Companies Authority objects to the presentation method of details in the financial statements or any other report that the Government company is required to submit pursuant to any law, it is entitled, if it deems that a public interest requires it, to instruct the Company to disclose the position of the Companies Authority and to describe the dispute in the Financial Statements, to the satisfaction of the Companies Authority.

The general accounting standards for Government companies are the same as for the private sector. The unique standards for Government companies aim to supplement the private sector's standards or to elaborate or highlight certain issues regarding Government companies as detailed in the Government Companies Authority's circulars. The unique standards for Government companies will be executed in accordance with the law.

The Government Companies Regulations, updated as of the date of this report, were published in the Official Gazette on June 30, 2008 (the original regulations were published in 2004, as aforesaid, and were also amended in 2006, 2008, 2009, 2010, 2011, 2012, with the transition of the Israeli economy to international standards). The updated regulation included directives on a standard for regulated companies (see Note 2 a below) due to the fact that the then international standards did not include, standards related to regulated companies. Under the Israeli standard, prior to the transition period of the economy to international standards, the Company adopted an American standard for regulated companies – (RE6). The regulations were extended several times since then and are applied to the Financial Statements up to December 31, 2014, to these Financial Statements and the interim periods of these years, including comparative data included in these Financial Statements.

Under the directives of the Government Companies Regulations, Rules for Preparing the Financial Statements of the Company are as follows:

- a) The Financial Statements as of the date included in the transition period will be prepared in accordance with the International Financial Reporting Standards (IFRS), and the interpretations adopted by the International Accounting Standards Board (IASB), including IFRS 1 which, for our purposes, the date of transition to International Financial Reporting Standards is January 1, 2007.

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

a. The Basis of Financial Reporting (continued)

1) Government Companies Regulations (continued)

- b) Notwithstanding any of the instructions of Section a) above, the Company has not implemented the IFRS in full, due to the rules for preparing financial statements that are detailed below:
- (1) The Company will prepare its Financial Statements with adjustment for changes in the general purchasing power of New Israeli Shekels (NIS) (according to the rules established in Opinion No. 36, including the provisions set in Opinions Nos. 40, 50 and 56, of the Institute of Certified Public Accountants in Israel), see details in section 3 below.
 - (2) The Company is a regulated company and therefore, prepares its Financial Statements under the principles of the US Financial Accounting Standards Board (FASB) as listed in Chapter RE6 with respect to regulated activities ("Chapter RE6"), in the combined version of the standards of that Board, including revisions, clarifications or additions to these principles, as they were from time to time (hereinafter "Standard for Regulated Companies"), see details in sections 2) and 5) below.
- c) The manner of applying International Financial Reporting Standards and the interpretations adopted by the IASB will be modified or adjusted as required for purposes of implementation.
- d) In these notes to the Financial Statements (under the Securities Regulations), since the Company is expected to transition to full implementation of IFRS as of January 1, 2015, both a qualitative disclosure explaining the aspects in which the reporting principles implemented in the Financial Statements of the Company are different from the IFRS, and a full quantitative disclosure for the transition to IFRS, are provided in Note 36 below.

Reporting Directives under the Government Companies Regulations

In January 2012, the Director General of the Government Companies Authority decided to accept the recommendation of the Advisory Committee to the Director General of the Government Companies Authority, pursuant to which the effective period of the regulations should be extended until December 31, 2014. Consequently, on May 22, 2012, the Minister of Finance signed the extension of the regulations until December 31, 2014. The extension of the regulations was published in the Official Gazette on May 30, 2012.

According to the decision of the Government Companies Authority, these financial statements are the last ones that are prepared in accordance to the Government Companies Regulations. As from January 1, 2015, the Company should fully implement International Financial Reporting Standards (hereinafter: the "IFRS Standards"), see Note 3d and Note 36 below.

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

a. The Basis of Financial Reporting (continued)

2) Main Principles of the American Financial Accounting Standards Board (FASB), Specified in Chapter "RE6" on Regulated Operations

Under the financial reporting principles of the Company in accordance with the Government Companies Regulations, the Company applies the Standards of the Financial Accounting Standards Board in the U.S.A., (FASB) as listed in Chapter RE6, which deal with the effects of certain types of regulation on the accounting policies ("the Standard"). The Standard was published in order to determine and define how generally accepted accounting principles must be applied for regulated companies and how decisions by the regulatory agency must be reflected in the Financial Statements of these companies. Under certain circumstances, the Standard permits accounting treatment other than that accepted with regard to the timing of attribution of expenses and income to operations, all for the purpose of reflecting and creating proper matching between expenses and income incurred by the Company on the dates when they are recognized for purposes of the electricity rates.

The Standard applies when all three conditions listed below are met:

- a) Regulation of rates - rates of regulated products or services are either established by an independent third party regulator or by a committee so empowered, or are subject to authorization by such regulator or committee, all under legal or contractual provisions governing consumer rates
- b) Specific coverage of costs - regulated rates are so constructed as to cover the specific costs (including required return on capital) associated with the provision of the regulated product or service.
- c) Competition and collectability from customers – in view of the demand for the regulated product or service and also of the level of direct and indirect competition, it would be reasonable to assume that the rates established so as to cover the costs are chargeable and collectible.

These conditions may also be applied to separate portions of activities, such as generation or transmission of electricity, or to a specific sector of consumers.

In the event that the conclusion is reached that the Company no longer meets the conditions listed above for the application of the Standard, the regulatory assets/ liabilities should be deleted, based in directives defined in that standard. A company meeting the conditions above will capitalize the expenses which would have otherwise been attributed to the statement of profit and loss, while the regulatory agency establishes rates which would cover these expenses in the future. Expenses capitalized as above are a regulatory asset. Such companies must also record regulatory liabilities consisting mainly of refunding consumers for collection or postponement of income to a later date (see Note 9 below).

The Standard requires that the regulated entity reevaluate the probability of coverage of regulatory assets as of any date that it publishes Financial Statements. In the event that the conclusion is reached that the Company no longer meets the conditions listed in section 1 above for the application of the Standard "Chapter RE6" and not all regulated assets are covered by the rates, the regulatory assets/liabilities should be erased from the statement of financial position.

Provision for Assets Impairment according to SFAS 90

Under the Company's financial reporting principles as based on the Government Companies Regulations, the Company applies, inter alia, the provisions of SFAS 90, included in Chapter RE6, which is intended to provide guidelines on the required accounting treatment in cases of asset abandonment or denying cost coverage of assets where construction was recently completed. Assets where construction was recently completed are assets built after determining the previous rate base which therefore were not included in that rate. Namely, assets for which no rate was initially determined after they were commissioned.

According to SFAS 90, part of the assets cost should be recognized as an immediate loss, in that part of the asset's cost (which conformed to the definition of a recently completed asset) which will not be covered under a future rate, provided that the following two conditions are met:

- (a) Anticipated coverage shortage with respect to certain costs.
- (b) It can be measured reliably.

The Company performs this test at every financial statements publication date.

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

a. The Basis of Financial Reporting (continued)

2) Main Principles of the American Financial Accounting Standards Board (FASB), Specified in Chapter "RE6" on Regulated Operations (continued)

Capitalization of Financing Costs

Financing and capital costs with respect to construction of fixed assets that are recognized in the electricity rate are recorded as part of assets under construction, when a "very certain" probability exists that these costs will be recognized in the rate. Financing and capital costs are capitalized to assets under construction until the date on which these assets are substantially complete for the designated use. Capitalized financing costs with respect to construction are recorded as a reduction of financing expenses. Capitalization of costs on return on equity with respect to construction are recorded as other income, see section i below.

3) Principles of Adjusting the Financial Statements According to Changes in the General Purchasing Power of the NIS

General:

- a) As stated above, the Company prepares its Financial Statements on the basis of historical cost, adjusted for changes in the general purchasing power of the NIS.
- b) The adjusted values of non-monetary assets do not necessarily represent the market value of these assets or their value to the Company, but only their cost adjusted for changes in the general purchasing power of the NIS.
- c) In the adjusted statements, the term "cost" shall mean "adjusted cost".
- d) The comparative figures in these Financial Statements were adjusted to NIS of the statement of financial position month.
- e) Statement of Financial Position
 - (1) The amounts of non-monetary items (items that their balance in the statement of financial position reflects their historical values on the date of their acquisition or creation – see below) have been adjusted on the basis of the changes in the CPI for the month ending in the reporting period.
The following items have been treated as non-monetary items: fixed assets, intangible assets and the amortization accumulated thereon, capital raising expenses, inventories, prepaid expenses, receipts and expenses in respect of work in progress, capital reserves and share capital.
 - (2) Monetary items (items that their balance in the statement of financial position reflects current values or realization values as of the date of the statement of financial position) are presented in the statement of financial position adjusted for the cut-off date in an amount that is equal to their nominal amount as of that date (the comparative figures have been adjusted to NIS of the month of the statement of financial position).
- f) Statement of Operations and Comprehensive Income and Loss
 - (1) The components of the statement of operations (excluding financing) that reflect transactions carried out in the reported year – revenues, expenses etc. – have been adjusted based on the changes in the CPI for the month of each transaction through to the CPI for the month ending in the reporting period. The erosion of monetary balances that relate to such transactions was included under financing, net.
 - (2) The components of the statement of operations that relate to non-monetary items in the statement of financial position (such as depreciation and amortization, changes in inventory, expenses and income received in advance) have been adjusted on the same basis that was used in adjusting the related statement of financial position items.
 - (3) The components of the statement of operations that relate to provisions that are included in the statement of financial position (such as: provisions for pension and severance pay, vacation fees and contingent liabilities) have been determined on the basis of the change in the balances of the related items in the statement of financial position, after taking into account the cash flows in respect thereof.
 - (4) The item of financing, net reflects real financing expenses and income, including erosion of the monetary items during the year.

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

a. The Basis of Financial Reporting (continued)

4) Transition to International Standards on January 1, 2015

- a) From January 1, 2015, the Company will fully implement the IFRS standards in its financial statements. On August 21, 2013, the reply of the Securities Authority (to a preliminary application by the Company regarding the manner of transition to international standards) was received, under it the Company received an exemption from the obligation to include comparative data for two years in its first financial statements that are prepared under the IFRS standards (the reports of 2015 only) and the Company will be permitted to include comparative figures for one year (2014) in these reports only. In addition, the date of transition to the IFRS standards was set as January 1, 2014.
- b) As stated in section z 4) below, in January, 2014, International Financial Reporting Standard number 14 was published, regarding deferred regulatory accounts (hereinafter: the "Standard" or "IFRS 14"). The standard enables a Company that implements the IFRS provisions and reporting rules for the first time to continue to implement the existing practice on the subject of recognition of regulatory assets and liabilities. Therefore, the Company will recognize regulatory deferred accounts, which are essentially similar to the regulatory assets and liabilities existing in these statements, in its financial statements that will be prepared in accordance with IFRS standards.
- c) According to the international standards as of the date of transition, the Company will use the relief provided under IFRS 1 to determine the "deemed cost" of the fixed assets and the other assets as cost, that was presented in the Financial Statements as of December 31, 2013.

Regarding the implications of the transition to the international standards see Note 36 below.

5) Qualitative Disclosure

For details of the main gaps between the financial reporting rules applied in these Financial Statements as detailed above and the IFRS, that will apply to the Company as of January 1, 2015, including after implementation of IFRS 14 as detailed above, see Note 36 b below.

- 6) The Electricity Sector Law prescribes that licensed essential service suppliers will prepare their financial statements as required by the Ministers in consultation with the Minister of Justice with regard to their level of detail, the accounting principles under which they are prepared, and any attached declarations and notes. Such instructions and obligations with regard to the Company's Financial Statements have not yet been established by the Ministers.

7) Material Valuations

In accordance with Section 8b of Regulation 1 of the Securities Regulations (Periodic and Immediate Reports) – 1970, the Company is required to provide disclosure for valuations that are material to the Company. Therefore, the Company applied a quantitative test that considers as material a single asset/liability valued at 5% or more of the total assets of the Company as of the Periodic Statements date or a single asset/liability, where the change in their value is 5% or more of the net profit or comprehensive profit for the reported period, as well as the stated change constituting at least 2.5% of the equity of the Company.

8) Highly Material Valuations

In accordance with Section 8b of Chapter 1 of the Securities Regulations (Periodic and Immediate Reports) – 1970, the Company is required to attach to the periodic reports valuations that are highly material to the Company. Therefore, the Company applied a quantitative qualitative test that considers as highly material a single asset/liability valued at 10% or more of the total assets of the Company as of the Periodic Statements date or a single asset/liability, where the change in their value is 10% or more of the net profit or comprehensive profit for the reported period, as well as the stated change constituting at least 5% of the equity of the Company.

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

b. Functional Currency and Foreign Currency

1) Functional Currency and Presentation Currency

The Financial Statements of the Company and the consolidated company are prepared in the currency of the primary economic environment in which they operate ("the functional currency"). For purpose of consolidating the financial statements, the results and financial position of the Company and the consolidated company are expressed in NIS, which is the functional currency of the Company. The consolidated financial statements of the Company and the consolidated company are presented in NIS.

2) Translation of Transactions in Currencies other than the Functional Currency

In preparing the financial statements of the Company and the consolidated company, transactions in currencies other than the Company's functional currency ("foreign currency") are recorded at the rates of exchange prevailing at the dates of the transactions. At each statement of financial position date, monetary items denominated in a foreign currency are translated at the rates published by the Bank of Israel and were valid at that date. Non-monetary items carried at fair value that are denominated in a foreign currency are translated at rates prevailing at the date that the fair value was determined. Non-monetary items that are measured in terms of historical cost are translated at exchange rates in effect on the transaction date, as they relate to the non-monetary item.

3) Method of Recording Exchange Rate Differences

Exchange rate differences are recognized in operations in the period in which these arise, except for the cases detailed below:

- Exchange differences with respect to transactions intended to hedge certain foreign currency risks (regarding the accounting policy of the Company on hedging transactions, see section o below).
- Exchange differences which relate to assets under construction for future use in production are included in costs of those assets, when they are regarded as an adjustment to interest costs on foreign currency borrowings (regarding the accounting policy of the Company on capitalization of borrowing costs, see section (i) below).
- Exchange differences recognized in the electricity rates and expected to be collected for periods following the balance sheet date (see Note 9 c below).

c. Consolidated Financial Statements

The consolidated financial statements of the Company incorporate the financial statements of the Company and the entity controlled by the Company (the Coal Company). Control is achieved where the Company has the power to govern the financial and operating policy of an entity, so as to obtain benefits from its activities.

Financial statements of a subsidiary which are not prepared in accordance with the accounting policies of the Company are adjusted, prior to consolidation, to the accounting policies implemented by the Company.

All intercompany balances and transactions are eliminated in full on consolidation.

d. Non-Inclusion of Separate Financial Statements in the Quarterly Financial Statements

The Company did not include separate financial information according to Regulation 9(c) of the Securities Regulations, since it does not contain any material information required by the reasonable investor to comprehend the financial position, operating results and cash flow of the corporation, which may affect economic decisions related to the corporation, that are not included already in the Consolidated Financial Statements of the Company. The criteria implemented by the Company to determine the negligibility of the additional information were: the quantity aspect and the quality aspect.

The Company fully owns the Coal Company. The Coal Company purchases the coal for the power stations of the Company and acts in practice as the extension of the Company for purchasing coal for its power stations. Except for a very minor quantity, the Coal Company sells all of the coal to the Company.

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

f. Investments in Associates

An associate company is an entity in which the Company has material influence, and it is not a subsidiary. The material influence is the power to participate in decision making regarding the financial and operational policies of the associate, but does not constitute control of these policies.

The financial statements of an associate are prepared according to IFRS standards. The results, assets and liabilities of the associate, are included in these financial statements using the equity method, the investment in the associate is included in the statement of consolidated financial position at cost adjusted to the changes which took place after the purchase of the share of the Company in the income/loss of the associates and in their comprehensive income/loss.

The value of the Company's holdings in an associate company as of its date of incorporation is recognized as deferred income within other liabilities, and recognized as income over a period of service provision under the agreement, by the straight line method.

Profit or losses created from transactions executed between the Company and an associate of the Company are cancelled in accordance with the Company's share in the rights of the relevant associate. For details see Note 11b.

g. Inventory in Warehouses

Inventory in warehouses (spare parts inventory kept in Company warehouses) is evaluated at cost determined in accordance with the weighted average method.

h. Fixed Assets

1. A fixed asset is a tangible asset, held for use in production or supply of goods or services or for renting to others, expected to be used during more than one period. The Company presents its fixed asset items in accordance with the cost model. In the cost model, fixed asset items are presented in the statement of financial position at cost, net of accumulated depreciation and net of a reduction for impairment. . The cost of the fixed assets includes asset acquisition costs (less receipts from development works orders), costs that can be attributed directly to bringing the asset to the location and condition required to operate it as intended by the management. The cost of fixed assets also includes direct salary and related expenses, materials, contractors and other indispensable costs which may be attributed directly to fixed assets construction activity. Cost of qualified fixed assets also includes capitalization of borrowing costs used to build the fixed assets that should be capitalized, as indicated in section i below. See section k below on impairment testing of tangible assets.

2. All components of the depreciable fixed assets are depreciated. The depreciation is calculated systematically using the straight line method over the expected useful life of the component from the date on which the asset is ready for its intended use, while considering the expected residual value at the end of the useful life.

Additions to the existing generation systems are depreciated over the remaining depreciation period of their original cost.

Details of depreciation of investments in operational power stations, including renovations are presented in Note 36 b 2) below.

Assets leased under financing lease agreements are depreciated over their expected useful life on the same basis as owned assets, or over the leasing period if the leasing period is shorter than the useful life of the asset.

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

h. Fixed Assets (continued)

The useful lives and depreciation rates used in the calculation of depreciation are as follows:

	Useful life (years)	Depreciation rates (%)
Power stations	30 - 50 (mainly 30 years)	2-3.33
Industrial gas turbines	25	4
Jet gas turbines	15	6.67
Transmission system	30	3.33
Distribution system	20 - 30 (mainly 30 years)	3.33-5
Meters	9-14 (mainly 14 years)	7.1-11.1
Inventories (including office equipment), mobile mechanical equipment and telecommunications	10	10
Computers and auxiliary equipment	3-5	20-33.33
Motor vehicles	5-7	14.3-20
Buildings	30	3.33

The residual values, depreciation method and useful life of the asset are reviewed by the Management of the Company at the end of every fiscal year. Changes are handled as a change of estimate in a prospective manner. Gains or loss incurred by sale or withdrawal from service of a fixed asset is determined in accordance with the difference between the proceeds from its sale and its carrying amount at the date of sale or withdrawal from service, and is recognized in the statement of operations.

3. Subsequent Costs

The replacement cost of a material part of a fixed asset item, which can be assessed reliably, is recognized as an increase of the cost in the books on the materialization date, if it is expected that the future economic benefits attributed to the item will go to the entity. Current maintenance costs are charged to the statement of operations and comprehensive income when incurred.

4. Liability with respect to disassembly, preservation and removal costs of an item and restoration of the site on which the item was placed

The cost of an item of fixed assets includes, inter alia, costs of disassembly and removal of the item, and restoration of the site on which it was placed, for which the entity incurs a liability when the item is purchased or as a result of using the item for a certain period, other than producing inventory during that period. After the first recognition date:

- a. Changes in the aforementioned liability up to the end of the item's depreciation period will be added to or deducted from the asset during the current period.
- b. Changes in the aforementioned liability due to the passage of time (cost of interest) are recognized in the statement of operations and comprehensive income as financing expenses, when incurred.

i. Capitalization of Borrowing Costs and Capital used to Construct Fixed Assets and Other Assets

Borrowing costs and capital for construction of fixed assets, accepted in the electricity rate, are recorded as part of assets under construction, when it is highly likely that these costs will be recognized in the rate. Borrowing costs and capital are capitalized to assets under construction until these assets are substantially ready for their intended use. Capitalized borrowing costs with respect to construction are recorded as decreasing the borrowing costs. Capitalized capital costs with respect to construction are recorded as other income, according to section 15 of the American standard SFAS 71.

Cash flow with respect to interest capitalized to assets

In the statement of cash flows, the Company classifies cash flows with respect to interest payments that are capitalized to qualifying assets in investment operations together with the other investments in assets.

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

j. Intangible Assets

1) Intangible assets

An intangible asset is an identifiable non-monetary asset without physical substance. The intangible assets of the Company are primarily capitalization of independent software development, with a defined useful life. These assets are amortized using the straight-line basis over their estimated useful life, subject to evaluation of impairment of value.

The useful lives and depreciation rates used in the calculation of amortization of these intangible assets are as follows:

	<u>Useful life (years)</u>	<u>Amortization rates (%)</u>
Software	5-15	6.67-20

Intangible assets purchased separately are presented at cost less amortization and accumulated impairment losses. Amortization of intangible assets is calculated in accordance with the straight line method over their estimated useful life.

The estimation of useful life and amortization methods are reviewed at the end of each annual reporting period, In case of changes in estimates, the effect is handled as a change in estimate presented in a prospective manner.

The useful life of the software that was defined as strategic projects of the Company was set to 15 years.

2) Intangible assets created internally - research and development costs

Costs with respect to research activities are charged to profit or loss on the date of their creation. An intangible asset, that was internally created by development activities of the Company, is recognized as other assets when all the following conditions are fulfilled:

- It is technically feasible to complete the asset so that it will be available for use.
- The Company intends to complete the asset and use it.
- The Company is able to complete the asset and use it.
- It is possible to determine the manner in which the asset will produce future economic benefits.
- The Company has technical, financial and other resources available for completing the development and for use of the asset.

k. Impairment of Tangible and Intangible Assets

At the end of each reporting period, the Company examines the book value of its tangible and intangible assets, to detect any signs that indicate the impairment of these assets. When such indications exist, the recoverable amount of the asset is estimated for the purpose of determining the loss created by the impairment, if any. When the recoverable amount of a single asset cannot be estimated, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs. Joint assets are also allocated to the individual cash-generating units, when a reasonable and consistent basis can be identified for this allocation.

When the joint assets cannot be allocated to the individual cash-generating units on this basis, the joint assets are allocated to the smallest group of the cash-generating units for which a reasonable and consistent allocation basis can be identified.

A recoverable amount is the higher of the fair value of the asset less costs to sell and its value in use. When assessing the value in use, estimated future cash flow are discounted to their present value by using a discount rate before tax that reflects the current market estimates regarding the time value of the money and the specific prospects of the asset for which no estimated future cash flow were adjusted.

When the recoverable amount of the asset (or of a cash-generating unit) is estimated as lower than its book value, the book value of the asset (or the cash-generating unit) is decreased to its recoverable amount. Loss from impairment is immediately recognized as an expense in the statement of operations and comprehensive income. When an

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

k. Impairment of Tangible and Intangible Assets (continued)

impairment loss recognized in previous periods is cancelled, the book value of the asset (or of a cash-generating unit) is increased again to the updated estimated recoverable amount, but not over what would have been the asset's (or the cash-generating unit's) book value, if no impairment loss was recognized for it in previous periods. Writing off a recognized loss from impairment is recognized immediately in the statement of operations and comprehensive income.

The Company examines tangible assets defined as recently completed assets (as defined by SFAS 90) at each period to decide if it is virtually certain that these assets will be covered by the rate. The Company examines the provision for impairment for all other assets at each period according to IAS 36, see Note 14 and Note 36 b 1) below.

l. Fuels Inventory

Fuels inventory is an inventory of materials consumed in the electricity generation process.

Inventory costs include all of the purchase costs, direct labor costs, fixed and variable overhead expenses and also other costs incurred to bring the inventory to the current location and condition. The cost of inventory is measured in accordance with the weighted average method. The inventory is stated at the lower of cost and net realizable value. The fuels inventory that is held for use in the electricity generation process is not written down if electricity sales equal the cost or exceed cost. Inventory designated for sale is stated according to net realizable value (see Note 8 below).

When inventories are purchased under borrowing terms whereby the arrangement involves a financing element, the inventories are stated at cost reflecting the purchase cost at usual borrowing terms. The difference between the actual purchase price and the purchase cost at usual borrowing terms is recognized as interest expense over the period of the financing.

Fuels Inventory – Non Current Assets

The policy of the Company, of maintaining fuels inventory is mainly for backup and availability needs of the electricity system in case of mishap in the supply of gas, and for times of emergency. Inventory that the Company anticipates will be used it during a period exceeding a year is presented within the section of Inventory fuels - Non-Current Assets.

m. Financial Assets

1) General

Financial assets are recognized in the statement of financial position of the Company when the Company becomes a party to the contractual terms of the instrument. Financial assets are recognized at fair value. Financial assets classified in the category of fair value through operations, the accompanying purchase costs are recorded to the statement of operations.

The financial assets of the Company are classified into the following categories. Classification into these categories depends on the nature and purpose of holding the financial asset and is determined upon the initial recognition date of the financial asset.

- Financial assets at fair value through operations;
- Loans and receivables.

2) Financial Asset at Fair Value through Operations

A financial asset is classified as "financial assets at fair value through operations" when those assets are held for trading or designated at the initial recognition stage as financial assets at fair value through profit and loss, including those originating from changes in exchange rates. The change is recognized in operations in the period in which it occurred.

The financial assets of the Company that are included in this category include: swap transactions and forward transactions. See section o above.

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

m. Financial Assets (continued)

3) Loans and Receivables

Deposits, loans and other receivables that have fixed or determinable payments, and are not quoted in an active market, are classified as loans and receivables. Loans and receivables are measured at amortized cost, using the effective interest method, less impairment in value, if any. Interest income is recognized by applying the effective interest rate, except for short-term receivables, when the recognition of interest would be immaterial.

A customer's outstanding balance is measured at cost, while the provision for doubtful debts is deducted from the customer's outstanding balance and calculated in accordance with a statistical model and also according to an individual test (see Note 6 below)

4) Impairment of Financial Assets

Financial assets, other than those classified as financial assets at fair value through operations, are assessed for indications of impairment of value at each statement of financial position date. Such impairment of value exists where there is objective evidence that, as the result of one or more events that occurred after the initial recognition of the financial asset, the anticipated future cash flows of the investment have been impacted.

Indications of impairment of value of other financial assets, including receivables due to financing leases, may include:

- Significant financial difficulties of the issuer or debtor;
- Failure to meet current payments of interest or principal;
- Probability that the debtor will enter bankruptcy or financial reorganization.

The Company examines indications of impairment of value on a group basis for certain financial assets, e.g. customers for which no indications of impairment were identified, based on past experience with groups of receivables with similar characteristics and changes in the level of delinquent payments and also economic changes related to the sector and the economic environment in which they operate.

For financial assets carried at amortized cost, impairment of value that is recognized is the difference between the book value of the financial asset and the present value of anticipated future cash flows, discounted at their original effective interest rate.

If the amount of loss due to impairment of value of a financial asset decreased in the following period and that decrease is objectively related to an event that occurred after the impairment in value was recognized, then in this case, the loss from impairment of value recognized in the past is fully or partially cancelled through operations. Such cancellation is limited in amount to the extent that the book value of the investment in the asset at the date that the loss from impairment of value is cancelled does not exceed what the amortized cost would have been at that date had impairment in value not been recognized in the past.

The book value of a financial asset is directly reduced by the loss from impairment of value for all the financial assets, with the exception of trade receivables, where the book value is reduced through the use of an allowance account. When trade receivables are considered uncollectible, they are written off against the allowance account. Collections in subsequent periods of amounts previously written off are credited against the allowance account. Changes in the book value of the allowance account are recognized in operations.

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

n. Financial Liabilities and Financial Instruments Issued by the Company

Classification as a Financial Liability

Non-derivative financial instruments are classified as a financial liability, according to the essence of the underlying contractual arrangements.

Financial liabilities are presented and measured according to the following classification:

- Financial liabilities at fair value through operations.
- Other financial liabilities.

1) Financial Liabilities at Fair Value through Operations

A financial liability is classified at fair value through operations if it is held for trading purposes.

Financial liabilities of the Company, included in this category, include swap transactions and forward transactions. See also section o below.

2) Other Financial Liabilities

Other financial liabilities (mainly including debentures and liabilities to banks), are initially measured at fair value net of transaction costs. Subsequent to the date of initial recognition, other financial liabilities are measured at amortized cost, using the effective interest rate method.

The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that accurately discounts the forecasted stream of the estimated future cash flow through the expected life of the financial liability to its book value or a shorter period, where appropriate.

3) Financial Liabilities Linked to the Consumers Price Index

The Company has financial liabilities that are linked to the Consumers Price Index ("CPI") which are not measured at fair value through profit and loss. The Company determines the effective interest rate as the real interest rate for these liabilities with the addition of linkage differences, according to the actual changes in the CPI up to the end of the reporting period.

4) Reduction of Financial Liabilities

A financial liability is removed when and only when it is cleared, namely, when the liability that is defined in the contract was paid-up, canceled or expired.

o. Derivative Financial Instruments

- 1) The Company enters into a variety of derivative financial instruments to manage its exposure to interest rate and foreign currency rate risks, including currency swaps, interest swaps, and combined interest swaps and currency swaps transactions, and foreign exchange forward contracts. Further details on the derivative financial instruments used by the Company are presented in Note 27 below.

Derivative financial instruments are initially recognized at fair value on the date that a derivative contract is entered into and are subsequently at their fair value at each statement of financial position date. As a rule, changes in fair value of derivative financial instruments are recognized in operations.

Derivative financial instruments are generally presented as current assets, non-current assets, current liabilities or long term liabilities. This is according to their fair value as determined by the valuation performed by the Company. For additional details of the Company's valuation techniques see section aa 2 a below.

- 2) The Company implements hedge accounting - the Company is designating hedging of derivative financial instruments. The hedged items are designated as hedged cash flows.

The hedging relationship is documented by the Company on the date of the contractual engagement of the hedge transaction. As part of the documentation, the hedged instrument, the hedged item, the hedged risk and the implemented hedging strategy are identified, and the degree of suitability of the strategy to the overall policy of the Company is examined. Additionally, from the beginning of the hedging relationship and throughout their period, the Company documents the media in which the hedging instrument is effective, offsetting the exposure to changes in the cash flows with respect to the hedged risk in the hedged item.

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

o. Derivative Financial Instruments (continued)

The balance sheet classification of hedging instruments is determined according to the remainder of the period of the hedging relationship at the end of the reporting period. If the remainder of the hedging relationship period exceeds 12 months at the end of the reporting period, the hedging instrument is classified in the statement of financial position as a non-current asset or liability. If the remainder of the hedging relationship period does not exceed 12 months at the end of the reporting period, the hedging instrument is classified in the statement of financial position as a current asset or liability.

The Company applies cash flow hedging accounting with respect to fixed interest bearing loans, for which the Company has engaged in currency exchange contracts.

The effective part of the changes in value of the financial instruments that are designated for cash flow hedging is recognized in other comprehensive income in the "Income (loss) with respect to cash flow hedging" item and the part that is not effective is immediately recognized in the profit or loss.

Cash flow hedging accounting is terminated when the hedging instrument lapses, is sold or realized or when the hedging relationship no longer meets the threshold conditions for hedging. In this matter, changing the counterparty to the hedging instrument as a result of legal or regulatory requirements, in a manner that does include additional changes to the conditions of the hedging instrument beyond the changes necessary as a result of changing the counterparty, does not constitute lapse or realization. After the hedging accounting is ended, the amounts attributed to the other comprehensive income are classified to profit or loss when the hedged item is recorded as profit or loss.

For additional details regarding financial instruments see Note 27 below.

p. Revenue Recognition

Revenue is measured at the fair value of the consideration received or the consideration which the Company is entitled to receive as revenue from sale of electricity and provision of services in the ordinary course of business. The revenue is presented less estimated discounts, granted according to regulatory conditions applied to the Company.

1) Revenue from Sale of Electricity

- a) Revenues from sale of electricity are recognized upon consumption of electricity by customers, according to meter readings. Revenues for the quantity consumed during the period between the last meter reading and the statement of financial position date are included according to estimates.
- b) The Company examines the compliance with conditions for recognition of income from sale of electricity in accordance with the provisions of IAS 18. If it is not possible to determine that it is expected that the economic benefits attributed to the transaction will flow to the Company, the Company recognizes income from sale of electricity in accordance with the amount it expects to collect.

2) Revenues from Interest

- a) Interest revenue from deposits is accrued on a time basis, by reference to the principal outstanding and at by use of the effective interest method.
- b) Interest income with respect to electricity customers is recognized at the time of collecting the debt with respect to which it was accrued.

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

q. Works according to an Implementation Contract

Where the outcome of a material works according to an implementation contract can be reliably estimated, principal revenues and costs are recognized by reference to the stage of completion of the works, as of the statement of financial position date. The rate of completion is generally measured by the proportion of costs incurred for the work performed as of the statement of financial position date relative to the estimated total costs to implement the contract, except for costs not representative of the stage of completion.

Changes in work, claims payment and incentives are included in work revenues, if agreed upon with the party that placed the order for the work. Contract performance costs are recognized as expenses in the period in which they are incurred. When it is probable that total contract costs will exceed total contract revenues, the expected loss is immediately recognized to operations (see also Note 18 below).

r. Leasing

1) General

Leases are classified as financing leases, whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

2) Assets Leased

Financial Leases

With respect to finance lease transactions in which the Company leases assets to another entity, the Company recognizes an asset at the inception of the lease to the extent of the present value of the minimal lease payments. Financing income derived from a finance lease is allocated to accounting reporting periods so as to reflect a constant periodic rate of return on the Company's net investment outstanding with respect to the lease transaction (see also note 33 b. 2) below).

Operating Leases

Rental income from operating leases is recognized on a straight line basis over the lease term. With regard to operating lease arrangements in which at the inception of the lease period, no lease fees are received, or reduced lease fees are received, and also when additional benefits are granted to the lessee, the Company recognizes revenue on the straight line basis, over the lease term.

3) Asset Leasing

Financial Leasing

Under financing lease transactions in which the Company leases assets from another entity, the Company, on the date of inception of the lease, recognizes the asset at fair value, or if lower, at the present value of the minimum lease payments. The liability for the transfer of the minimal lease payments to the lesser is included in the statement of financial position as a finance lease obligation. In subsequent periods, current payments with respect to the finance lease are apportioned between the financing component and the liability component so as to achieve a constant rate of interest that is allocated on the balance of the liability.

The portion attributed to the financing element is charged to operations, other than instances in which the leased asset is a qualifying asset, where borrowing costs are capitalized. (Regarding capitalizing borrowing costs, see section i above).

Land leases from the Israel Lands Administration are classified as a financial lease. Deferred leasing payments paid at the inception date of the lease are presented in the statement of financial position in the fixed assets section, amortized over the leasing term.

Operating Lease

Lease expenses related to operating leases are recognized on a straight-line basis over the lease term. In lease arrangements, where no leasing fees are paid at the beginning of the lease period, or reduced fees are paid and also when the lesser grants additional benefits, the Company recognizes the expenses on the straight line basis, over the lease term.

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

s. Provisions

Provisions are recognized when the Company has a legal obligation or constructive obligation as a result of a past event, as to which the utilization of economic resources is probable to liquidate the obligation and they can be reliably estimated.

The amount recognized as a provision reflects the best estimate of the management of the consideration required to settle the present obligation as of the statement of financial position date, taking into account the risks and uncertainties surrounding the obligation. Where the provision is measured by using the cash flow estimated to settle the obligation, the book value of the provision is the present value of those anticipated cash flow. Changes with respect to the time value are charged to profit and loss in the accounts.

When all or part of the present amount to settle an obligation is expected to be recovered from a third party, the Company recognizes an asset with respect to the recovery, to the extent of the provision that was recognized, only if it is virtually certain that the indemnification will be received and it can be reliably estimated.

t. Income Taxes

1) General

Income tax expense (income) represents the sum of the total change in balances of deferred taxes.

2) Deferred Taxes

The Company creates deferred taxes for temporary differences between the value for tax purposes of assets and liabilities and their value in the financial statements. Balances of deferred taxes (asset or liability) are computed according to tax rates and tax laws enacted or substantially enacted by the statement of financial position date. Deferred tax liabilities are usually recognized for taxable temporary differences between the value for tax purposes of assets and liabilities and their value in the Financial Statements. Deferred tax assets are recognized for all temporary differences that may be deducted up to the amount of anticipated taxable income, against which the deductible temporary difference may be utilized.

In the calculation of the deferred taxes, the deferred taxes on distribution of earnings in held companies are not taken into account since the dividends are not taxable.

Assets and liabilities for deferred taxes are presented on an offset basis, when an entity has a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to taxes on income levied by the same tax authority and the Company intends to settle its current tax assets and the liabilities on a net basis.

See Note 22 below.

u. Benefits to Employees

1) Post-Employment Benefits (see Note 12 below)

Post-employment benefits of the Company include: pension and grants. Post-employment benefits of the Company are partly defined contribution plans and partly defined benefits plans.

Expenses for the liability of the Company to deposit funds in a defined contribution plan (cumulative pension fund see Note 12 e) are charged to operations, or capitalized to the cost of assets, at the time that the labor services, as to which the Company is obligated to make the deposit, are supplied. The difference between the deposit amount payable and the total deposits paid is presented in the statement of financial position in the payables item.

Expenses for a defined benefit plan (the Company's pension fund see Note 12 d) are charged to operations, or capitalized to the cost of the asset according to the projected unit credit method, while utilizing actuarial valuations carried out at the end of every reporting period. The current value of the liability of the Company with respect to a plan for a benefit defined for December 31, 2014 is determined by capitalization of the expected future cash flows with respect to the plan. According to the International Accounting Standard 19 (IAS 19), the rate used for capitalization of liabilities with respect to post-employment benefits will be determined by using the market yields at the end of the reporting period for the high quality corporate debentures. In countries in which there is no deep market for such debentures, the market yields (at the end of the reporting period) for government debentures should be used, and with maturity periods closely identical to the anticipated payoff dates of the plan.

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

u. Benefits to Employees (continued)

1) Post-Employment Benefits (continued)

In November, 2014, the Securities Authority published a staff accounting bulletin number 21-1: The existence of a high quality corporate debenture deep market in Israel (hereinafter: the "Bulletin"). According to this Bulletin, that is based on the opinion of Dr. Haim Levi-Keidar, there exists in Israel a deep market for high quality index-linked corporate debentures (hereinafter: the "Corporate Debentures").

According to the Bulletin, the liability with respect to bonuses for employees in the financial statements of the companies will be capitalized in accordance with the market yields for the Corporate Debentures, instead of their capitalization according to the market yields of government debentures, and this will cause an increase in the capitalization rate and a decrease in the liability of the companies. It was further determined in the Bulletin that the abovementioned accounting change will be accounted for prospectively as a change in an accounting estimate, beginning from the financial statements for 2014.

Since the change in liability as a result of change of the capitalization rate constitutes a change in an actuarial assumption, then in the case of post-employment benefits, the stated change in liability will be charged as other comprehensive income. Regarding other long term bonuses, the stated change will be charged to income and loss. Additionally, when companies customarily capitalize income or loss with respect to remeasurements of the costs of assets on which the employees' salary cost is loaded, then the stated change will be charged to the cost of those assets.

As stated, in accordance with the Bulletin of the Securities Authority, this change is initially reflected in the measurement of liability in the financial statements of December 31, 2014, see Note 12 below.

In addition, the Securities Authority published a response regarding the disclosure required within the financial statements pertaining to the change in estimate deriving from staff accounting bulletin no. 21-2 above (FAQ 22) (see Note 12 h 1 below).

According to the accounting policy of the Company, the plan assets are measured at fair value. Interest income on the plan assets and the funds in trust are set on the basis of the rate of capitalization of the liability for the beginning of the year and are recorded to the statement of operations or capitalized to the cost of assets. The difference between the interest income for the plan assets and funds in trust and the comprehensive yield of the plan assets and funds in trust is recorded to remeasurements in other comprehensive income and will not be reclassified to income or loss at a later date.

When the total deposits paid exceeds the deposit required with respect to the service that was provided up to the date of the statements of financial position, and this surplus will lead to decrease of the future deposits, or a monetary repayment, the group recognizes the asset.

Actuarial gains and losses derive primarily from the difference between the actuarial assumptions, that are long-term assumptions, and the behavior of those variables during the reporting year (such as the expected rate of increase in salaries, the capitalization interest rate, the rates of early retirement and mortality and from the difference between the actual return on the funded amounts during the reporting year, and the expected return as of the beginning of the year) and from the changes in the actuarial assumptions themselves. Actuarial gains and losses are recorded to the other comprehensive income on the date of their creation, or capitalized to the asset cost. Actuarial gains and losses that were recorded to remeasurements in other comprehensive income will not be reclassified to income or loss at a later date.

Past service cost is recognized immediately in the statement of operations during the period in which the plan was changed.

The liability of the Company for a defined benefit plan, recognized in the statement of financial position, represents the present value of the defined benefit obligation less fair value of the assets of the plan. A net asset, created by this calculation, is limited to the amount of the future economic benefits available in the form of refunds from the plan or in the form of a reduction in future deposits in the plan ("cap amount").

Pension liability is assigned to service periods of the employees according to the rights accumulation rate in the pension plan.

See section Z 2) below with respect to the IAS 19 amendment "Benefits for Employees".

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

u. Benefits to Employees (continued)

2) Other Long Term Benefits to Employees in the Other Liabilities section

Other long term benefits to employees are benefits that are not anticipated to be paid off in full before 12 months after the end of the period when the service entitling to the benefit was rendered and do not constitute benefits after termination of employment or/benefits with respect to dismissal .

Other employee benefits of the Company include liabilities for a 20-year grant.

The change in these benefits (including actuarial gains and losses) is recorded to the statement of operations or capitalized to the cost of the assets, applying actuarial estimates calculated on every statement of financial position date, in accordance with the projected unit credit method. The present value of the Company's liability for the grant is determined by capitalizing anticipated future cash flows for the plan at market yields of high quality Corporate Debentures (see Note 12 h) above regarding the Securities Authority's staff accounting Bulletin number 21-1: The existence of a deep market for high quality Corporate Debentures in Israel including the accounting at the transition from a capitalization rate that conforms to market yields of government debentures to a capitalization rate that conforms to market yields of high quality Corporate Debentures beginning from December 31, 2014), that are denominated in the currency in which the other long term employee benefits will be paid, and with maturity periods closely identical to the anticipated payoff dates of these benefits.

Actuarial gains and losses are charged to profit and loss upon their creation. Past service cost is recognized immediately in the profit and loss in the period in which the plan was changed.

3) Short Term Employee Benefits

Short term benefits to employees are benefits expected to be utilized or paid within a period that does not exceed 12 months after the end of the period when service entitling to the benefit was rendered.

Short term benefits to employees include the Company's liabilities for short term absence, holiday, payments of grants and salaries. These benefits are recorded to the statement of operations or capitalized to the cost of the assets when incurred. The benefits are measured on a non-capitalized basis. The difference between the amount of short term benefits to which the employee is entitled and the relevant amount is recognized as an asset or a liability.

4) Benefits for Dismissal

Benefits for dismissal are benefits due to be paid as a result of the Company's decision to dismiss employees prior to the usual retirement age or as a result of the employee's decision to agree to voluntary retirement in return for these benefits.

The liability of the Company for an early retirement plan is charged to operations, where the Company is liable under a formal severance plan, that includes, at least, the location, position and estimated number of dismissed employees, the benefits to which the dismissed employees are entitled and the plan implementation date. Also the period of time for completing the implementation will be such that will not reasonably allow material changes in the plan.

5) IAS 19 Amendment "Employee Benefits"

According to the amendment, employee deposits relating to the employee's service will be treated as a decrease of the service cost. The amendment enables a practical way, in a case in which the sum of deposits is not dependent on the number of years of service, to decrease the cost of the current service in a period during which the related service was provided.

The Company implements the provisions of this amendment in the financial statements.

The implementation of the amendment does not have implications on the financial statements of the Company.

6) Funds in Trust (see Note 13 below)

Funds held in trust are recorded in their fair value in accordance with the IFRS standards.

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

v. Earnings per Share

The Company does not provide disclosure of earnings per share in its financial statements, since its ordinary shares are not listed for trading or in the process of being listed for trading on public markets.

w. Segmental Reporting

Operating segments are reported according to the same base that serves internal reporting needs, that are presented to the chief operating decision maker of the Company. The chief operating decision maker, who is responsible for allocating resources to the operation sectors of the Company and assessing their performances, has been identified as the Company's CEO (see Note 35 below).

x. Classification of interest paid, dividends paid and interest and dividends received in the cash flow statement

The Group classifies cash flows with respect to interest and dividends received and cash flows with respect to interest paid as cash flows that were used for or derived from current operations. Cash flows with respect to taxes on income are in general classified as cash flows that served current operations, except for those that can be easily identified with cash flows that were used for investment or financing activities. Dividends paid by the Group are classified as cash flows from financing activities.

Regarding cash flows with respect to interest capitalized on qualifying assets see Note 32 below.

- 1) Balances in foreign currency or linked thereto are included in the Financial Statements at the representative exchange rates published by the Bank of Israel and in effect as of the statement of financial position date.
- 2) CPI-linked balances are presented at the last known index on the statement of financial position date (index of the month preceding the Financial Statements month) according to the terms of the transaction.

y. New Standards and Clarifications Published which are in Force, which have an Effect on the Current or Previous Years:

1) Amendment of International Accounting Standard 36 "Impairment of Assets", with respect to disclosures of recoverable amounts (hereinafter: "amendment of IAS 36").

The amendment of IAS 36 deals with disclosure requirements in situations where loss due to asset impairment, including goodwill (or cash generating unit) was recognized or cancelled.

The amendment to IAS 36 will be applied to the financial statements of the annual periods commencing on January 1, 2014 or later, by way of retrospective application. Early adoption is possible. The amendment will not be applied to periods (including comparative figures) for which IFRS 13 was not applied.

There are not expected to be implications on the Financial Statements of the Company.

2) Improvements project 2010-2012, 2011-2013, 2012-2014

a) IFRS 8 - "Operating Segments"

The amendment requires the Company to add disclosure as to the consideration it applied during the grouping of the operating segments for the purpose of presenting them as reportable sectors.

Additionally, compatibility is required between the total reportable sectors and the assets of the entity, only if they are regularly reported to the head operational decision maker of the Company.

The Company is implementing this amendment in the Financial Statements.

The implementation of the standard does not have implications on the financial statements of the Company.

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

y. New Standards and Clarifications Published which are in Force, which have an Effect on the Current or Previous Years:

2) Improvements project 2010-2012, 2011-2013, 2012-2014 (continued)

b) IFRS 13 - "Fair Value Measurement"

The basis of the conclusions was amended so that it was clarified that the publication of the standard enables the measurement of receivables and payables for a short term without the use of the effective interest method, but rather according to the original invoice sum, and this if the effect of the capitalization is not material.

Additionally, the standard expands the application of possibility of measuring fair value of a portfolio of financial assets and financial liabilities on the basis of the net position also to other contracts that are under the application of IAS 39 and IFRS 9.

The Company is implementing this amendment in the Financial Statements.

The implementation of the standard does not have implications on the financial statements of the Company.

c) IFRS 1 - "First Time Adoption of International Financial Reporting Standards"

The standard clarifies that a first-time adopter may implement a new international financial reporting standard that is not yet in force if that standard enables early implementation.

The implementation of the standard has as yet no implications on the financial statements of the Company, but an implication is expected for the date of transition to full implementation of the IFRS. See Note 36 below.

z. New Standards and Clarifications Published which are not in Force and were not Adopted by the Company in Early Adoption:

1) IFRS 7 - Financial Instruments, Presentation (Service Contracts)

The amendments provide additional instructions in order to clarify if the service contracts constitute continued involvement in transferred assets, regarding the disclosure required pertaining to transferred assets.

The amendments are to be implemented retrospectively, for annual periods commencing on January 1, 2016 or later, but in order to refrain from retrospectively determining fair value, the Company is not required to implement the amendments for periods beginning before January 1, 2016.

2) IAS 19 - Employee benefits, discount rate regional market issues

The amendment clarifies that high quality corporate debentures serving to calculate the discount rate of post-employment benefits will be denominated in the same currency in which the benefits will be paid, so that as a result of the amendment, the examination of the depth of the high quality corporate debenture market will be determined at the currency level.

The amendment is to be implemented from the beginning of the earliest comparative period presented in the financial statements in which the amendment is implemented for the first time. Adjustments with respect to the initial implementation will be recognized in balance of retained earnings as of the beginning of the period.

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

z. New Standards and Clarifications Published which are not in Force and were not Adopted by the Company in Early Adoption: (continued)

3) IFRS 9 (2014) "Financial Instruments"

The International Financial Reporting Standard (2014) IFRS 9 "Financial Instruments" (hereinafter: the "Standard") is the final Standard of the financial instruments project. The Standard cancels the previous stages of the IFRS 9 that were published in 2009, 2010 and 2013. The final Standard includes classification and measurement provisions for financial assets that were amended with respect to those published in the first stage in 2009, and also includes the classification and measurement provisions for financial liabilities as published in the second stage in 2010, offers a more updated model based on principles regarding hedging accounting, and presents a new model for examining forecasted loss from impairment, as detailed below. Additionally, the Standard cancels the interpretation IFRIC 9 "Reexamination of Embedded Derivatives".

Financial assets:

The standard determines that all the financial assets are to be treated as follows:

- Debt instruments will be classified and measured subsequent to initial recognition at amortized cost or at fair value through profit or loss, or fair value through other comprehensive income. The measurement model will be determined based on the Company's business model for managing financial assets and in accordance with the characteristics of the contractual cash flows deriving from such financial assets.
- A debt instrument which, according to the criteria, is measured at amortized cost or fair value through other comprehensive income, may only be designated at fair value through profit or loss if such designation eliminates inconsistencies in the recognition and measurement that would have arisen had the asset been measured at amortized cost or fair value through other comprehensive income.
- Equity instruments will be measured at fair value through profit or loss.
- Equity instruments may be designated at fair value through other comprehensive income upon initial recognition. Instruments that have been designated as aforesaid will cease to be tested for impairment and any related gain or loss will not be recognized in profit or loss, including in the event of disposal.
- Embedded derivatives will not be separated from a host contract that falls within the scope of the standard. Instead, hybrid contracts will be measured as a whole at amortized cost or at fair value, in accordance with the business model and the contractual cash flows criteria.
- Debt instruments will be reclassified only if the Company changes its business model for managing financial assets.
- Investments in equity instruments that are not quoted on an active market, including derivatives on such assets, will be measured solely at fair value. The alternative measurement at cost under certain circumstances has been eliminated. Nevertheless, the Standard determines that, under limited circumstances, cost may be an appropriate estimate of fair value.

Financial Liabilities

The standard also prescribes the following provisions with respect to financial liabilities:

- The change in the fair value of a financial liability that is designated to fair value through profit or loss upon initial recognition, and which is attributed to changes in the credit risk of the liability, is recognized directly in other comprehensive income, unless such recognition gives rise to or increases an accounting mismatch.
- Upon the repayment or settlement of a financial liability, the amount of the fair value recognized in other comprehensive income will not be classified to profit or loss.
- All derivatives, whether assets or liabilities, will be measured at fair value, through comprehensive income, including a derivative financial instrument that constitutes a liability, which is related to an unquoted equity instrument for which a fair value cannot be determined reliably.

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

z. New Standards and Clarifications Published which are not in Force and were not Adopted by the Company in Early Adoption: (continued)

3) IFRS 9 "Financial Instruments" (continued)

Hedging

The Standard sets new hedging provisions and provides an option to choose an accounting policy of implementing the new hedging provisions that will be detailed below in brief or, alternatively, those existing under IAS 39. When the hedging project will be completed in the future, the IASB will again examine the possibility of choosing the stated policy.

Within the standard, the three types of hedge accounting remained unchanged: hedging of cash flows, fair value and net investment in foreign operations. However, material changes were made with regard to the transactions qualifying for hedge accounting, especially expansion of the risks eligible for hedge accounting of non-financial items. Additionally, changes have occurred in the manner in which forward contracts and derivative options will be treated when they constitute hedging instruments.

Furthermore, some of the hedging effectiveness tests have been replaced with a more substantial test that is based on "financial ratios". Retrospective estimation of the effectiveness of hedging will no longer be required. The disclosure requirements regarding the risk management activities of the Company have been expanded within the new standard.

Impairment

The new impairment model that is based on expected credit losses will be applied to debt instruments that are measured according to amortized cost or fair value through other comprehensive income, receivables with respect to leases, contract assets recognized under IFRS 15 and written obligations for granting loans and financial guarantee contracts.

Provision for impairment will be for forecasted losses according to probability of insolvency during the next 12 months (in the coming year), or according to probability of insolvency for the lifetime of the instrument. An examination throughout the lifetime of the instrument is required if the credit risk has risen significantly from the date of initial recognition of the asset. Another approach applies if the financial instrument is created or purchased when it is credit-impaired.

The standard adds instructions for presentation and disclosure concerning impairments of financial instruments

Date of commencement and possibilities of early adoption

The standard will become obligatory for annual reporting periods starting from January 1, 2018 or later.

As a rule, the provisions of the standard with respect to assets and financial liabilities were implemented retrospectively, except for certain exceptions determined in the transitional provisions of the standard. It was further determined that despite the retrospective implementation, companies implementing the standard for the first time will not be obliged to amend their comparative figures for previous periods. Moreover, comparative figures will be able to be amended only when their amendment as stated does not use hindsight. Provisions relating to hedging will be implemented, in general, in a prospective manner with limited retrospective implementation.

At this stage, the Company's Management is unable to assess the effect of the adoption of the standard on its financial position and operating results.

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

z. New Standards and Clarifications Published which are not in Force and were not Adopted by the Company in Early Adoption (continued):

4) IFRS 14 - Regulatory Assets and Liabilities (Regulatory Deferral Accounts)

In January 2014, the IFRS 14 standard was published, which deals with regulatory assets and liabilities. The standard enables to implement the practice existing in the Company on the subject of recognition of regulatory liability assets, in the reports prepared according to the IFRS standards, as the Company has implemented in its accounts thus far. During transition to complete international standards, a company that is under regulatory supervision can continue to recognize regulatory assets or liabilities.

The standard was published as an intermediate standard and its aim is to allow, as a possible alternative, the continued implementation of the previous accepted accounting principles and the accounting policy for recognition, measurement, decrease in value, and removal of regulatory assets and regulatory liabilities in the financial statements of supervised companies during the initial transition to IFRS. The standard applies to supervised companies that adopt the full implementation of the IFRS standards for the first time in accordance with IFRS 1.

The standard also details extensive presentation and disclosure requirements of regulatory assets and liabilities that are different to that which exists in the reports at present.

The standard will apply to annual reporting periods beginning on January 1, 2016, or later. Early implementation is possible, subject to disclosing this fact.

The Company intends to implement the standard by early implementation from the date of full implementation of the IFRS, namely as of January 1, 2015 (with incidence from the date of transition to IFRS). For the implications expected from the implementation of the standard see note 36 below.

5) IFRS 15 - Income with respect to contracts with customers

The new standard determines a comprehensive and uniform mechanism that regulates the accounting handling of revenues deriving from contracts with customers. The standard cancels IAS 18 "revenues" and IAS 11 "Construction contracts" and the interpretations accompanying them. The central principal of the standard is that the revenue recognition will reflect the transfer of the goods or the services to customers in an amount that represents the economic benefits that the Company is expecting to receive in consideration for them. For this purpose, the standard determines that the recognition of revenue will exist when the Company transfers to the customer the goods and/or services designated in the contract with him in such a manner that the customer gains control over those goods or services.

The standard determines a five stage model for implementing this principle:

- Identifying the contract (or contracts) with the customer.
- Identifying the performance obligations of the contract.
- Determining the transaction price.
- Allocating the transaction price to the performance obligations.
- Recognizing the income when the Company completes the performance obligations.

Implementing the model depends on facts and circumstances specific to the contract and sometimes requires extensive exercise of discretion.

Furthermore, the standard determines extensive disclosure obligations regarding contracts with customers, the significant assessments and amendments to them that were used when implementing the instructions of the standard, in order to enable the users of the financial statements to understand the nature, quantity, timing and reliability of the revenues and cash flows deriving from the contracts with the customers.

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

z. New Standards and Clarifications Published which are not in Force and were not Adopted by the Company in Early Adoption (continued):

The standard shall enter into a binding effect regarding annual reporting periods commencing from January 1, 2017, or later. Early implementation is possible. In general, the standard will be retrospectively implemented, but entities will be permitted to choose certain adjustments within the framework of the standard's transitional provisions regarding its implementation for prior reporting periods.

At this stage, the Company is studying the effect of the implementation of the standard's provisions on the contracts with its customers and manner of recognition of the revenue from them. This examination has not yet ended.

aa. Principal Factors of Uncertainty in Estimates and Accounting Considerations in Applying Accounting Policies

1) General

In application of the accounting policies of the Company described in sections a-z, the management of the Company is required, in certain cases, to exercise extensive accounting judgment with regard to assessments and assumptions concerning the book value of assets and liabilities that are not necessarily available from other sources. The assessments and related assumptions are based on past experience and other factors that are deemed relevant. The results in practice may be different from these assessments.

The assessments and the assumptions on which they are based are continuously examined by the management. Changes of the accounting assessments are only recognized for the period in which an assessment change was executed if the change only affects that period, or recognized for that period and future periods if the change affects the present period and the future periods.

2) Key factors of uncertainty in assessment

a) Fair value of financial instruments

The management of the Company exercises judgment in selecting appropriate estimation techniques for financial instruments that do not have a quoted market price in an active market. The estimation techniques used by the management of the Company are like those applied by market participants. The fair value of other financial instruments is determined on the basis of the capitalization of their forecasted cash flow, based on assumptions supported by observed market prices and rates. The assessment of the fair value of financial instruments that are not listed for trading in an active market includes several assumptions that are not supported by observed market prices and rates. The book value of the financial instruments that are estimated through estimation techniques as of December 31, 2014 adds up to approximately NIS 1,394 million (as of December 31, 2013, approximately NIS 2,804 million. For additional details of the assumptions used by the Company see Note 27 j below).

b) Provision for legal proceedings

Legal claims, including class actions, are pending against the Company. See Note 34 b 1) below.

The management of the Company relies on the opinion of legal and professional advisors in order to examine the legal relevancy of these claims, as well as to determine the probability that they will be realized to its detriment. After the advisors of the Company formulate their legal position and the prospects of the Company regarding the claim, whether the Company will have to bear the consequences or whether it can reject it, the management of the Company assesses the sum that should be recorded in the financial statements, if any. An interpretation to an existing legal situation that is different from that of the legal advisors of the Company, a different comprehension by the management of the Company regarding contractual engagements and changes that originate from relevant case law, or addition of new facts, can affect the value of the total provision with respect to the legal proceedings pending against the Company and thus materially affect the financial position and results of the operation of the Company.

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

aa. Principal Factors of Uncertainty Estimates and Accounting Considerations in Applying an Accounting Policy (continued)

2) Principal Factors of Uncertainty in Estimates (continued)

c) Provision for municipal taxes (rates), fees and levies

The Company receives demands with respect to municipal taxes for periods that preceded the report date. These demands mainly derive from a change in classification of the areas held by the Company, a demand to increase charged areas and a demand with respect to municipal tax rates. Additionally, from time to time, the Company receives demands to pay retroactive development levies with respect to the Company sites, with respect to levies that were not demanded by the authorities in the past and/or demands to pay levies for infrastructure works that are currently executed by the authorities.

The Company executes an estimation every cut-off period, including with the assistance of external lawyers and/or receiving external advice from consultants in the field, for the purpose of examining the payment demands versus facts, documents and data held by the Company, and examining the reasonability of the payment demands. Changes that occur in the legal environment, case law and addition of new facts may affect the value of the provision in the books, and thus affect the financial position and the outcome of the operations of the Company (see Note 34 b 7) and Note 34 b 9 c) below).

d) Employee benefits

The present value of the Company's liability for payment to severance pay and pension plan and bonuses to its employees is based on a large number of data that are determined on the basis of an actuarial evaluation, while using a large number of assumptions, including the capitalization rate (also see Note 12 h below). Changes in the actuarial evaluations may affect the book value of the liabilities of the Company for payment of severance pay and pension payments and bonuses. The Company assesses the capitalization rate once a quarter, and as of December 31, 2014, based on the high quality Corporate Debentures return rate. Other key assumptions are determined on the basis of the conditions of the market and the experience accumulated by the Company. For additional details regarding the assumptions used by the Company see Note 12 below.

e) Life span, fixed assets and intangible assets

As stated in sections h and j above, the management of the Company examines the useful life span assessment of fixed assets and other asset items every reporting year. During 2014, the management determined that there was no significant change in the useful life span of fixed assets and intangible assets.

f) Standards for regulated companies (SFAS 71)

The Company applies the SFAS standards 71 and 90 (see also section a above) to the Annual Financial Statements), the standard requires a regulated body to reassess the likelihood of covering the regulatory assets at every date of publication of financial statements.

Additionally, within the framework of the estimates formulated for the purpose of calculating regulatory assets, the Company is assisted by assessments and there is no certainty that the Electricity Authority (the public body regulating the electricity rates) will approve them in the future.

If a conclusion is reached that the Company no longer meets the above mentioned conditions for implementing the standard, and not all of the regulated assets are covered by the rates, or if it turns out that the actual rate update is different from the assessment used in the calculation of regulatory assets, or determination of a new rate in matters for which the Electricity Authority has reached a fundamental decision, then the regulatory assets, or some of them, have to be deleted.

g) Classifying fuels inventory in the statements

Based on its forecasts, the Company estimates the expected use of the liquid fuels inventory it holds. According to these forecasts, the liquid fuels inventory is presented in the financial statements of the Company in current assets and non-current assets item, which is expected to be used after a year.

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NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

aa. Principal Factors of Uncertainty Estimates and Accounting Considerations in Applying an Accounting Policy (continued)

2) Principal Factors of Uncertainty in Estimates (continued)

h) Tangible and intangible asset impairment

- (1) The Company examines the need of a provision for impairment of assets that have been completed recently, in accordance with the provisions of SFAS 90. For this purpose, the Company assesses the recognized cost in the rate in comparison with the assessment of the construction cost. Changes in the recognized cost assessment, expected costs forecast, and cash flow forecast are able to affect the amount of the provision for asset impairment.
- (2) The Company examines the need of a provision for the impairment of its assets under IAS 36. Changes in assumptions and assessments are able to affect the forecasts of the results of the operation of the Company, and accordingly to the need of provision for asset impairment. For additional details see Note 14 b below.

i) Accounts receivable

The Company estimates, under statistical models, the revenue from electricity sales with respect to the relative part of the revenue included in invoices issued after the date of the Statement of Financial Position, that were generated in practice according to estimate, for the report period. The statistical models are based on a statistical simulation that creates several scenarios that are built, inter alia, on electricity generation in practice by the Company and by private producers, losses rate assessment, and the average price estimate. The estimate of accounts receivable in the Company's books as of December 31, 2014 adds up to approximately NIS 2,618 million (as of December 31, 2013 approximately NIS 1,754 million).

j) Provision for doubtful debts

The Company examines the need of a provision for the impairment of its accounts receivables in accordance with the provisions of IAS 39, which instructs examining the need for a provision for impairment of financial assets.

For this purpose, the Company examines signs of impairment in the period based on past experience, financial difficulties of its customers, not meeting payments, and more. A provision for impairment, i.e. provision for doubtful debts, is determined in accordance with the estimate of the Company that is based on the above mentioned. Actual collection may eventually be different from the assumptions of the Company if the conditions taken into account are changed.

k) Income Recognition

The Company recognizes income when it is probable that the financial benefits deriving from the transactions will flow to the Company. When this cannot be determined, due to uncertainty as to the ability to collect from the customer, the income is recognized only when the uncertainty is lifted, namely when there is high certainty as to the ability to collect or when the sum is received.

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NOTE 3:- THE ELECTRICITY RATE

a. General

1) The Manner of Determining the Charge Rate

The revenues of the Corporation are based on the electricity charge rate that the Company charges consumers. In accordance with the Electricity Sector Law, the electricity charge rates and their manners of update are determined by the Electricity Authority. The electricity charge rates are determined in accordance with the following rules:

- The charge rates shall be determined based on the principle of cost, considering, inter alia, the type and standard of services. Each price shall reflect the cost of the particular service, without any price decreasing at the expense of increasing another.
- With respect to the cost, an adequate return on capital rate shall be taken into account, considering the rights and duties of an essential service supplier license holder. The law does not define what an adequate return on capital rate is.
- For the purpose of setting the charge rates, the Electricity Authority shall perform cost control actions for the essential service supplier license holder, and it is entitled not to include expenses which in its opinion are not required for fulfillment of the duties of the essential service supplier license holder.
- When determining the rates of all the consumers, the Electricity Authority will take into account the costs that were not taken into account as a result of the decreased prices.

In accordance with these principles, the electricity charge rate is supposed to cover all of the costs required by the Company for fulfilling its duties as an essential service supplier, subject to cost control. These costs consist mainly of costs of fuels, costs of operations and maintenance and costs of capital (depreciation, financing and return on capital).

The bases of the transmission and distribution rates came into effect in July 2002 and have not been updated since then. Until the updating of the rates, which according to the decision of the Electricity Authority will retrospectively apply from April 1, 2012, the Company is receiving advance payments for these segments (see section c below). The new generation rate came into effect in February 2010 (see section b below). The electricity charge rates for the various consumers are set in accordance with the type of consumption and the supply voltage. The main charge rate types are: uniform charge rate or load and time charge rates (a rate that changes in accordance with the seasons and day time hours during a whole day).

2) Rate Update Mechanism

In accordance with the Electricity Sector Law, the electricity charge rates are to be updated according to an update formula that the Electricity Authority will prescribe. The charge rate can be updated during the year due to an annual update or an ongoing update, as follows:

- a) Annual Update – Every year, in April, the Electricity Authority is said to implement an annual update of different components of the costs recognized in the rate of the Company, according to changes in different components of the input basket of the Company.
- b) Current rate update - the following update formulas were defined for the following parameters:
 - The recognized fuels costs are linked to changes in fuels prices.
 - Costs of foreign capital are linked to the Consumer Price Index.
 - Operating costs are partially linked to the CPI and partially to a mean index of a salaried position in the economy.
 - All other components are linked to the CPI.

In the Authority's decision of January 21, 2015, the Authority determined that a current update will be conducted when the one of the following conditions is fulfilled, according to the earliest among them:

- (1) A change in the recognized cost of the input basket of the whole system of at least 3.5%, provided that four months have passed since the last update.
- (2) The date of the annual update, as of 2016.

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NOTE 3:- THE ELECTRICITY RATE (continued)

a. General (continued)

3) Rate Updates for 2014

According to the decision of the Electricity Authority of July 10, 2014, the electricity rate for consumers remained unchanged during 2014.

On January 21, 2015, the Authority published decisions pertaining to the 2014 annual update. Following are the principal points of the decisions:

- a) The electricity rate will be decreased by on average by 11.8% as of February 1, 2015, with regard to the rate entered into effect on May 16, 2013.
- b) The Authority set a new methodology according to which the balance of the consumers debt to the Company with respect to spread of the fuels cost for 2012 will be offset from the balance of the compensation with respect to consecutive non-update that accumulated until the end of 2014.
- c) The advance given to the Company regarding the update of the rate base in the transmission and distribution segments for investments in the electricity grid was increased by approximately NIS 300 million for the year 2015. A condition for this supplement and ensuring its routing to investments in the electricity grid is its deposit in a dedicated account supervised by the Authority.
- d) Current update mechanism - see section 2) above.
- e) The rate is determined on the basis of forecasted recognized costs for 2015, in order not to create wide fluctuations in the rate and considering the annual update date expected in April 2015. The differences between the forecast and the final cost will be expressed within the compensation mechanism with respect to consecutive non-update.
- f) The theoretical recognized costs were retroactively updated from January 1, 2013.
- g) The compensation mechanism with respect to delay in the rate update was updated in accordance with the energy transferred in every segment, commencing from the compensation calculation for 2013.
- h) Recognition of capital services cost with respect to spare parts inventory - the Authority gave an advance of an additional 50% of the cost recognized for the Company in the rate base book for the generation segment for the years 2010-2014 (so that the complete costs of the rate base data will be recognized). The recognition will apply from the date the generation rate base of February 2010 entered into effect. However, a final decision in this matter will be received within the 2015 annual update. These costs are based on the Company costs in the years 2002-2006 and do not reflect its full costs at present.
- i) The Authority recognized a temporary cost for the Company with respect to the system management services provided to consumers of the Electric Company in the amount of NIS 160 million (in December 2012 prices). The rate derived from this cost is 0.29 Agora per kWh.

The recognized cost is on condition that the Company will report, by July 1 2015 (hereinafter: the "Determining Date"), in the Notes to its Financial Statements, on revenue and expenditure according to the decision of May 2013.

If the Note will not be reported on the stated date, the Authority will subtract all the recognized cost with respect to the system management service from May 2013 and it will be recognized for the Company only after execution of the report in the Notes to the Financial Statements. With respect to every day of delay from the Determining Date, the Company will not receive recognition from the Authority within the compensation mechanism with respect to delay in the updating date. On the date of publication of the Note, all the sums subtracted will be returned to the Company. However, interest will not be given for these sums with respect to the past within a compensation mechanism due to delay in update.

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NOTE 3:- THE ELECTRICITY RATE (continued)

b. The Generation Segment Rate

1) General

On February 1, 2010, the Electricity Authority published a decision on updating the rate base for the generation segment for the years 2010-2014. This decision and the rates derived from it became effective on February 15, 2010. The base of this rate determined the level of costs recognized for the Company in the generation segment for 2010-2014 and within it rate components were updated, such as: costs, fuels, capital costs and operational costs.

The Company reviews periodically the effect of the new rate base on its Financial Statements, estimated exposure to fines and estimated provisions, if needed, and updates accordingly.

2) The Main Points of the New Rate Base for the Generation Segment and the Effect on the Financial Statements

a) Depreciation and Assets Base

Assets recognized in the new rate base for the generation segment were determined according to an outline for the future in 2010-2014 and are updated every year.

The generation units were divided into two main types:

- 1) Generation units that commenced operation before December 31, 2002 ("Old units"). Recognition of the costs of these units is mainly based on their costs in the Company's books.
- 2) Generation units that were operated and that will be operated from January 1, 2003 ("New units") - recognition of the costs of the new units is determined according to normative parameters

The decision of the Electricity Authority of February, 2010, reflects non-recognition of the full construction costs of the Company's generation units. Therefore, the Company recorded in its accounts (mainly in 2010), a provision for asset impairment (see Note 14 i below).

According to the decision of the Authority concerning the 2014 annual update, a supplement of construction costs of new generating units (combined cycles at Haifa and a steam addition at Alon Tavor) was recognized for the Company. Regarding the combined cycles in Haifa, the Company applied to the Authority, requesting to recognize the complete construction costs and regarding the other construction costs of the new units (Gezer 3, Gezer 4, Hagit 2 and Alon Tavor), the Authority clarified that it will apply to the Company for additional data in order to examine the recognition of these costs.

b) Costs Reduction Due to Failure to Meet Normative Operation Dates ("Fines")

The Electricity Authority determined normative operation dates for operating generation units which are expected to operate during the test period (2010-2014). In accordance with the decision of the Electricity Authority, if the Company fails to meet predetermined normative timetables for commencing operation of generation units, the recognized income of the Company will be decreased under a reduction mechanism, calculated on a daily basis ("The Fines").

The total assessment of fines with respect to failure to meet normative operation dates as of December 31, 2014 is approximately NIS 73 million with respect to the Haifa 3 generation units, gas turbine 4 and the Eshkol steam addition.

In view of the fact that the decisions of the Authority regarding the 2012-2013 annual update and the 2014 annual update do not include the abovementioned fines in the cost recognized for the Company in view of the fact that the delay in operating the units stemmed from exogenous and systemic constraints that are not under the control of the Company, the Company estimates at a level of likelihood of more likely than not, that the Authority will refrain from applying these fines to the Company.

The Management reviews this estimate quarterly and updates it accordingly.

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NOTE 3:- THE ELECTRICITY RATE (continued)

b. The Generation Segment Rate (continued)

2) The Main Points of the New Rate Base for the Generation Segment and the Effect on the Financial Statements (continued)

c) Financing Costs

Financing costs will continue to be recognized, based on the recognized operating assets. The recognized leverage remains one third equity and two thirds foreign capital. The recognized return on foreign capital is derived from three components: The NIS financing basket (reflecting loans raised in the local market), a hedged financing basket derived from a new hedging mechanism (see paragraph d below) and NIS at higher interest rates (reflecting loans in foreign currency for which the Company is required to initiate hedging transactions).

d) The Hedging Mechanism

The hedging mechanism in the rate is intended to hedge the exposure of the Company to changes in foreign currency. Under the rate base of February 1, 2010, the hedging mechanism in its previous format was cancelled and a new hedging mechanism (a hedged financing basket) was determined for all the segments of the electricity chain which was supposed to be gradually cancelled within 3 years up to April 1, 2013. The collection of debt accumulated in favor of the consumers due to the cancellation of the old hedging mechanism was spread across a period of five years until February 2015. The following components were recognized for the hedged financing basket: an average real NIS interest rate, and spread rate of the hedging debt to the Company or of the Company for 3 years due to CPI - basket differentials and due to interest differentials between the average foreign currency interest rate and the average real NIS interest rate.

In the Authority's decision of January 21, 2015, it is noted that the outline of the cancellation of the hedging mechanism that was set in the decision of February 1, 2010 will be frozen until the annual update date for 2015 or until the determination of a rate base for the grid's segments, according to the earliest among them. Therefore, the composition of the financing basket remained identical to the one that existed in April 2012.

e) Operating Costs

Recognition of operating costs for the test period was calculated based on past costs (years 2002-2006), according to an increase in generation, less a 2% annual efficiency.

- The recognized operating costs of the generation segments include the pension costs according to a correction published by the Company on December 27, 2009 (restatement of the financial statements). The Electricity Authority did not complete the audit of the pension costs as yet. This subject is still being discussed between the Company and the Electricity Authority. Upon reaching a final decision on the subject of recognized pension costs, the pension costs component will be updated accordingly.

Following the applications of the Company, a change occurred in the decision of the Authority of January 21, 2015, regarding the manner of recognizing the operating costs. The operating costs were divided into fixed costs (88%) and variable costs (12%). The stated Authority's decision also determined that the fixed cost will be advanced according to the installed megawatts and the variable cost will be advanced according to net generation. This manner of recognition will apply retroactively from June 1, 2013 and until a new rate base is set for the generation segment.

Additionally, this decision granted a supplement for the operating costs with respect to recognition of spare parts inventory retrospectively from 2010 (see section a 3)h) above).

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NOTE 3:- THE ELECTRICITY RATE (continued)

b. The Generation Segment Rate (continued)

2) The Main Points of the New Rate Base for the Generation Segment and the Effect on the Financial Statements (continued)

f) Fuels Costs

The recognized fuels mix for a certain year is calculated twice: the first time during the annual update of that year and the second time during the annual update of the following year while updating demand in practice, and updating parameters of the mix due to new professional information the Authority did not have previously. Within the annual update of the following year a settling of accounts will be held according to the difference between the revenues of the Company from the fuels mix retroactively and the revenues of the Company from the fuels mix that was calculated in advance. The difference will be returned to the consumers or the Company plus interest and linkage through a compensation mechanism for a delay in the update. Additionally, the fuels mix will apply in a calendar manner in the months of January - December.

In the decision of the Authority regarding the annual update for 2014, it was determined that the fuel basket for 2013 will be determined on a monthly basis and not an annual average as is usually done.

In addition, within this decision of the Authority, the expected (not final) fuels mix for 2014 and 2015 were calculated for the first time based on a sector model on the basis of an expected load curve for all the sector.

The final methodology for calculating the fuels mix recognized in the rate in a sectorial point of view has not yet been arranged.

g) Costs of Conversion to Gas

In the rate base book, it was determined that recognition of costs of conversion to gas would be executed only after the unit starts to operate by gas. The recognition was executed on the basis of investments up to the date of operating by gas with the addition of investments that are executed a year after the operating date, on condition that they do not exceed 10% of the construction cost.

Following the applications of the Company, the costs of conversion to gas, piping, connection fees and emission reduction for the sites: Tzafit, Alon Tavor, Haifa, Gezer, Ramat Hovav Eshkol and Hagit were recognized for the Company within the decision of the Authority regarding the 2014 annual update.

The Company estimates that there is no probable level of reasonability that the costs of conversion to gas in Haifa and Ramat Hovav will not be fully recognized. In view of this, the Company has not executed provisions for impairment with respect to these costs.

3) The position of the Company with respect to the new generation charge rate basis

The Company has many reservations with respect to the new rate basis for the generation segment, which it believes may have a material effect on the Company, inter alia due to non-recognition of the full costs of construction and operation of the generation units of the Company.

In the Authority's decision of January 21, 2015, regarding the 2014 annual update, the Company received recognition for costs with respect to previous years, with regard to which the Company applied to the Authority many times. However, the Company has additional demands concerning lack of recognition such as recognizing the full costs of conversion to gas of Haifa and Ramat Hovav, recognizing interest costs at the time of construction with respect to common property, recognizing the full costs of spare parts inventory, recognizing the full costs of renovations, recognizing additional costs beyond the normative base.

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NOTE 3:- THE ELECTRICITY RATE (continued)

c. The Transmission and Distribution Segments

An update of the rate base in the transmission and distribution segments was to be executed at the end of 2005 and has not been executed until the date of this statement.

Following the establishment of a rate base for the generation segment in February 2010, the Electricity Authority also updated some of the components for the transmission and distribution segments.

According to the decisions of the Electricity Authority, as of April, 2012 the Company is receiving advances as an addition to the recognized cost for the transmission and distribution rates in an annual amount of approximately NIS 300 million and as of April 2013 in an annual amount of approximately NIS 400 million, until a new rate base will be determined for these segments, to be retroactively effective from April 1, 2012. In the decision of the Authority regarding the 2014 annual update, the Authority increased the amount of the advances for 2015 by approximately NIS 300 million (such that the total advance is approximately NIS 700 million).

The Company estimates that this increment, in addition to the cessation of the amortization factor, will not be taken away from the Company in the future due to the lack of rate coverage existing in the transmission and distribution segment, and the Company is therefore crediting this advance as income in its Financial Statements (see Note 9 i below).

In January 2015, the Company received the draft of the paper prepared by the consulting company on behalf of the Electricity Authority (hereinafter: "Navigant") updating the rate bases for transmission and distribution; a public hearing has not yet been published for this subject. The Navigant report adopts the methodology proposed by the Company, according to which its income recognized in the rate will be based on investment and operating forecasts in the segments of the grid. A retrospective update mechanism of the recognized income will apply, based on the Company's performance in practice, with the Authority executing thorough control and requiring detailed reports. Additionally, the Company's request to increase the net recognized yield rate to equity to approximately 7.7%, and to delay the reduction of the savings coefficients during the current rate period, was approved. Furthermore, there is a recommendation to transfer to a nominal rate. However, the findings of the Navigant Company point to high salaries of the employees of the Electric Company compared to the average salary of the market, compared to the U.S.A. In view of this, the recommendation of the report is not to recognize in the rate approximately 34% of the salary costs of the Company. The Company appealed this recommendation as part of its response to the draft report that was delivered to the Authority and the Navigant Company. The Company is of the opinion that the recommendations of the report do not indicate as to the final decision that will be made by the Electricity Authority. Notwithstanding, if the recommendations of the report are fully accepted by the Electricity Authority, it will have a material impact on the financial results of the Company, both in terms of expected growth in income and possibility of reduction in impairment of assets.

On March 2, 2015, a letter was received from the Authority, including a response by the Navigant Company to the Company's response to the draft report received from them. The Company delivered its response on March 16, 2015.

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NOTE 3:- THE ELECTRICITY RATE (continued)

d. Adjustment of the Rate to the Implications of the Adoption of International Financial Reporting Standards

Regarding the implications of transition to implementation of full IFRS in the Company, see Note 2 a 5 above and Note 36 below.

The Company is of the opinion that transition to full implementation of IFRS, as stated, should be accompanied by a suitable rate or accounting solution, in order to reflect the nominal financing costs and ensure the adequate return on equity as well as execution of rate updates, so that significant arrears will not be created between the sums due to the Company or the electricity consumers and the date of their collection, in order to prevent serious damage in future that will result in erosion of the Company's equity and make it harder to raise funds.

In light of that stated, during 2014, the Company applied to the Companies Authority, requesting an extension of the validity of the reporting regulations beyond January 1, 2015, and postponement of the transition to implementation of full IFRS, but its request was refused.

On August 10, 2014, the Company once again applied to the Companies Authority, explicitly noting that at this point in time the Company does not have a complete solution for preventing the expected damage to the Company's equity and that the Company is going to enter a situation of damage to its equity and to the results of its operation in the future as of January 1, 2015. On August 27, 2014, the response of the Authority to the Company's application was received, regarding damage to the equity with respect to termination of adjusting the financial statements to the CPI. The Authority clarified that it will assist the Company in discussions with the Electricity Authority in order to promote a solution for the impacts expected for the financial statements that stem from transition to reporting under the IFRS. Nonetheless, even if a full solution will not be provided, it will not change its decision.

IFRS 14 was published in January, 2014, and it deals with regulatory deferred assets and liabilities. The standard enables to implement the existing practice in the Company regarding recognition of regulatory assets and liabilities, in statements prepared according to IFRS, as the Company has implemented in its books thus far. This interim standard comes into effect from 2016, and early implementation is possible. The Company will implement the standard at the time of transition to full international standardization (January 1, 2015).

The estimate of the Company, which was presented to the Companies Authority and the Electricity Authority, is that the impact of ceasing to adjust the financial statements to the CPI, without finding a suitable solution, will cause erosion of the profitability of the Company such that for every increase of 1% inflation, the equity will be eroded by approximately NIS 480 million net, after tax effect (compared to a statement adjusted to the CPI).

The Company is conducting continuing discussions with the professional team of the Electricity Authority in order to solve the stated issue.

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NOTE 3:- THE ELECTRICITY RATE (continued)

e. Determining a Temporary Rate for the System Management Service

In its decision of May, 2013, the Electricity Authority determined a temporary rate for the services of managing the electricity system, and its application as regards all the consumers of the electricity in the economy is from June 1, 2013.

The Authority noted, inter alia, that one of the conditions for recognizing the system management costs is the reporting of revenues and expenses from services with respect to management of the system as a separate operations segment in the Notes to the Financial Statements.

The employee union of the Company instructed the employees dealing with the matter not to give the stated information. The issue was brought to a hearing in the Labor Court that ruled on September 17, 2013 that the condition of recognizing the system management costs by including notes to the financial statements was unlawful and unnecessary and the Electricity Authority has all the tools necessary to determine the cost of system management without need of notes. The judgment determined that there is no justification to connect between the temporary rate and the publication of the notes.

On January 6, 2014, the letter of the Electric Authority was received, noting that the employee sanctions do not exempt the Company from meeting its obligations to comply with the decisions of the Authority and also to comply with its obligations according to law. For additional details see Note 34 c 3) below.

An application has been received from private producers, contesting the Company's right to collect this rate. According to a legal opinion, the Company is permitted to collect the system administration rate as stated. Accordingly, in its letter to the Authority of February 19, 2014, the Company requested that the Authority will strictly act in accordance with the provisions of the law and the instructions of the stated judgment.

On March 23, 2014, the response of the legal advisor of the Electricity Authority was received, under which the judgment of the Labor Tribunal was given in the field of the labor dispute between the Company and its employees alone, and it has no implications on the commitment of the Company concerning the decisions of the Electricity Authority or their validity. The Authority did not see fit to change the decision of the Authority on this issue and the Company is required to act in accordance with its contents and refrain from collecting a system management rate as long as the required information is not detailed in the Notes to the Financial Statements.

On May 4, 2014, the Company delivered its reaction to the stated position of the Electricity Authority to the Government Attorney General, and requested him to instruct the Authority to cancel, and at the very least to suspend, its demand to publish the Notes as a condition for recognizing the system management costs, in a manner that the Notes will be published in the Financial Statements of the Company within three months from the date on which the employee sanctions on this matter will end and the preparation of the Notes will become possible, and until then the Company will be permitted to collect the temporary rate from the private producers, as determined by the decision.

Without derogating from the above mentioned, as of March, 2014, the Company is not collecting the system management component from the private producers.

The opinion of the Company is that the exposure due to financial reimbursement (collected by the Company until March, 2014) to private electricity producers and/or to all the consumers is very low as the Company estimates that it is highly likely that the Authority will recognize the full costs with respect to system administration services and will not demand financial reimbursement with respect to these costs due to their presentation as a separate activity segment.

Regarding the Authority's recognition of a temporary rate for the system management service under its decision of January 21, 2015, see section a. 3 i above and Note 34 c. 3) below.

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NOTE 3:- THE ELECTRICITY RATE (continued)

f. Rates of Backup, Auxiliary Services and System Costs

According to the Electricity Sector Law 1996, the Company is obligated, as an essential service provider, to provide backup services to all the customers in the economy, including to customers purchasing electricity directly from private producers. In addition, the Company is presently operating as a system manager and is therefore providing system services to the entire electricity sector.

In light of the entry of private electricity producers in significant volumes, as of July 2013, and the forecast for an additional massive entry of private producers in the coming years, it is necessary to impose the total system costs, including the backup costs borne by the Company for providing availability of all its generation units (despite the decrease in generation volumes), on the entire sector. This is in order to equally impose the costs of the system services and to prevent cross subsidy between the Company's consumers and the private producers' consumers.

In view of this, in May, 2013, the Electricity Authority published a decision in which it noted that it intends to determine rates for backup and auxiliary services during the coming months, and similarly to the rates of system management services, they will apply to all the consumers of electricity in the economy. The rate application date was set to June 1, 2013, and onwards. In the decision, the Authority noted, inter alia, that it will examine the issue of decrease in energy produced by the Company as a result of the entry of private producers.

In this context, on July 9, 2014, the private producer Dorad Energy Ltd. submitted a petition to the High Court of Justice against the Electricity Authority, regarding the application of a total system costs rate, as stated.

On August 25, 2014, The Electricity Authority published a decision proposal for a hearing, regarding the rates of the electricity system management rates (system rates). This proposal was intended, subject to balances of the law, to minimize the cross subsidizing between the consumers of the Company and the consumers of the private producers.

The level of the recognized costs and the system rates are published in this proposal and they include: administrative costs, system balancing services, backup services, services provided to power stations on a unit basis, and pan-system costs.

According to the decision proposal, the period from June 1, 2013 to December 31, 2014 will be defined as an adaptation period during which the system rates will apply at a rate of 60% of their cost. As of January 1, 2015, the rates will apply at their full cost.

It is noted that the position of the Company is that due to the necessity to continue to preserve and maintain all the generation units of the Company and make them available, both for generation needs and for providing backup services that are provided, as stated, to all the consumers in the sector, including those of the private producers which have begun operating and who will begin operating, determining backup rates is not supposed to change the revenue amount of the Company but rather to solve the cross subsidizing problem existing at present.

The Company delivered its reaction on December 25, 2014, and is invited to present its position in an oral hearing that will be held on March 23, 2015.

Additionally, the Company applied to the Electricity Authority in January 2015 and requested publication of a temporary rate for the system costs segment, and to retroactively update the rates if necessary when the final rates will be determined. The response of the Authority has not been received as of the date of publication of these financial statements.

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NOTE 3:- THE ELECTRICITY RATE (continued)

g. Project to Reduce Emissions at the Coal-Powered Power Stations

The Company is committed to implement the project to reduce emissions at the coal-powered power stations by virtue of decisions of several entities: NOP 10, personal order for Orot Rabin power station units 5-6, and decision of an inter-ministerial professional team to upgrade all the coal units (with the participation of the Ministry for Environmental Protection, Ministry of National Infrastructures, Electricity Authority, and the Company) (see Note 1 g above).

The Company has approached the Electricity Authority many times since the beginning of execution of the project (units 5-6 at the Orot Rabin power station and units 1-4 at the Rutenberg power station), for recognition of all the costs. In 2014, the position of the Electricity Authority was received, regarding the outline of recognition of the project costs that includes recognition of 70% of the project costs, initially, and of the comprehensive investment budget for 2013, subject to costs control by the Authority. The recognition will begin from the actual activation date of each unit. The Authority will examine every increase in budget and a decision to recognize will be made only after examination of the issue. Nonetheless, in case the Company expects material exceptions from the 2013 budget, it has to apply to the Authority for approval of the exception.

The Company opposed the above mentioned recognition outline and delivered its response to the Authority. Additionally, during 2014, the Company applied to the Companies Authority, the Ministry of Energy, the Ministry for Environmental Protection and the Electricity Authority, requesting clear instructions regarding the continued advancement of the emission reduction project, in light of the uncertainty existing in the matter of covering the project costs, capability to meet the schedules set for the projects' execution, and the draft recommendations of the steering team.

In October 2014, the Company presented to the Authority an increase of approximately NIS 800 million in the comprehensive investment budget for 2015, compared to 2013, that constitutes the basis for costs recognition for the Authority. Pursuant to the Authority's request, the Company delivered detailed explanations for the above mentioned increase.

As to the conversion to gas and establishing installations for emission reduction at units 1-4 of the Orot Rabin power station, in October, 2014, the Authority delivered a letter of principles to the Company, regarding the recognition of the costs of converting these units to gas and a demand to receive data.

The Company has to present to the Authority the major components of the project according to inputs and the financial valuations of each component as well as a schedule of advancement of the stages of the project. Afterwards, the Authority is expected to formulate a position regarding the manner of outline of recognition. After the balance date, in January, 2015, the Company delivered its reaction and included a proposal of an outline for recognition of the costs of the project of converting the Orot Rabin units 1-4 to gas.

h. A Designated Account for Financing the Emergency Plan

As of December 31, 2014, the designated account balance is approximately NIS 385 million. After the balance date, in January 2015, the Company received approval for the release of approximately NIS 85 million from the account. The Company has applied to the Electricity Authority several times, requesting to release all the money existing in the designated account for current use by the Company. On January 11, 2015, a letter was received from the professional team of the Authority, stating: "the balance of NIS 300 million will be converted in favor of a designated account for the transmission and distribution segments and will serve as pre-financing to boost the investments in this segment".

The Company was requested to deliver to the Authority a list of projects essential for the electricity sector in the transmission and distribution segments, which will be examined by the professional team of the Authority, and later on it will be decided which projects will be supervised by it and money from the account will be released for them.

The Company is of the opinion that most of the sum will be transferred during the current year.

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NOTE 3:- THE ELECTRICITY RATE (continued)

i. Decision of the Authority Regarding Irregularities between the Costs Recognized s in the Electricity Rates and the Company's Actual Costs

After the balance date, on February 9, 2015, the Authority published a decision, under which the Company is required to annually report to the public about the differences between the actual costs in that year compared to the costs recognized in the electricity rate, according to activity segments, in accordance with the format presented in the decision. The decision entered into effect from the date of publication of these Financial Statements. Additionally, under the decision, these reports for the years 2010-2013 will be displayed retrospectively on the Company's website within three months from the date the decision was reached.

j. Implementation of Reporting Obligations on the Company

On January 15, 2015, the Authority published a decision on the implementation of reporting obligations on the Company, in which the Authority imposes on the Company regular annual, quarterly and monthly reporting obligations, following work carried out by the Authority in the past year, inter alia after consultation with the Company. The reporting dates the Company is required and will be required to meet are according to the decision.

The obligation to report is a requirement to receive, in a format and on fixed dates, quantitative, financial, technical and professional data relating to the Company's entire operations, and most of the data is required to be reported on June 1 of each year, pertaining to the passing year.

On March 1, 2015, the Company applied to the Authority, requesting a solution for the Company's inability, at this stage, to comply with some of the data requirements in the required reporting format. The Company needs comprehensive preparation that will include development of supportive information systems and allocation of managerial resources in order to meet the requirements of the report.

k. Pension Costs

The Authority has not yet completed its examination concerning the pension costs of the Company and therefore there is only partial recognition of the pension costs in the rate.

A meeting was held by the Authority on October 21, 2014, and the updated recognition gaps in the costs of the Company were presented in the meeting.

From time to time, the Company delivers data in the matter (recently in January, 2015), in accordance with the demand of the professional team of the Authority.

The Company estimates that at the end of the procedure, the Authority will approve the entire pension costs since these costs are an integral part of the wage components that are backed by various agreements and approved by the relevant regulators (subject to decisions by the Supervisor of Wages regarding wage deviations).

l. Distribution License

On January 15, 2015, the Electricity Authority reached a decision which ratified a previous decision of the Electricity Authority of June 25, 2012, for providing electricity distribution and supply licenses to the Shean (Electricity) Development Company Ltd. ("Shean Development Company"), and according to which the Minister signed in the past supply and distribution licenses for the Shean Development Company that were in force until January 1, 2015. The Shean Development Company supplies electricity to plants in the industrial area that is close to Beit Shean. The distribution license was granted for a period of one year that begins on the date that the permit is received. The supply license was granted until June 30, 2015. The licenses will enter into force upon receiving the Minister's approval, and to the best of the Company's knowledge it has not yet been received as of the date of the report.

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NOTE 4:- CASH AND CASH EQUIVALENTS

	December 31	
	2014	2013
	NIS in millions	
Cash and balances in banks	22	16
Short-term deposits*	4,482	3,378
Total cash and cash equivalents	4,504	3,394

*Dollar, NIS and EUR deposits (see Note 27 f for currency spread)

The average interest for Dollar deposits ranges between 0.15%-0.46% (according to the deposit period).

The average interest for NIS deposits ranges between 0.55%-0.58% (according to the deposit period).

The average interest for EUR deposits is 0.21%.

NOTE 5:- SHORT TERM INVESTMENTS

	December 31	
	2014	2013
	NIS in millions	
Designated account*	85	492
Short-term deposits **	2,474	-
Total short term investments	2,559	492

* Funds that are held in a designated account and of limited use, for financing Company investments in development of the electricity sector. The funds were released after the balance sheet date due to the termination of investments in the emergency plan stage B.

** Dollar deposits for a period exceeding three months. The average interest for these deposits is 0.49%.

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NOTE 6: TRADE RECEIVABLES FOR SALES OF ELECTRICITY

a. Composition

	December 31	
	2014	2013
	NIS in millions	
Issued electricity invoices	3,270	3,324
Provision for doubtful debts.....	(561)	(309)
Unrecognized income (1)	(281)	-
	2,428	3,015
Income receivable (2)	2,618	1,754
Total customer receivables with respect to electricity sales.....	5,046	4,769
Stated in current assets	4,546	4,383
Stated in non-current assets (see section d below)	500	386
Total customer debt with respect to electricity sales	5,046	4,769

(1) The above mentioned relates to income from the Palestinian Authority and the East Jerusalem Company as detailed in section d below. Regarding the examination of the manner of recognizing the income see Note 2 p.2) above.

(2) Income with respect to the relative part of the electricity invoices issued after the date of the Statement of Financial Position, that according to an estimate relate to the relative reporting period.

The last date for paying electricity bills without charging interest is between 11 to 14 days from the date of preparation of the bills according to the type of customer as detailed in the criteria. After this period, customers are debited with an annual interest at a rate of approximately 8.25% with respect to the balance of their debt.

According to the accounting policies, interest revenue with respect to arrears from electricity customers are charged at the time of collection of the debt with respect to which they were accrued.

b. Aging of all customer receivables in excess of credit days, before provision for doubtful debts (with respect to invoices sent up to November 30, 2014) on the report date:

	December 31	
	2014	2013
	NIS in millions	
From 2 months to 3 months.....	644	615
From 3 months to 6 months.....	534	410
Over 6 months.....	1,181	590
Total.....	2,359	1,615

c. For credit risk management, see Note 27 below.

d. Following are transactions in reserve for doubtful debts:

	As of December 31	
	2014	2013
	NIS in millions	
Opening balance	(309)	(172)
Provision for doubtful debts.....	(252)	(137)
Closing balance.....	(561)	(309)

1) The customers balance includes, among others, the debts of the customers of the Palestinian Authority and the East Jerusalem Electricity Company.

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NOTE 6: TRADE RECEIVABLES FOR SALES OF ELECTRICITY (continued)

d. Following are transactions in reserve for doubtful debts: (continued)

Below are details of the balances of the Palestinian Authority and the East Jerusalem Electricity Company after provision for doubtful debts and income that was not recognized:

	December 31	
	2014	2013
	NIS in millions	
Total debts of the East Jerusalem Electricity Company and the Palestinian Authority	1,182	1,105
Presented in item of trade receivables for sales of electricity	682	719
Presented in long-term receivables item	500	386
Total	1,182	1,105

2) The payments of the Palestinian Authority and the East Jerusalem Electricity Company are executed both through transferring payments of the two and through transfers that the Company received from the Ministry of Finance, out of the sums held by the Ministry of Finance that are at the disposal of the Palestinian Authority.

As the invoices are not paid in full, the management of the Company is acting to collect the debts both by way of operating together with various State entities and by legal means as stated below:

a) On May 8, 2014, the Company submitted an action to the Jerusalem District Court against the East Jerusalem Electricity Company in the amount of approximately NIS 531 million.

Within this action, the East Jerusalem Electricity Company is demanded to pay the Company the debt for electricity provided to it in the period of up to October 2013, which has not been paid up to the present.

The Company is examining the possibility of also submitting an action with respect to the balance of the debt of the East Jerusalem Electricity Company for the period after October 2013.

b) At the Company's request, on May 15, 2014, the Jerusalem District Court gave its decision on the application submitted by the Company to impose a provisional attachment.

According to the decision, given the existence of allegedly reliable evidence for the existence of a cause of action, the Court granted the Company's application, imposing a provisional attachment order (by registry) in the amount of NIS 380 million over the office building of the East Jerusalem Electricity Company and all its assets that are held by banks and credit companies, except for current accounts insofar as they have a debit balance. So far, the Company has seized a few NIS millions through attachment orders.

c) On June 12, 2014, the Company submitted a petition to the High Court of Justice against the Minister of Finance, The Government of Israel, the Minister of Defence, The Minister of Energy, the Authority for Public Utilities - Electricity and the Palestinian Authority, requesting the Minister of Finance to use his authority and offset the amount of the debt to the Company from the monies transferred to the Palestinian Authority, and alternatively to address the collection of the debt through the State's budget or by another manner.

d) As part of the activity of collection and reduction of trade receivables, the Company restricts and/or cuts off the electricity supply to customers with debts. As part of this policy, the Company restricted the electricity supply to the Palestinian Authority in certain areas, and partially.

It is noted that on March 3, 2015, the Ministry of Finance transferred a sum of approximately NIS 300 million to the Company on account of the Palestinian Authority's debts to the Company.

The Company is examining the implications of the legal proceedings and sources for paying the debt and in accordance has included in the Financial Statements an appropriate provision.

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NOTE 7:- OTHER CURRENT ASSETS

	December 31	
	2014	2013
	NIS in millions	
Current maturities (loans to employees, chartering tug boats and currency exchange transactions).....	131	36
Deposits for securing swap transactions.....	46	-
Prepaid expenses.....	58	51
Income receivable	113	66
Other receivables	189	175
	537	328

NOTE 8:- INVENTORY - FUELS

	December 31	
	2014	2013
	NIS in millions	
Fuel oil(*).....	537	649
Diesel oil	1,240	1,296
Liquid natural gas (hereinafter: "LNG").....	47	24
Coal.....	478	513
Coal in transit	292	316
Methanol	2	-
Total.....	2,596	2,798
Presented in Current Assets	1,057	1,065
Presented in Non-Current Assets(*).....	1,539	1,733
Total.....	2,596	2,798

* A provision for fuel oil inventory impairment was made in 2014, in the amount of NIS 100 million, for 61 thousand tons of fuel oil the Company intends to sell in order to empty a number of fuel oil tanks in Company sites that are designated for renovation. The impairment of net realizable value was charged to the electricity system operating cost.

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NOTE 9:- REGULATORY ASSETS/LIABILITIES

- a. The Company applies the accounting principles of the US Financial Accounting Standards Board (FASB) as listed in Chapter RE6 which permit a company under regulatory control, under certain conditions, an accounting treatment other than by that acceptable with regard to the timing of expense/income attribution to operations, all for the purpose of reflecting and creating proper matching between expenses and income incurred by the Company on the dates when they are recognized for purposes of the electricity rates. One of the conditions for the implementing the said standards stipulates that regulated rates be so constructed as to cover the specific costs (including required return on capital) associated with the provision of the regulated product or service (see also Note 2. a. 2 above).

b. Details of the amounts of the regulatory liabilities, net

	December 31	
	2014	2013
	NIS in millions	
With respect to the erosion of the Company's liabilities in foreign currency, passed on to the electricity consumers (see section c. below)	230	(623)
With respect to the gap between dates for actual updating rates and the theoretical rate and a supplement for the recognized operating costs (see section d below)	1,502	460
With respect to social rate (see section e below)	376	305
With respect to electricity purchases from private producers and photovoltaic facilities and load management arrangements (see section f below)	439	467
With respect to provision for fines - Electricity Authority	-	(20)
With respect to consecutive non-update of the fuels component in the rate (see section g below)	(2,029)	3,328
With respect to consumers participation in financing emergency plan stage B (see section h below)	(1,333)	(1,754)
With respect to not updating the electricity rate for the transmission and distribution segment (see section i below)	148	148
With respect to other regulatory liability/ assets (see section j below)	6	(45)
Total	(661)	2,266
Presented in current assets.....	-	2,966
Presented in non-current assets	-	695
Presented in current liabilities	(400)	-
Presented in non-current liabilities.....	(261)	(1,395)
Total	(661)	2,266

c. Liabilities/Assets with Respect to the Hedging Mechanism

The Former Hedging Mechanism

The rate hedging mechanism has been in place since 1998 and hedges the Company's exposure with respect to foreign currency loans. The Electricity Authority decided in its decision in February 2010 on a new rates base for the generation segment to end the old hedging mechanism and return the debt to the consumers, spread over five years. The balance of the regulative liability, less the refund to the consumers, as of the statement of financial position date with respect to this debt, is approximately NIS 40 million. According to the decision of the Authority of January 21, 2015, regarding the 2014 annual update, the debt collection with respect to the former hedging mechanism will end in February, 2015 and differences accrued will be expressed in the compensation mechanism with respect to consecutive non-updating.

The New Hedging Mechanism

At the same time, within the decision of the Authority of February 2010 regarding the rate base in the generation segment, a new hedging mechanism was defined, to be completely decreased by March 31, 2013. In the decision of the Authority of January 21, 2015, regarding the 2014 annual update, it was determined that the outline for cancelling the hedging mechanism that was determined in the above-mentioned decision will be frozen until the date of the 2015 annual update or until determination of a rate base for the grid's segments, according to the earliest of the two.

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NOTE 9:- REGULATORY ASSETS/LIABILITIES (continued)

c. Liabilities/Assets with Respect to the Hedging Mechanism (continued)

The New Hedging Mechanism (continued)

The balance of the regulatory asset with respect to this debt, as of the date of the statement of financial position, is approximately NIS 270 million.

In 2014, the Company transferred financing expenses to regulatory asset with respect to real interest and linkage differentials in the amount of NIS 231 million.

See Note 32 a below.

d. Asset with Respect to a Gap between Rate Updating Dates (without fuel)

The electricity rate is not updated in a continuous manner; therefore, a gap was created in income between the income collected according to the actual rate and the income that is due to the Company according to the theoretical rate. The gap accumulates during the whole calendar year and is added to the recognized cost of the Company on the date of the annual update in the following year. The Company creates a regulatory asset in its Financial Statements with respect to this gap. The change in the assets for the period starting January 1, 2014 to December 31, 2014 is calculated as the difference between the total theoretical cost recognized and the actual recognized cost less the theoretical collection.

The theoretical recognized cost for the period of January-December 2014 is calculated in accordance with the decision of the Authority with regard to the 2014 annual update and based on the estimates of the management of the Company on issues regarding which a formal Authority Decision has not yet been received and the Company predicts at a high level of certainty that the rate will be updated in accordance with its estimate.

According to the decision of the Authority regarding the 2014 annual update, gaps stemming from a change in the manner of recognizing the operating costs are included in the compensation mechanism with respect to a delay in update. In view of this, regulatory asset with respect to the supplement to the recognized operating costs as a result of the entry of private producers is presented within the compensation asset with respect to a delay in update.

The balance of this asset as of December 31, 2014 is NIS 1,502 million and includes the sum accumulated with respect to consecutive non-updating of the electricity rates for 2014, the asset with respect to the supplement to the operating costs as aforesaid, supplement of recognition of various costs with respect to previous years in accordance with the decision of the Authority regarding the 2014 annual update, and the Company's liability to consumers with respect to the former hedging (as stated in section c above).

e. Asset with Respect to Social Rate

On March 27, 2007, the Electricity Sector Law (Amendment No. 6, Reduced Rates), 2007 was made public. According to the Law, a consumer who has reached legal retirement age and is entitled to income support from the State, will pay a reduced rate of 50% of the home consumption rate for the first 400 kWh consumed on a monthly basis for home consumption only.

In addition, a number of additional groups of the population received this entitlement during 2007-2012:

- 1) Disabled holocaust survivors.
- 2) Disabled who receive old age pensions for the disabled.
- 3) Six additional groups are eligible to reduced electricity prices.

The law authorizes the Minister, upon consulting the Minister of Welfare and upon consent of the Minister of Finance, to determine other needy populations which will be entitled to reduced payments, at the determined proportion of the household rate, the quantity of electricity that will entitle it to a reduced payment, so that the total reduction from the payment for electricity consumption will not exceed an amount equaling to 1.5% of the total payments paid by all consumers for electricity consumption.

In accordance with the decision of the Authority of August 6, 2012, the social rate also applies to consumers of the East Jerusalem Electricity Company who meet the criteria detailed above.

As of the statement of financial position date, the balance of the regulatory asset with respect to collecting reduced payment for needy populations is NIS 376 million. According to the decision of the Electricity Authority, this cost will be charged to all electricity consumers.

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NOTE 9:- REGULATORY ASSETS/LIABILITIES (continued)

f. Asset with respect to Electricity Purchases from Private Producers and Photovoltaic Facilities and Load Management Arrangements

On the annual update date every year, the Electricity Authority updates the recognized cost with respect to purchase of electricity and load management arrangements. Commencing April 1, 2012, advances are paid to the Company for electricity purchases from private electricity producers and the owners of photovoltaic facilities. With respect to the differences that may be created between the advances, as stated, and the actual costs, a regulatory asset or liability is created. In addition, the Company also records in its books a regulatory asset, with respect to the gap in the timing of the recognition of the costs arising from these arrangements and the date of recording the expenses with respect to them. The balance of the regulatory asset as of December 31, 2014 is NIS 439 million.

g. Asset With Respect to Non-Update of the Fuel Component in the Rate, Net

The update of the fuel component in the electricity rate is executed retroactively, every year, according to the actual demand curve and updates of new relevant information with respect to the fuels basket that is recognized for the Company. With respect to the gaps created between the actual rate and the theoretical rate that according to the estimate of the Company will be retroactively recognized, the Company records in its books a regulatory liability or a regulatory asset that is refunded to the consumers or to the Company with the addition of interest and linkage differentials. For details of the rate update mechanism see Note 3 a 2) above.

As of December 31, 2014, the balance of the regulatory asset with respect to a consecutive non-update of the fuel component is NIS 2,029 million. The balance includes the following components:

- According to the decision of the Authority of January 21, 2015, regarding the 2014 annual update, the fuels debt asset balance pertaining to the year 2012, as of December 31, 2014, was offset from the compensation balance with respect to consecutive non-updating, that accumulated until the end of 2014.
- Compensation liability with respect to the delayed updating of the fuel component in the rate in the amount of NIS 1,670 million. This balance reflects the difference between the actual rate and the theoretical rate that is based on existing valid decisions of the Authority as of the date of the report.
- Regulatory liability in the amount of NIS 1,053 million with respect to the Company's projection of a probable change in a compensation liability with respect to a delay in the update of the fuel component for the year 2014, with respect to components for which the decision of the Authority has not been received. This calculation includes the impact of changing the theoretical fuels basket in accordance with the decision of the Authority with an updated assessment of income from fuels expected to be recognized with respect to 2014. This liability balance also includes the 2012 fuels debt offset as stated above, the regulatory asset with respect to LNG related costs and the regulatory liability with respect to a compromise agreement with Yam Thetis.
- A regulatory liability in the amount of approximately NIS 694 million that constitutes a supplement to recognized costs with respect to previous years, according to the decision of the Authority of January 21, 2015.

h. Long Term Liability with respect to Consumers Participation in Financing Stage B

The creation of the liability in the amount of approximately NIS 2 billion was subject to the Authority's decision of March 7, 2011, regarding the spread of the Company debt for the purpose of financing stage B of the emergency plan. The Authority states that the balance of the principal with respect to the loan will be repaid to consumers retroactively from April 2010, where this repayment will be deducted from the recognized cost.

In its decision of May 6, 2013, pertaining to the updating of the rate increase, the Authority determined to shorten this debt return period by half, so that the debt will already end in 2017 instead of 2025. As of December 31, 2014, the liability balance (including current maturities) is NIS 1,333 million, and the Company is expected to return to the consumers principal and interest of approximately NIS 480 million in the coming year.

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NOTE 9:- REGULATORY ASSETS/LIABILITIES (continued)

i. Asset With Respect to not updating the Electricity Rate in the Transmission and Distribution Segments

As detailed in Note 3 c above, as of 2013, the Electricity Authority recognizes, for the Company, a supplement to the recognized cost for the transmission and distribution segments in an amount of approximately NIS 390 million per year, as an advance until the determination of new rate bases for these segments, that will apply retroactively from April 1, 2012. As of the date of this Report, new rate bases for these segments have not yet been published. The Company estimates that, within the updating of new rate bases, an additional supplement will be provided (beyond the above mentioned advances) for the recognized costs of the transmission and distribution segments for the period between April 2012 and December 2014. Considering this, as of December 31, 2014, there is a regulatory asset balance in the amount of approximately NIS 148 million in the Company books.

j. Asset/liability in respect of coal price differences

The Company records a regulatory asset or liability with respect to the price differences in coal costs during the reporting period, for which rate coverage is expected in subsequent periods. These differences arise between the costs of coal prices that are paid to the Coal Company and the price of coal in the current electricity rate. Therefore, the Company recorded in its books, as on December 31, 2014, a regulatory asset in the amount of approximately NIS 6 million.

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NOTE 10:- LONG-TERM RECEIVABLES

	December 31	
	2014	2013
	NIS in millions	
Natural Gas Lines - gas transmission project (see Note 33b1)a) below).....	709	646
Receivables for currency swap transactions	262	-
Customers with respect to electricity sales (see Note 6 d above)	500	386
Designated deposit.....	300	-
Other *	193	180
Total long-term receivables.....	1,964	1,212
Less – current maturities (see Note 7 above).....	131	36
	<u>1,833</u>	<u>1,176</u>

- * Including mainly loans to employees and chartering tug boats. The majority of loans to employees were at a non-linked annual interest rate of approximately 2.1%. The interest with respect to chartering tug boats was in the range of 7.9%-8.4% per year, linked to the dollar.

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NOTE 11:- INVESTMENT IN HELD COMPANIES

a. Held Companies:

1) Details of the Consolidated Companies of the Company

Subsidiary Name	Company Operation	Place of Incorporation	Holding rate of capital rights as of December 31	
			2014	2013
			%	%
National Coal Supply Corporation Ltd.	The company purchases coal for the coal power stations of the Electric Company	Israel	100	100

- a) The National Coal Supply Corporation Ltd. (hereinafter: the "Coal Company") is a company that was established under a decision by the Ministers for Economic Affairs and is subject to the Government Companies Law, 1975, and the provisions under it. The Company controls the Coal Company. The Coal Company deals mainly with the sale of coal it imports from abroad to the Company.
- b) On July 15, 2004, the Company signed an agreement with the National Coal Supply Corporation for the purchase and supply of coal for the Company's power stations that consume coal - Orot Rabin in Hadera and Rutenberg in Ashkelon. The agreement is in force from December 31, 2003 and will remain in force for as long as the Company shall have generation licenses for the aforesaid power stations. The Company reserves the right to cancel the agreement with one year's advance notice. The consideration that is paid is calculated based on cost in addition to an agreed upon profit and is subject to the coal price approved for the Company by the Electricity Authority. In 2011, an amendment to the agreement was entered, on the timing of transferring the ownership of coal shipments. According to the agreement prior to the amendment, the ownership was transferred to the Company at the shipping port, causing the outstanding balance owed by the Company to the Coal Company to include a charge for the "inventory on route". According to the amendment to the agreement, the ownership of and responsibility for the coal will be transferred to the Company at the deck of the ship that offloads the coal at the offloading port. The Coal Company will also be responsible for performing all the actions required to release the coal shipments and transfer the ownership to the Company upon offloading the coal from the ship, using the cranes on the quay, including payment of the charges, tolls and taxes.
- c) In the years 2014 and 2013, the Company acquired coal from the Coal Company at a cost of approximately NIS 3,794 million, and NIS 4,807 million respectively.
- d) The Company has financing expenses with respect to a loan received from the Coal Company. The total financing expenses for 2014 and 2013 are NIS 12 and 3 million, respectively.
- e) Dividends from the Coal Company - In December, 2014, dividends in the amount of NIS 7 million were received from the Coal Company with respect to 2013. Dividends in the amount of NIS 6 million were proposed after the balance date with respect to 2014.
- f) Regarding the contractual engagements of the Coal Company, see Note 34 a 5) below.

2) Details of Held Companies

Investee Company Name	Residence	Status	Holding rate of Ordinary Shares	
			December 31	
			2014	2013
			%	%
PAMA Ltd.	Israel	Inactive since 2000	49.99	49.99
Migrashei Kablanim Ltd.	Israel	Inactive	76.00	76.00
Jordan Properties Company (*) Ltd.	Israel	Active	99.98	99.98

(*) Jordan Properties Company Ltd. holds real estate, registered in its name in the lands register and used by the Company. Jordan Properties Ltd. has two wholly-owned inactive affiliated companies - Ma'abarot Hayarden Ltd. and the Palestine Construction Company Ltd.

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NOTE 11:- INVESTMENT IN HELD COMPANIES (continued)

a. Held Companies (continued)

3) The Advanced Studies Fund of the Employees of the Israel Electric Corporation Ltd. ("Advanced Studies Fund")

The Company holds 50% of the Management shares and of the rights to appoint Directors (without the right to share the profits) of the Advanced Studies Fund of Company employees. The Company deposits funds in the Advanced Studies Fund with respect to entitled employees, according to employment agreements.

The amounts deposited during the periods are as follows:

	<u>NIS Million</u>
For the year ended on December 31, 2014	<u>80</u>
For the Year ended on December 31, 2013	<u>79</u>

The Advanced Studies Fund does not invest in the securities of the Company

b. Investment in Associate Company

- 1) In accordance with resolutions adopted by the Government of Israel during the years 2010-2012 regarding the entry of the Company into activity in the field of communications through the establishment of a communications company which will be permitted to use the electricity grid for the purpose of deploying a stationary infrastructure of optical fibers (hereinafter: the "Communications Company"), a procedure was conducted by a selection committee (composed of State and Company representatives) for the selection of a private investor who will be the controlling shareholder of the Communications Company (hereinafter: the "Selection Procedure")

Following the Government Resolutions detailed above, and by their authority under section 6d to the Electricity Sector Law, and after consulting with the Electricity Authority, on March 3, 2013, the Minister of Finance and the Minister of Infrastructures, Energy and Water signed a permit that authorizes the Electric Company to operate in other activities in the field of communications.

On June 16, 2013, the committee announced the selection of a winning bidder of the selection process. According to the results of the selection process the winning bidder, that will be the controlling shareholder of the Communications Company and will hold 60% of its total shares, is a consortium (hereinafter: the "Consortium") composed of the following companies: Via Europe Israel Ltd., that will hold 50% of the shares of the winning bidder; as well as BATM Advanced Communications Ltd., Rapac Communications and Infrastructures Ltd., Tamares Holdings Sweden AB, and Zisapel Assets (1992) Ltd., that will each hold approximately 12.5% of the shares of the winning bidder. The Company will hold 40% of the total shares of the Communications Company.

Within the agreement signed by the parties to grant the right of use and services, the Company granted the Communications Company an exclusive right of use, to use the infrastructures of the Company and a future right to order, by demand, wavelength allocations of the Communications Company in the optical network backbone of the Company. Furthermore, the agreement settles the ownership rights of the Company and the Communications Company in the various communications' network components, and the services that the Communications Company will be able to order from the Company.

IBC is meant to provide stationary telecommunications services for communication operators and big business customers approved by the Minister of Communications, through a communication infrastructure of optical fibers that will be spread, inter alia, on Company infrastructures.

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NOTE 11:- INVESTMENT IN HELD COMPANIES (continued)

b. Investment in Associate Company (continued)

- 2) On July 11, 2013 (hereinafter; the "Transaction Date"), the transaction between the Company and the Consortium was completed, including the signing of the founders' agreement of the Communications Company between the Company and the Consortium and a representative of the Communications Company. Against 60% of shares of the Communications Company, the Consortium transferred NIS 100 million in cash in accordance with the agreement and committed to a transfer of an additional NIS 50 million. All the members of the Consortium, together, undertook to grant the Communications Company a loan of NIS 150 million and the Communications Company received a bank guarantee of NIS 200 million to secure the stated committed amounts. Up to the date of approval of these statements, the Consortium has transferred NIS 50 million which it undertook to transfer against the share capital and the sum of the bank guarantee was updated accordingly. It is further noted that the loans that the Consortium undertook to transfer have not yet been received. The Communications Company is entitled to receive a government grant of NIS 150 million. The first payment on account of this grant in the amount of NIS 75 million was received in December 2013 and an amount of approximately NIS 75 million is expected to be received in 2015.

On July 14, 2013, the Communications Company was incorporated under the name IBC Israel Broadband Company (2013) Ltd. (hereinafter: "IBC"). The Company holds IBC at a rate of 40% of the share capital and voting rights at a shareholders' meeting of IBC.

On July 16, 2013, five directors were appointed to IBC (three were appointed by the Via Europe Group and two by the Company).

On July 25, 2013, an agreement was signed between the Company and IBC for the provision of right of use and services.

On August 27, 2013, the Minister of Communications granted IBC with a license to provide telecommunications services.

- 3) On the Transaction date, the Company recognized in its books an investment in the amount of NIS 100 million. This sum reflects the fair value of 40% of the share capital of IBC.
- 4) The Company and the employees' union reached agreements regarding the arrangement of the Company employees' rights pertaining to the profit of the Electric Company from the communications enterprise, subject to receiving all the approvals from the required entities. These agreements required the approval of the State. The Company submitted a request to receive the State's approval for these agreements. As of the date of the report, the State representatives made it clear to the Company that their position is that the employees are not entitled to compensation in the form of shares in the communications enterprise. The Companies Authority has started a process of reviewing the issue which has not yet been completed. The required approvals have not yet been received from the entities for the State's agreements, and an agreement has not yet been signed.
- 5) The Company examined the transaction on the Transaction Date in accordance with the provisions of IFRIC 4 (determination whether an arrangement includes leasing) with regard to the transfer of the right of use of the Company infrastructures, and reached a conclusion that the arrangement constitutes a service agreement as it is defined in International Accounting Standard 18 (IAS 18). Therefore, the Company has recognized the share value as deferred income within other liabilities, which will be recognized over the service provision period according to the agreement, by the straight line method.

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NOTE 11:- INVESTMENT IN HELD COMPANIES (continued)

b. Investment in Associate Company (continued)

Name of associate	Operation of the Company	Country of incorporation	Holding rate of rights in capital		Scope of investment in the associate (*)	
			as of December 31		as of December 31	
			2014	2013	2014	2013
			%	%	(in NIS millions)	
IBC company (hereinafter: "IBC")	Providing stationary Bezeq services to communication operators and business customers through an optical fiber communications infrastructure	Israel	40	40	86	98

(*) The scope of investment in IBC is the book value of the investment handled according to the equity method.

Presentation in the Statement of Financial Position

	as of December 31	
	2014	2013
	(in NIS millions)	
Investment in associate	98	100
Company's share of the loss of IBC	(12)	(2)
	<u>86</u>	<u>98</u>

IBC prepares its financial statements in accordance with IFRS standards.

The financial statements of IBC were not attached to the reports of the Company, due to lack of being material in relation to the reports of the Company according to regulation 23 (b) of the Securities Regulations.

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NOTE 12:- POST EMPLOYMENT EMPLOYEE BENEFITS

a. Excess of amounts of pension plan assets over the pension obligation

	December 31	
	2014	2013
	NIS in millions	
Fair value of plan assets (see section l) 2) below)	27,739	24,988
Present value of pension obligations (see section k) 1) below)	(23,352)	(22,853)
	4,387	2,135
Present value of pension obligations with respect to special agreements on early retirement (see section k) 3) below)	(77)	(119)
Excess of pension plan assets over pension obligations	4,310	2,016

b. Funds in Trust

	December 31	
	2014	2013
	NIS in millions	
Fair value of funds in trust	1,909	1,725

Funds in trust are designated to cover actuarial liabilities for non-budgetary pension payments to employees and liabilities related to termination of employee – employer relations and are invested in Government debentures (assets according to section 116 A of IAS 19 (2011) see section m and note 13 below).

c. Liabilities with respect to other post-employment benefits

	December 31	
	2014	2013
	NIS in millions	
Present value of obligation with respect to other post-employment benefits (see section k) 2) below)	2,930	2,918

Composition according to types of the other benefits:

	December 31	
	2014	2013
	NIS in millions	
Discounted electricity	1,035	1,055
V.A.T. and grossed up tax with respect to discounted electricity	383	380
Retirement benefits	1,120	1,081
Welfare Fund for pensioners insured in the budgetary pension	47	48
Holiday gifts including grossed up tax	345	354
Total	2,930	2,918

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NOTE 12:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)

d. The Pension Plan of the Company and Other Post-Employment Benefits

- 1) The pension regulations from 1958 apply to all Company tenured employees and pensioners and their survivors who were admitted to work in the Company up to June 10, 1996 (inclusive) (hereinafter: "the Insured under the Budgetary Pension Arrangement"). The code of the central provident fund for pension to the Company's employees pensioners and their survivors is based on the provisions of the aforesaid pension regulations and prescribes the entitlements of the Insured under the Budgetary Pension Arrangement (see also section I 1) below). On March 5, 2012, the "Change of Method of Updating the Budgetary Pension, 2012 Law" was published in the Official Gazette. This law changed the method of updating the pension of the insured under the Budgetary Pension Arrangement to linkage to the Consumer Price Index.

Following is a summary of the budgetary pension arrangement under the by-laws of the central provident fund for pension:

The entitlement for pension is created with the existence of one of the following conditions:

- a) At the mandatory retirement date (for a woman - from the retirement age date) which is determined under the Retirement Age Law.
- b) Early retirement after a minimum of 30 years of work in the Company, provided that the employee has reached the age of 55 for men and age 50 for women (provided that the Company desires his retirement and with the approval of the employee union)..
- c) An employee aged 40 years or over who has been working in the Company at least 10 years and is dismissed.
- d) Retirement due to disability.
- e) Special retirement - if and insofar as will be carried out according to a specific arrangement that was prepared and approved by the authorized authorities according to law, and according to rules that will be approved.

The survivors of an employee/a pensioner are entitled to a pension in accordance with the pension rates that are set out in the pension code.

Rates of pension:

- Upon reaching retirement age (mandatory), dismissal, early retirement– the pension rate shall not fall below 25% and shall not exceed 70% of the determining salary of the employee for the calculation of pension and its amount will be calculated based on the number of years of employment in the Company, in accordance with the principles set out below:
- After first 10 years of work– 25% of the employee's determining salary for pension.
- For every additional year of employment, up to 30 years of work– an additional 2% for every full year of work in excess of the first 10 years of work (up to a maximum of 65%).
- For every additional year of work in excess of 30 years and up to 35 years of work – an additional 1% for every work year or a part thereof in excess of the first 30 years of work (up to a maximum of 70%).
- In the event of the retirement of a permanent employee due to disability, the pension rates are determined in accordance with the Pension Regulations.

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NOTE 12:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)

d. The Pension Plan of the Company and Other Post-Employment Benefits (continued)

1) (continued)

Rates of pension: (continued)

The actuarial liability with respect to employees and pensioners/ survivors who are insured under the Budgetary Pension Arrangement includes, in addition to the pension that is payable after the termination of employment, the following entitling components:

- "Excess employment grant" (over 35 years of work). The eligibility is conditional upon retirement after the age of 60 for men or 55 for women. For fractional years, the relative share of the grant will be paid. The grant is also paid for survivors in the event of death of an employee, upon the fulfillment of the entitling criteria.
 - "Up to 35 years grant" that is paid upon retirement and to survivors in the event of the death of an employee. This grant will not be paid to employees with a seniority of less than 10 years and in respect of years for which another compensation is payable.
 - Grant upon retirement due to disability (an employee who is eligible for this grant will not receive in addition the "up to 35 years grant").
 - Grant for the non-utilization of sick days.
 - Reduced electricity price benefit for pensioners/ survivors (including grossing up for tax and VAT).
 - Holiday gifts for pensioners/ survivors (including grossing up for tax).
 - Grant to employees completing 20 years of work in the Company.
 - The Company has a (perpetual) liability under a collective agreement to bear the costs of welfare activities in an amount that is equal to 0.49% of the salary of every employee and of the pension and grants to which every pensioner/survivor is entitled (this liability is not calculated with respect to the components that are not regular salary or those that are not affected by an hourly price: convalescence, electricity, gift, house duty by roster and Arava).
 - Starting January 2012, as part of the change of the updating mechanism of the pension of those insured by the budgetary pension arrangement to linkage to the CPI, a welfare fund was established for pensioners who are entitled to budgetary pension, similarly to the fund that was established under the Civil Service.
 - The Company insures its employees and pensioners with collective life insurance. A third of the premium is paid by the employee and the rest by the Company.
 - The Company retirees/survivors possess a basket of benefits and additional rights that are not included in the actuarial liability due to their being non material.
- 2) The estimated financial liability for pensions and grants for termination of employee-employer relations is based on actuarial calculations by an external actuary. The liability is calculated in accordance with rights and assumptions of the Company submitted to the actuary for the calculation. See section h below.

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NOTE 12:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)

e. Pension to Employees who are not Included in the Pension Plan

The remaining permanent employees of the Company (hereinafter: "Generation C Employees") who started working on June 11, 1996 and thereafter and are not included under the budgetary pension plan, as described in section d. above are insured by default under a comprehensive paying pension fund (an external long-standing or new cumulative pension fund, or under another pension insurance policy at the personal choice of the employee). The Company makes deposits on a regular basis in respect of its liabilities to these employees, excluding the severance pay supplement at the rate of 2.33% of the determining salary for severance pay. For the 2.33% severance pay supplement the Company has created an actuarial liability that is included among liabilities with respect to other benefits after employment termination (see section c) above).

The amounts that are deposited in the pension insurance policy are registered in the names of the employees and the relevant liabilities are not presented in the Company's Statement of Financial Position since the deposited amounts are not under the control and management of the Company. Additionally, these employees are entitled to receive certain grants from the Company after termination of employment as detailed below, and the Company liability with respect to these grants is included in the liability with respect to other grants as detailed in section c) above.

As stated, the actuarial liability with respect to Generation C Employees includes, subject to the fulfillment of criteria:

- Severance pay supplement (2.33%) on regular salary and 13th salary (for those employees who started working in the Company before January 1, 2004 and are entitled to a 14th salary, the severance pay supplement in respect of this component will be calculated for the work years in excess of 35 years).
- "Up to 35 years grant" that is paid upon retirement and to survivors in the event of the death of an employee. This grant will not be paid to an employee that has worked for less than 10 years, and for years for which another grant is paid.
- Grant for the non-utilization of sick days.
- Reduced electricity price benefit for pensioners/ survivors (including grossing up for tax and VAT).
- Holiday gifts for pensioners/ survivors (including grossing up for tax).
- Grant to employees completing 20 years of work in the Company.
- In addition to the aforesaid, the Company has an obligation (perpetual) by force of labor agreement to bear costs of welfare actions in an amount equaling 0.49% of the normal salary and hourly components of each employee and the grants to which each pensioner/ survivor is entitled
- The Company insures its employees and pensioners with collective life insurance. A third of the premium is paid by the employee and the rest by the Company.
- The Company retirees possess of a basket of benefits and additional rights that are not included in the actuarial liability due to their being non material.

f. Collective Agreements

After the balance sheet date, on February 25, 2015, a special collective agreement was signed between the Company and the New National Labor Federation and the Employee union (hereinafter: the "Collective Agreement"). It was agreed in the agreement, inter alia, on early retirement of 400 to 440 permanent employees in 2015, granting tenure and conditions for erasing permanent positions following the agreements, extending employment of temporary employees employed in projects, deducting salary due to participation of employees in sanctions and strike, industrial peace and exhausting claims in issues arranged in the agreement.

As of the date of signing the financial statements, the Collective Agreement is still not in force as it is subject to approval by the Commissioner of Wages and the Government Companies Authority, which has not yet been received. The assessment of the provision that will be included in the financial statements (during the period of approval of the report) for realizing this said agreement (with respect to early retirement of approximately 440 retirees) is approximately NIS 650 million before tax effect (approximately NIS 480 million after tax effect). This assessment is not based on a list of employees, and may change according to retirements in practice.

On July 18, 2013, a collective (salary agreement) agreement was signed between the Company and the employee organization and the New National Employee Labor Federation (hereinafter: the "July 2013 Agreement"). This salary agreement was based on the salary agreement signed by the civil service in May, 2013, and entered into effect with the legislation of the law for "participation of employees, officers and other officials in the public service in measures to stabilize the fiscal situation in the country during the years 2013 and 2014 (Temporary Order) - 2013" (hereinafter the "Fiscal Stability Law").

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NOTE 12:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)

f. Collective Agreements (continued)

The previous salary agreement of the Company of January 31, 2011, granted the Company employees a salary increment of 5.75% for the period ended on June 30, 2012. Under the July 2013 Agreement, the employees are entitled to a salary increment of approximately 1% (completion to 6.75%) commencing on July 1, 2013. However, the entitlement to this increment was postponed and only commenced on January 1, 2015. It was further determined in this agreement that as of July 1, 2015, the provision rates of the Company and the employee deduction for the provident fund will increase by 0.5%.

The agreement of July 2013 exhausts the employees' claims regarding the salary increments for a period up to December 31, 2012, moreover a commitment to industrial peace in this matter was determined in the agreement up to December 31, 2014.

Under the stated Fiscal Stability Law, the Company has to transfer to the State Treasury the sum saved as a result of postponement of the date of payment of the salary increment of 1%, pursuant to the provisions of the Minister of Finance. This sum is estimated at approximately NIS 30 million a year. An adequate provision was included in these financial statements. On July 2, 2014, the Minister of Finance published regulations that include provisions with regard to the manner of transferring the funds to the State and the Company will act as required.

The actuarial liability due to the active employees is calculated on the basis of the wage components for pension that are included in the last salary as of the date of the Financial Statements.

As the last salary agreement exhausts the salary updates in the Company up to December 2012, the actuarial liability also includes an assessment of an expected salary raise in a future agreement for the period from January 1, 2013, and until December 31, 2014, at a rate of approximately 0.8% per year (an expected salary increase at a rate of 1.6% with respect to the period ended on December 31, 2014). This assessment was determined considering past experience. This accounting assumption constitutes the best assessment for an expected salary raise in 2013-2014 in a future agreement.

g. Examinations by the Supervisor of Wages

In the months of February and March 2012 the Supervisor of Wages and Labor Agreements of the Ministry of Finance (hereinafter: the "Supervisor of Wages") approached the Company by power of his authority under section 29 of the Budget Foundations Law - 1985 (that requires his approval for every change in wages and benefits for employees), regarding 5 issues he regards as allegedly constituting wage deviations: increased severance pay for employees employed by special agreement, global pension overtime for members of the management, paying overtime not according to actual performance, payments of board and lodging, and command increment. In April and May 2012, the Company delivered its position on these issues to the Supervisor of Wages, detailing its position that these are not wage deviations, but rather wage components paid according to the law.

A year and a half after the Company delivered its position, on October 10, 2013, the Company received a letter from the Supervisor of Wages, including decisions regarding wage deviations in the following issues:

- 1) Payment for overtime not according to actual performance – the Supervisor of Wages instructs the Company to integrate external employees in accordance with the work requirements of the Company, and not to operate according to the Company Management's memorandum of 1990, under which a work day of external employees is 10 hours long. Overtime payment will only be paid subject to report of actual performance and subject to the existence of an arrangement that enables a stricter supervision of the work hours of the external employees. He intends to bring his decision to the attention of the Board of Directors so that it will supervise their execution and the allocation of the additional hours of the external employees.
- 2) Board and lodging payments – the Supervisor of Wages determines that Company payments for board and lodging deviate from that which is customary in the Civil Service, are contrary to section 29 of the Foundations of Budget Law and are therefore not valid. The Supervisor of Wages instructed the Company to adjust these payments to those customary in the Civil Service. The Supervisor of Wages intends to consider demanding return of payments from employees who received this benefit and were paid these payments in excess as of October 1, 2010, subject to the employees' right to a hearing within 60 days.
- 3) Command increment – the command increment is paid to various groups of employees of command level at different rates. According to the letter of the Supervisor of Wages, command increment should only be paid in accordance with a collective agreement of 1994. Additionally, according to the letter of the Supervisor of Wages, command increment is not to be paid to managers of deputy division/district manager level and upwards. The Supervisor of Wages intends to consider demanding a return of the payments paid to employees in excess as of October 1, 2010, and to pensioners as of October 1, 2011, subject to the employees' and pensioners' right to a hearing within 60 days.

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NOTE 12:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)

g. Examinations by the Supervisor of Wages (continued)

- 4) Global pension overtime – members of the management of the Company (at a level of division/district managers and upwards) receive wages structured as “total pay”, which are composed of a rank value and a global overtime value, and are not entitled to a separate payment for overtime. The Supervisor of Wages is instructing not to include the global overtime component in the calculation of the pension determining salary of management members who were appointed after 1996. Additionally, the Supervisor of Wages instructs that as of the salary of October 2013, the global overtime will not be taken into account as a determining component of the pension salary, with all that it entails (including their inclusion as a basis for calculating salary components that are paid based on the pension salary) for anyone who is not of A rank (anyone appointed as a member of management after the A rank was blocked in 1996. The Supervisor of Wages intends to consider demanding a return of the payments paid to management members in excess as of October 1, 2010, and pensioned management members as of October 1, 2011, subject to the these employees’ and pensioners’ right to a hearing within 60 days.

- 5) Increased compensation to temporary employees in an emergency plant – the Supervisor of Wages has decided not to intervene in this component.
According to the position of the Supervisor of Wages, as arises from the State’s response which was submitted to the Haifa Regional Labor Court within a legal proceeding that is being conducted following the decision of the Supervisor of Wages (see also Note 34 c 7). The possible effect of the Supervisor of Wages’ decision on the current salary cost of the Company employees is a decrease in the salary cost of approximately NIS 150 million per year, and a one-time decrease of approximately NIS 450 million in the actuarial obligation of the Company. The Company disagrees, as aforesaid, with the determination of the Supervisor of Wages that this concerns wage deviations. The position of the Company, which is based, inter alia, on legal opinions it has received, is that the four stated wage components are paid by it in accordance with the law and the Company has a valid obligation to continue to pay them to the employees, and accordingly the Company also disagrees with the scope of the possible effect (decrease) of the decision on the current expenses of wage costs and the stated change (decrease) in the actuarial liability.
On October 22, 2013, the Court granted validity of a decision to these agreements of the parties, according to which the stated Supervisor of Wages’ decision will not enter into effect, until the ruling in the main case that will be submitted in this matter. In March, 2014, the Regional Court of Labor ruled that the stated decision of the Supervisor of Wages will not enter into effect until a decision is reached in the main case in this matter, and on the other hand the employees’ representatives will not take organizational steps. On August 20, 2014, a partial ruling was passed in the proceeding, addressing the issue of the casing of the considerations of the decision (as opposed to the decision itself), under which there was no legal flaw and flawed considerations were considered in the casing of the decision of the Supervisor, except for the issue of exhausting the right to a hearing. Afterwards, the hearing proceeding by the Supervisor of Wages was completed, and following the hearing, the Supervisor of Wages published an updated decision on December 11, 2014. In his updated decision, the Supervisor of Wages repeated all the determinations that were included in his original decision as detailed above, except for the following changes: approval to pay a command increment of 2.5% to employees meeting the criteria detailed in the Company’s response and approval to pay a command increment of 12.5% to division managers and deputy CEO’s. The parties are in the midst of negotiations to agree about the authorization of the Court as their arbitrator for the decision of Supervisor itself according to the final call method, in a manner that will render a judicial decision in the proceeding superfluous.
In light of the aforesaid decision of the Court with regard to the decision of the Supervisor of Wages not entering into effect, until a decision is reached in the main case, and taking into account the position of the Company with regard to its obligation to continue paying the wage components that are the subject of the decision of the Supervisor of Wages, a change (decrease) was not performed in the actuarial liability of the Company in its Financial Statements.
Additionally, the Supervisor of Wages announced his intention to conduct an examination of the terms of the wages, work and pension paid to the Company employees and pensioners. Within this the validity of the Company wage components will be examined. In the first stage of the inspection, the Supervisor of Wages will use the information that will be delivered/was delivered by the Company to the team of regulators that was established in order to increase the coordination and more efficient supervision of the Company.

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NOTE 12:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)

h. Changes in the Actuarial Assumptions during the Report Period

- 1) According to the staff accounting bulletin number 21-1 of the Securities Authority of November 25, 2014, regarding the existence of a high quality corporate debenture deep market, as of December 31, 2014, the Company, for the purpose of capitalizing the liability with respect to the bonuses for employees, is using the capitalization rate that conforms to market yields for the high quality corporate debentures. In previous reporting periods and during the current period, except for the calculation of the liability balance as of December 31, 2014, the Company used the capitalization rate that conformed to market yields for government debentures. In accordance with this and in light of the increase in the capitalization rate that is derived from the decision as stated, in the reporting year, the Company recognized a decrease in liability with respect to a plan for a defined bonus, that is attributed to the increase in the capitalization rate as stated of approximately NIS 5.2 billion, which was charged to other comprehensive income of approximately NIS 2.9 billion (net of tax), and approximately NIS 1.2 billion for the fixed assets.

Details of the change derived from the existence of a deep market for high quality corporate debentures as of the end of the period:

	As of December 31, 2014	
	Capitalization rate %	Liability value (before changes in the assumptions in sections 2-4 above) in NIS millions
With assumption of capitalization rate conforming to yields of		
Government debentures	1.5	30,427
With assumption of capitalization rate conforming to yields of high		
quality corporate debentures	2.56	25,239
Gap as a result of change of the assessment of capitalization rates .	1.06	5,189

In addition, in light of the change in assessment as stated, as of 2015, the Company estimates that it will recognize a decrease in expenses with respect to a plan for a defined bonus, which will cause an increase in the profit or decrease in the loss of the Company in the amount of NIS 160 million, net of tax.

The weighted annual real interest rate grossed in the present value of the liability as of December 31, 2014 according to market yields for corporate debentures 2.56% and according to market yields for government debentures 1.5%.

- 2) In the actuarial estimate of liability as of December 31, 2014, the Company carried out through the actuary a salary study, based on past salary data (salary agreements including cost of living allowance), such that the nominal increase for 2013-2016 is 0.8% per year (real 0.1%), and from 2017 onwards a real salary erosion of - 0.75% a year.
The impact of the change of estimate is an increase in actuarial liability of approximately NIS 1,078 million that derives mainly from changes in forecasts of inflation and the low inflation in 2014. (Calculated as stated after implementation of the deep market).
- 3) An update was carried out for work hypotheses that served to calculate the forecasted electricity rate assessment, which constitutes part of the liability estimate with respect to discounted electricity. This update increased the actuarial liability as of December 31, 2014 by approximately NIS 53 million (calculated as stated after implementation of the deep market).
- 4) The salary study also included the examination of changes in the salary of Company employees that do not derive from general salary agreements or current or regular increases (such as promotion in rank or seniority increment). The findings of this study divided into rates of eligibility for advance study fund A or B for employees that are not entitled to these supplements according to age on the balance date, and to annual salary increase deriving from additional salary increases according to age. The total impact of the assumption update was a decrease of actuarial liability as of December 31, 2014 by approximately NIS 11 million. (Calculated as stated after implementation of the deep market).

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NOTE 12:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)

- i. The aforementioned reserve sections, with respect to post-employment employee benefits as of December 31, 2014 and December 31, 2013, amount to a total of NIS 26,359 million, NIS 25,890 million respectively.
- j. In October, 2012, the State Comptroller published a report relating to the period December 2008 until January 2012, pertaining to the pension arrangements of the employees of the Company. Within the report, the State Comptroller notes, inter alia, the following issues: the change of the spread mechanism of the Company payments to the Central provident Fund for Pension, the manner of recording the actuarial liability in the financial statements of the Company and the reports of the fund, lack of recognition of the pension expenses component within the rate by the Electricity Authority, depositing money in a trust account to cover the actuarial liability and the appropriate approvals, improvement of employment terms and pension terms and the appropriate approvals, lack of coordination between various supervisory bodies having supervisory authority over the Electric Company, the functioning of the Board of Directors of the Company and its management in the matter of the pension arrangements, as well as defects in the functioning of the Government Ministries, the Board of Directors and the management of the Company.

The Company has worked to repair the defects that were raised within the report of the State Comptroller.

Based on the opinion of its legal counselors, the Company estimates that the report of the State Comptroller is not expected to have a material impact on the Financial Statements.

k. Reserves

1) Changes in the present value of the obligation for pensions

	For the Year ended December 31		
	2014	2013	2012
	NIS in millions		
Present value of the obligation for pensions as of the beginning of the year	22,853	22,756	16,967
Cost of interest	522	519	533
Current service cost	299	306	257
Past service cost - changes in the plan's conditions that were recognized due to the pension linkage to the CPI.....	-	-	2,810
Benefits paid	(692)	(636)	(616)
	<u>22,982</u>	<u>22,945</u>	<u>19,951</u>
<u>Losses (gains) with respect to remeasurement:</u>			
Actuarial gains deriving from changes in demographic assumptions	-	(152)	(6)
Actuarial losses (gains) deriving From changes in financial assumptions*	25	(108)	2,362
Impact of differences between the previous actuarial assumptions and that which occurred in practice (hereinafter: "Adjustments based on past experience").....	345	168	449
	<u>370</u>	<u>(92)</u>	<u>2,805</u>
Present value of the obligation for pensions as of the end of the period.....	<u>23,352</u>	<u>22,853</u>	<u>22,756</u>

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NOTE 12:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)

k. Reserves (continued)

2) Changes in the present value of the obligation for other post-employment benefits

	For the Year ended December 31		
	2014	2013	2012
	NIS in millions		
Present value of the obligation for other post-employment benefits as of the beginning of the year	2,918	3,044	2,633
Cost of interest	67	70	72
Current service cost	61	61	50
Past service cost - changes in the plan's conditions that were recognized due to the pension linkage to the CPI.....	-	-	42
Benefits paid	(95)	(66)	(63)
	<u>2,951</u>	<u>3,109</u>	<u>2,734</u>
<u>Losses (gains) with respect to remeasurement:</u>			
Actuarial gains deriving from changes in demographic assumptions	-	(24)	(1)
Actuarial losses (gains) deriving from changes in financial assumptions *	(111)	(160)	507
Adjustments based on past experience	90	(7)	(196)
	<u>(21)</u>	<u>(191)</u>	<u>310</u>
Present value of the obligation for other post-employment benefits as of the end of the period.....	<u>2,930</u>	<u>2,918</u>	<u>3,044</u>

* The changes in the financial assumptions in the report period in the amount of NIS (86) million are composed of the impact of the change of the salary erosion assumption NIS 1,078 million, offset by the impact of the transition from using a government capitalization rate to using a corporate capitalization rate NIS (5,189) million plus impact of change of estimate of the discounted electricity rate NIS 53 million, offset by the impact of the change in the salary increase assumption that do not derive from general agreements or current increases NIS (11) million, plus impact of the change in capitalization rates according to Government debentures' market yields in the report period NIS 3,983 million.

3) Changes in present value of the obligation with respect to special agreements on early retirement

	For the Year ended December 31		
	2014	2013	2012
	NIS in millions		
Present value of the obligation as of the beginning of the year	119	171	217
Cost of interest	2	3	5
Additional provision with respect to employee retirement at termination of employment.....	2	-	2
Past service cost - changes in the plan's conditions that were recognized due to the pension linkage to the CPI.....	-	-	17
Benefits paid	(48)	(68)	(76)
Actuarial losses with respect to the obligation charged to the Profit and Loss.....	2	13	6
Present value of the obligation as of the period end.....	<u>77</u>	<u>119</u>	<u>171</u>

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NOTE 12:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)

I. Funds

1) Central Pension Fund

- a) From March 8, 2005, the Company deposits funds in the Central Pension Fund (hereinafter: the "Fund") to cover pension liabilities for pension for its employees entitled by the budgetary pension arrangements.

The Pension Fund acts by force of the Control of Financial Services (Provident Funds) (Rules for Management of a Central Provident Fund) Regulations – 2012. The fund was managed by the managing company accordingly. As of May 1, 2010, Infinity – Administrating the Main Pension Fund Ltd. (hereinafter: the "Fund"), manages the fund.

- b) According to the Financial Statements of the Fund, the actuarial liability as of December 31, 2014 is NIS 29,905 million and the debt of the Company on that date is approximately NIS 2,166 million. According to the Financial Statements of the Company, its actuarial liability for the pension obligations as of December 31, 2014 is NIS 23,429 million.
- c) The difference between the actuarial liability in the financial statements of the Fund as of December 31, 2014, and the actuarial liability in the financial statements of the Company as of December 31, 2014, derives from a difference in calculation methodology between the bodies, which partly derives from different professional approaches, according to the rules that oblige each of the bodies: the Company calculates the actuarial liability in accordance with the accounting rules applied to the Company (in accordance with the International Financial Reporting Standards, including IAS 19 and the directives of the Securities Authority), while the Fund acts in accordance with the instructions of the Capital Market, Insurance and Savings Division Officer, where the Actuary of the Fund noted that the assumptions used to prepare the statement of financial position comply with the instructions of the Capital Market, Insurance and Savings Division Officer for preparing actuarial statements of financial position.

The main difference between the assumptions derives from the discount rate, used to calculate the actuarial liability, i.e. the Fund capitalizes the actuarial liability according to the discount rate of government debentures and the Company according to corporate debentures, see section h above, and the assumption of the real increase in salary assumption, rate of employee promotion, seniority increment, labor agreements, salary erosion, etc. The difference in these assumptions causes a difference of approximately NIS 6.5 billion.

- d) Following the decision of the Board of Directors to examine the gap between the actuarial calculations of the Company and the Fund and in response to the Company's application to the Fund's management on this issue, on October 22, 2013, the Company received the Fund management's response to the issue of the gap between the actuarial calculations. Within this, the Fund's explanations of its choice of the calculating method of the actuarial obligation performed by the Fund's actuary were detailed. The Fund also noted that in the past, the calculation method of the Fund was examined by the Commissioner of the Capital Market, Insurance and Savings Division, who determined that he has no objection to the assumptions used by the actuary of the Fund. Following this, the Company applied to the Commissioner of the Capital Market, Insurance and Savings Division, requesting to accept his response and to settle the manner of handling the subject.

On December 4, 2013, the response of the Commissioner of the Capital Market, Insurance and Savings in the Ministry of Finance was received, stating, among others, that the calculation of the actuarial liability in the financial statements of the Fund was carried out according to accepted actuary principles.

Additionally, an ongoing dialogue and examinations of the differences in the actuarial assumptions between the Fund management and the Company management are maintained, so that the actuarial assumptions will be as similar as possible in accordance with all the above mentioned.

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NOTE 12:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)

I. Funds (continued)

1) Central Pension Fund (continued)

- e) On December 2, 2012, the Control of Financial Services (Provident Funds) (Rules for Management of a Central Provident Fund) Regulations – 2012 were published. At the same time, the circular “Instructions for Management of a Central Provident Fund” was published by the Commissioner of the Capital Market, Insurance and Saving. The circular enables, inter alia, to spread payments to the fund by the Company. This circular benefits the Company, mainly regarding the manner of spreading the payment with respect to debt to entitled pensioners.

The mentioned regulations and circular entered into effect on January 1, 2013. A parallel change to the articles of the fund was executed and approved by the Board of Directors of the Company on October 10, 2013. The approval of the Capital Market, Insurance and Savings Division of the Ministry of Finance was received on March 31, 2014.

In accordance with the aforesaid change, as of March 31, 2014, the manner of spreading the payments to the Fund with respect to the actuarial liability is detailed below:

(1) With respect to active employees:

Growth - as defined in the new regulations deriving from seniority supplement, the complete amount will be deposited during the year following the financial year in equal semiannual payments (at the end of the half and at the end of the year).

Other growth - the higher of the following sums will be deposited in the year following the financial year in two equal payments:

- (a) 10% of the lacking sum due to the employees.
- (b) A sum equal to 0.5% of the total actuarial liability with respect to the employees.

(2) With respect to pension receivers:

The higher of the following sums will be deposited in the year following the financial year, in two equal payments (at the end of the half and at the end of the year):

- (a) Half of the lacking sum due to the pension receivers.
- (b) A sum equal to 2% of the total actuarial liability with respect to pension receivers.

(3) With respect to entitling events - retirement or passing away of an entitled employee as defined in the instructions for managing a central pension fund:

At an expected retirement - the actuarial debt, if exists, will be completed a month before payment of the first pension.

At an unexpected passing away / retirement - the actuarial debt will be completed within a month from the date of demand which will be delivered a month from the first payment.

(4) Ongoing transfer:

A sum of not be less than NIS 50 million will be transferred every month (linked to the known CPI of the end of the year), provided that there is an actuarial deficit in the fund (until balanced).

The fund will pay a member the sum accumulated in the fund that exceeds the maximum sum in it, not later than 30 days from the date it submitted the fund's actuarial balance for a certain fiscal year. The maximum sum, as defined in the regulations, accrued actuarial obligation of the member plus 25%.

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NOTE 12:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)

I. Funds (continued)

l) Central Pension Fund (continued)

(5) With respect to special retirement operation - an increase has occurred in the accumulated actuarial liability due to employees or pension receivers as a result of change in the labor agreement, including early retirement agreement, a member will deposit into the employees' account or the pension receivers' account, as applicable, and not later than one year from the date of change in the labor agreement, and subject to regulation 2(f) of the regulations, the lower of the following:

- (a) The sum of the increase in the accumulated actuarial liability deriving from the stated change.
- (b) The amount required to equalize the total assets in the account to the total accumulated actuarial liability.

Regarding this, regulation 2 (f) - a member of a central pension fund will deposit sums required to complete the entire actuarial liability due to retirement of an entitled employee or due to his passing away, on a date and at a rate as the Supervisor will instruct, provided that the above mentioned date for completing the entire actuarial liability will not be later than two months from the first pension payment date.

- f) The Company deposited in the pension fund NIS 600 million during the period ended on December 31, 2014.
- g) The Fund approved its financial statements as of December 31, 2014, on March 18, 2015.
- h) The Fund presents the value of its assets at fair value according to international financial standard principles (IFRS).
- i) In addition to the sums already deposited, according to the forecast of the Company, according to the articles in effect (starting from March 31, 2014), the expected transfers to the Central Pension Fund (Infinity) for 2015 will amount to approximately NIS 600 million (not including deposits that will be required if and insofar as the collective agreement of February 25, 2015 will be approved by the Supervisor of Wages and the Companies Authority. See section f above).

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NOTE 12:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)

I. Funds (continued)

2) Changes in the fair value of the assets of the plan

	For the Year ended December 31		
	2014	2013	2012
	NIS in millions		
Fair value of plan assets as of the beginning of the year	24,988	24,103	21,948
Interest income on plan assets	570	552	607
Deposits.....	600	795	613
Benefits paid	(706)	(686)	(675)
Gains with respect to remeasurements of plan assets:			
Yield on plan assets (except for sums included in the net interest cost)	2,287	224	1,610
Fair value of plan assets as of the period end.....	<u>27,739</u>	<u>24,988</u>	<u>24,103</u>

	For the Year ended December 31		
	2014	2013	2012
	NIS in millions		
Interest income on plan assets	570	552	607
Gains with respect to remeasurements of plan assets	2,287	224	1,610
Actual yield on plan assets	<u>2,857</u>	<u>776</u>	<u>2,217</u>

	For the Year ended December 31		
	2014	2013	2012
	NIS in millions		
Employees participation in the plan	<u>28</u>	<u>27</u>	<u>26</u>

3) Composition of the asset portfolio of the funds of those insured by the Fund:

	For the year ended December 31			
	2014		2013	
	(in NIS million)			
	Quoted in active market	Not quoted in active market	Quoted in active market	Not quoted in active market
Negotiable government debentures	15,805	-	14,149	-
Corporate, negotiable debentures	1,215	-	1,321	-
Deposits and loans	-	4,516	-	4,817
Shares	4,754	-	3,761	-
Other investments	-	622	-	335
Cash	-	827	-	605
	21,774	5,965	19,231	5,757

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NOTE 12:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)

m. Funds in Trust

- 1) Funds in trust are designated to cover actuarial liabilities to employees and liabilities as related to the termination of employer/employee relationships and are invested in Government and corporate bonds.
 - a) The Company has a dedicated trust account for covering its actuarial liabilities (non-budgeted pension components) which exists in accordance with the agreement entered into on March 23, 2000, between the Company and the Trust Company of the United Mizrahi Bank Ltd., ("The Trust Account"). See also Note 13 below.
 - b) On May 20, 2013, the Company filed an application with the Center District Court, for implementing the decision of the plenum of the Board of Directors of March 21, 2013, under which the Company will approach the Trustee and instruct him to transfer the funds in the Trust Account to cover the deficit in the Fund, and/or to execute a reimbursement to the Company (subject to the application to the Court). The proceedings are still pending in the District Court.
 - c) Regarding the release of funds from the Trust Account, see Note 13 to the Annual Financial Statements, and regarding the draft of recommendations of the steering committee which was published on March 23, 2014, see Note 1 e 4 (j) above.

2) Changes in fair value of funds in trust designated to cover actuarial liabilities (assets according to section 116 A):

	For the Year ended December 31		
	2014	2013	2012
	NIS in millions		
Fair value of funds in trust as of the beginning of the year.....	1,725	1,972	2,113
Interest income from funds in trust	39	40	55
Transfer to Central Pension Fund	-	(253)	(355)
<u>Gains (losses) with respect to remeasurement:</u>			
Yield on plan assets (except for sums included in the net interest cost).....	145	(34)	159
Fair value of funds in trust as of the period end	<u>1,909</u>	<u>1,725</u>	<u>1,972</u>

3) Yield of funds in trust:

	For the Year ended December 31		
	2014	2013	2012
	NIS in millions		
Interest income from funds in trust	39	40	55
Gains (losses) with respect to remeasurement of funds in trust	145	(34)	159
Actual yield on funds in trust	<u>184</u>	<u>6</u>	<u>214</u>
Anticipated annual yield rate of funds in trust as of the beginning of the period	<u>2.29%</u>	<u>2.28%</u>	<u>2.77%</u>

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NOTE 12:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)

n. Capital Reserves With Respect to Remeasurements of the Liability (asset), net (Before Tax Effect)

	For the Year ended December 31		
	2014	2013	2012
	NIS in millions		
Balance as of the beginning of the year	1,391	1,735	690
Yield on the plan assets less sums included in the net interest cost*	(1,576)	(344)	1,045
Balance as of the end of the period	<u>(185)</u>	<u>1,391</u>	<u>1,735</u>

* Less reserve administration fees.

o. Amounts Presented in Cost of Salaries and in Expenses with respect to Liabilities to Pensioners and in fixed assets

	For the Year ended December 31		
	2014	2013	2012
	NIS in millions		
<u>Cost of Salaries and Expenses with respect to Liabilities to Pensioners</u>			
Current service cost after deducting employees participation in the pension plan.....	332	340	281
Cost of interest.....	589	589	605
Interest revenues	(609)	(592)	(642)
Costs due to early retirement	8	19	36
Past service cost - changes in the plan's conditions that were recognized due to pension linkage to the CPI	-	-	2,852
Total cost recognized in salaries cost and expenses with respect to liabilities to pensioners	320	356	3,132

p. Remeasurements that were capitalized to assets cost (fixed assets):

	For the year ended	
	2014	2013
	NIS in millions	
Decrease in fixed assets	<u>(488)</u>	<u>(109)</u>

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NOTE 12:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)

q. Main Actuarial Assumptions Applied to the Actuarial Liability and Plan Assets

	December 31		
	2014	2013	2012
Weighted annual real interest rate grossed in the present value of the obligation at the end of the year*	2.56%	2.29%	2.28%
Rate of return used to calculate the interest cost	2.29%	2.28%	2.77%
Anticipated annual real rate of return grossed in the fair value of plan assets	2.29%	2.28%	2.77%
Average liability lifetime	16.5 years	16.9 years	16.5 years
Real update of salaries during the work period	- individual salary development model of the active employees (according to salary table + ranks promotion according to work agreements +tenure promotion + individual advancement evaluation in addition to the assumption that the salary table will increase at a nominal rate of 0.8% per year for 2013-2016 and will erode at a real rate of 0.75% per year from 2017 onwards compared to the CPI**) and also inclusion of salary increments with respect to current salary agreements.		
Real update of pension amounts after employment termination	- Pension development model - from January 2012 the pensions are linked to the CPI and the actual linking of the pensions to the CPI began in January 2013 (according to the annual change in the CPI in 2012), and thus in future.		
Pensioners and next of kin mortality, including updated mortality data	- According to the Ministry of Finance draft circular dated July 11, 2012, and mortality study regarding employees, pensioners and survivors.		

* In 2012 and 2013, the Company used a capitalization rate that suits the market yields of Government debentures. As of December 31, 2014, the Company is using a capitalization rate that suits the market yields of high quality corporate debentures.

** The assumption with respect to future annual salary increment with respect to general salary agreements and cost of living increment net of the CPI (the general update of the salary scale), see section h 2) above.

r. Analysis of sensitivity of main actuarial assumptions as of December 31, 2014

<u>Actuarial assumptions</u>	<u>Change %</u>	<u>Increase in liability</u>	<u>Change %</u>	<u>Decrease in liability</u>
Rate of interest for capitalization	(0.1)	442	0.1	415
Future salary increase rate with respect to general salary agreements and cost of living increment less the CPI	0.5	730	(0.5)	684

Manner of determining the sensitivity – the actuarial liability for each of the above mentioned actuarial assumptions was calculated once according to the base assumption (as appears in the Financial Statements) and once according to an adjusted assumption (according to a specific scenario), and the increase (decrease) was calculated with respect to the change of this assumption.

- s. The funds for pensions cover all the liabilities of the Company to employees included in the pension plan, assuming that the employees will retire in accordance with the accepted actuarial estimates.
In the event that all employees included in the pension plan are discharged immediately, the liability amount for these employees is significantly higher than the liability amount presented in the Financial Statements. The Management of the Company estimates that such an event is not expected.

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NOTE 13:- FUNDS IN TRUST

- a. The Company holds funds in a trust account for several years, for the purpose of paying pension liabilities of the Company with respect to non-budgetary pension salary components. The trust account was opened in March 2000, after entering into a trust agreement with the Trust Company of Bank Hamizrachi Hameuchad Ltd. In accordance with the agreement, funds will be deposited in the trust account for the sole purpose of using these funds only for paying pensions to employees defined as "generation A" and "generation B" in the aforesaid arrangement with the Government on June 10, 1996 (hereinafter: "96 agreement") and not for any other purpose. The trust agreement stipulated that the trust will only act for the benefit of the entitled employees and the Company will not have any right to withdraw and/or use the funds in any way and/or instruct the trustee on using the fund, except one of the following three possibilities: instruct the trustee to transfer the funds to a pension fund, once it is established, a special payment order to pay entitled employees on account of pensions, instruct the trustee to pay the Company funds out of the trust funds, if the Company will prove that it actually paid entitled employees amounts that should have been paid to these employees by the trustee out of the trust account, had the Company not paid them.

After the Central Provident Fund for Pension was founded, the funds accrued in the trust account up to that date and reflecting the actuarial liability of the Company (as of the founding date of the Central Fund), related pension payments, were transferred to the fund. When the Central provident Fund was founded in 2005, it transpired that it was not possible to transfer all the funds deposited in the trust account: amounts related to payment of different bonuses to employees on the termination of employee - employer relations were not transferred to the Fund, since these are not pensions. Therefore, according to the amendment to the income tax regulations (rules for approving and managing pension funds) - 1964, these funds cannot be transferred to the Pension Fund. In addition, according to the amendment to the pension funds regulations and according to the interpretation of the Capital Market, Insurance and Saving Department in the Ministry of Finance, funds with respect to an actuarial liability deriving from non-budget rights, granted to pensioners (e.g., electricity charge rate benefit, holiday gifts) could not be transferred to the Fund. As of the date of the report, sums are deposited in the trust account to cover the Company's liability to pay the following components: holiday gifts (including grossing up), disability benefit, grossing up charging of the tax benefit with respect to the "discounted electricity" component, grant for unused sick leave, grant for 35 years of employment, grant for employment of up to 35 years, completion of compensation to generation C employees and liability with respect to increased compensation for temporary employees in a special agreement.

- b. On March 20, 2012, an outline of principles was concluded, with the consent of the Company and the Ministry of Finance, aimed at providing a solution to a cash flow problem that was occurred to the Company following the crisis of gas supply from Egypt. In light of that stated, the Company's Board of Directors decided on March 22, 2012, to adopt the concluded principles outline, which states, inter alia, that the Company will act to release surplus funds held in the dedicated trust account for covering the non-budgetary pension components.

Following this decision, and after several legal proceedings that were conducted in the Labor Court following sanctions taken in this matter, and in the District Court, during 2012-2013, the Company transferred NIS 600 million every month, from the trust account to the Central Pension Fund.

- c. On March 26, 2012, the Company received the recommendations of the regulators team on the subject of releasing funds from the dedicated trust account (hereinafter: the "Recommendations Document"). according to which the deposits deposited by the Company with respect to components for generation A employees, which are not listed in the Annex to the agreement of '96, with respect to generation A employees, and also each deposit with respect to components to generation B employees and also deposits with respect to components to generation C employees are deposits for which no obligation to deposit was found.

The Conclusions chapter in the Recommendations Document of the regulators team states that the Company should do everything necessary, including before the Trustee and the beneficiaries under the Trust Agreement, and by law, to release money deposited in the Trust Account, which the Company is not required to deposit. The decision of the Board of Directors of the Company of March 22, 2012, concerning the release of NIS 600 million, constituted, in the opinion of the regulators team, a "first step for the execution of the foregoing". At the same time, the regulators team believes that the Company's Board of Directors should continue to make the suitable decisions and act accordingly concerning the balance of the funds in this account, to implement the aforementioned principles. The regulators team also believes that the Company should consider acting, at the first stage and immediately to exercise the stipulations of the trust agreement in a way that will use the trust account funds for its purpose according to the trust agreement.

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NOTE 13:- FUNDS IN TRUST (continued)

c. (continued)

In practice, it is the opinion of the regulators team that the Company should consider exercising its authority, as determined by the trust agreement, to instruct the trustee for the purpose of receiving refunds from the trust account with respect to payments it paid out of its coffers.

It is also stated that as the founder of the trust account, the Company should also reconsider the range of means at its disposal, including according to trust laws, to interpret the trust agreement or adjust it to arrangements to which it is obligated and not beyond that.

Following the recommendations of the team of regulators, the Company legally examined if the Ministers' arrangement from 1996 obliged it to create a fund for liabilities with respect to the pension components that are of a non-budgetary character, and the ways it can use the money of the trust account. The Company also corresponded on this matter with the team of regulators.

On March 21, 2013, the Board of Directors of the Company decided that, while paying attention to the fact that according to the opinion received by the Company, the conclusion that the 1996 agreement obliges the Company to deposit money in the manner in which the Company acted is not unequivocal, when considering the total considerations pertaining to the matter, including the determinations of the State Comptroller, the recommendations of the team of regulators and after the position of the representative of the employees has also been considered, the Company shall approach the trustee and instruct him to transfer the money of the trust account to cover the deficit of the Central Pension Fund and/or to reimburse the Company (subject to an application to a Court of Law as detailed below).

Money that has accumulated in the trust account with respect to the non-budgetary components detailed in Annex A of the 1996 arrangement with respect to Generation A employees, that are designated to cover these payments to these employees and pensioners, will remain in the trust account and serve the stated need.

In view of the agreement reached in June 2012 at the District Court between the trustee, the Company, the representatives of the employees and the Attorney General, regarding the trust account, the Company applied to the District Court of the Central District with a suitable application for the purpose of implementation of the stated decision of the Board of Directors. This proceeding is still pending at the Center District Court.

- d. The funds of the trust account are invested in Government and corporate debentures and presented at fair value (see also Note 12 b above).
- e. Regarding the draft of recommendations of the steering committee which was published on March 23, 2014, see Note 1 e 4 (j) above.

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NOTE 14:- FIXED ASSETS

a. (1) <u>Composition and changes in 2014</u>	COST				ACCUMULATED DEPRECIATION				Depreciated balance	
	Balance on January 1, 2014	Classification	Deduction (*)	Net addition (**)	Balance on December 31, 2014	Balance on January 1, 2014	Deduction	Addition	Balance on December 31, 2014	On December 31, 2014
	(NIS in millions)									
<u>FIXED ASSETS IN USE</u>										
Power plants (including land, buildings and machinery)	70,235	1,127	153	443	71,958	45,716	-	2,411	48,127	23,831
Sub-stations.....	13,785	54	(17)	91	13,913	8,170	(11)	435	8,594	5,319
Overloading control center	1,026	1	-	33	1,060	919	-	25	944	116
Telecommunications.....	1,622	4	-	25	1,651	1,333	-	61	1,394	257
Switching stations and 400 KV voltage lines	8,408	66	(6)	(19)	8,449	4,581	(3)	294	4,872	3,577
High voltage transmission lines	6,602	61	(18)	(5)	6,640	3,682	(14)	170	3,838	2,802
Distribution networks	43,062	306	(132)	684	43,920	24,334	(94)	1,074	25,314	18,606
Installations, etc. - East Jerusalem district.....	138	-	-	-	138	138	-	-	138	-
Meters	1,878	19	(51)	48	1,894	1,330	(46)	87	1,371	523
Land, office buildings	3,230	9	(5)	34	3,268	1,820	(6)	87	1,901	1,367
Office equipment and tools	1,586	4	(1)	28	1,617	1,424	-	35	1,459	158
Computers.....	1,603	-	(32)	13	1,584	1,546	(32)	24	1,538	46
Motor vehicles	734	-	(62)	115	787	408	(58)	92	442	345
Mobile mechanical equipment	686	-	(108)	17	595	411	(107)	36	340	255
Emergency equipment	66	-	(1)	4	69	54	(1)	1	54	15
Other projects.....	723	10	-	20	753	96	-	25	121	632
	155,384	1,661	(280)	1,531	158,296	95,962	(372)	4,857	100,447	57,849
Less: receipts for extension of the electricity network	(9,315)	-	-	-	(9,315)	(7,348)	-	(145)	(7,493)	(1,822)
	146,069	1,661	(280)	1,531	148,981	88,614	(372)	4,712	92,954	56,027
Spare parts for power plants and substations	1,469	(87)		34	1,416	396	(31)	58	423	993
Total fixed assets in use.....	147,538	1,574	(280)	1,565	150,397	89,010	(403)	4,770	93,377	57,020
<u>FIXED ASSETS UNDER CONSTRUCTION</u>										
Power plants, buildings and other installations	4,051	(984)	(31)	1,110	4,146	19	-	1	20	4,126
Sub-stations and high voltage lines	1,050	(36)	(2)	277	1,289	53	-	2	55	1,234
Switching stations and 400 KV voltage lines	294	(33)	-	172	433	-	-	-	-	433
Payments on account of equipment	176	(50)	-	23	149	-	-	-	-	149
Materials and payments on account of materials designated for investments in fixed assets.....	564	(471)	(11)	473	555	-	-	-	-	555
Total fixed assets under construction.....	6,135	(1,574)	(44)	2,055	6,572	72	-	3	75	6,497
Total fixed assets	153,673	-	(324)	3,620	156,969	89,082	(403)	4,773	93,452	63,517

(*) Including cancellation of deduction according to FAS 90 in the amount of NIS 153 million (included in depreciation and amortization section).

(**) Less receipts from development works orders.

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NOTE 14:- FIXED ASSETS (continued)

	COST				ACCUMULATED DEPRECIATION				Depreciated balance	
	Balance on January 1, 2013	Classification	Deduction (*)	Net addition (**)	Balance on December 31, 2013	Balance on January 1, 2013	Deduction	Addition	Balance on December 31, 2013	On December 31, 2013
a. (2) <u>Composition and changes in 2013</u>	NIS in millions									
<u>FIXED ASSETS IN USE</u>										
Power plants (including land, buildings and machinery)	67,597	1,927	(36)	747	70,235	43,191	-	2,525	45,716	24,519
Sub-stations.....	13,683	29	(20)	93	13,785	7,753	(13)	430	8,170	5,615
Overloading control center	991	1	-	34	1,026	901	-	18	919	107
Telecommunications.....	1,585	3	-	34	1,622	1,268	-	65	1,333	289
Switching stations and 400 KV voltage lines	8,262	75	-	71	8,408	4,293	-	288	4,581	3,827
High voltage transmission lines	6,368	309	(63)	(12)	6,602	3,572	(56)	166	3,682	2,920
Distribution networks	42,181	345	(160)	696	43,062	23,411	(118)	1,041	24,334	18,728
Installations, etc. - East Jerusalem district.....	138	-	-	-	138	138	-	-	138	-
Meters	1,830	20	(40)	69	1,879	1,283	(36)	83	1,330	549
Land, office buildings	3,133	66	(3)	33	3,229	1,721	(2)	101	1,820	1,409
Office equipment and tools	1,558	3	-	25	1,586	1,387	-	37	1,424	162
Computers.....	1,589	-	(15)	29	1,603	1,534	(15)	27	1,546	57
Motor vehicles	724	-	(80)	90	734	396	(73)	85	408	326
Mobile mechanical equipment	659	-	(69)	96	686	445	(66)	32	411	275
Emergency equipment	63	-	-	3	66	52	-	2	54	12
Various projects	686	10	-	27	723	73	-	23	96	627
	151,047	2,788	(486)	2,035	155,384	91,418	(379)	4,923	95,962	59,422
Less: receipts for extension of the electricity network	(9,315)	-	-	-	(9,315)	(7,195)	-	(153)	(7,348)	(1,967)
	141,732	2,788	(486)	2,035	146,069	84,223	(379)	4,770	88,614	57,455
Spare parts for power plants and substations	1,473	(83)	-	79	1,469	381	(42)	57	396	1,073
Total fixed assets in use.....	143,205	2,705	(486)	2,114	147,538	84,604	(421)	4,827	89,010	58,528
<u>FIXED ASSETS UNDER CONSTRUCTION</u>										
Power plants, buildings and other installations	3,917	1,760	122)	2,016	4,051	16	-	3	19	4,032
Sub-stations and high voltage lines	1,030	(266)	3)	289	1,050	50	-	3	53	997
Switching stations and 400 KV voltage lines	204	25	(1)	66	294	-	-	-	-	294
Payments on account of equipment	274	139)	(6)	47	176	-	-	-	-	176
Materials and payments on account of materials designated for investments in fixed assets.....	582	565)	(16)	563	564	-	-	-	-	564
Total fixed assets under construction.....	6,007	2,705)	148)	2,981	6,135	66	-	6	72	6,063
Total fixed assets	149,212	-	634)	5,095	153,673	84,670	421)	4,833	89,082	64,591

(*) Including deduction according to FAS 90 in the amount of NIS 341 million (included in depreciation and amortization section).

(**) Less receipts from development works orders.

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NOTE 14:- FIXED ASSETS (continued)

b. Fixed Assets Impairment Test according to IAS 36

Through external consultants, the Company executed a review of the need for a provision for assets impairment, in accordance with IAS 36. This review was conducted in addition to the provision for assets impairment according to the directives of SFAS 90 (according to recognition of the assets for the rates, see section j above).

The work was executed in accordance with forecasts of future cash flow expected to be derived for the Company was prepared based on the current rates structure and on assumptions, representing, inter alia, the economic conditions that, according to the opinion of the management of the Company, will exist during the useful life span of unit assets. Following are the main assumptions:

- 1) In reviewing the cash-generating units, the Company identified the three operating segments of the Company as one cash-generating unit. The Company is of the opinion that cash yielding in the Company is integrated in all the segments and is not independent.
- 2) The current rate base for the generation segment, as determined in February 2010, set the level of costs recognized for the Company in the generation segment for 2010-2014. The estimate of the Company is that the new rate base for this segment will become effective as of July 2016.
- 3) The new rate base for the transmission and distribution sectors will become retroactively effective From April 1, 2012, based on the Decision of the Electricity Authority on March 22, 2012. Regarding the draft of the work of the consulting company on behalf of the Electricity Authority (the Navigant draft report) - update of rate base for transmission and distribution. The impact of the draft report regarding a new rate base was not reflected in the cash flow forecast, but its impact was examined in the sensitivity analyses (see Note 3 c above).
- 4) Based on past experience, work principles of the Electricity Authority and directives of the Electricity Sector Law, the Company's Management assumes that the rate base will be updated over time.

Pursuant to understanding the way in which the Electricity Authority determined rates recently, the Company assumes that the future rate bases also included normative components. These normative components are currently determined and will probably be determined in the future on the basis of costs of the Company in the past or the economic environment in which it operates.

The Company believes that the normative components will be structured in a way that will allow the Company to gain profit from some of them by performance that exceeds the norms and will earn less or incur a loss from costs that are higher than the rate coverage, for some components.

The policy of the Company in recent years is to decrease actions and investments that do not have full cost coverage in the rate from the Electricity Authority, for the purpose of meeting the rate outline. Therefore, the Company estimates that after the update of the rates bases, it is anticipated that full coverage will be provided to all investment and operating costs incurred by the Company, in each of the segments, starting from the update date of the rate base for this segment.

However, the Company estimates that certain events may prevent it from meeting the rate outline during a certain period, while in other periods it will meet the rate outline in a way that will yield a higher than required gain. On the average, and in view of the aforesaid, the Company expects that it will meet the rate outline in a way that will allow full costs coverage for its investment and operation costs.

- 5) Fuels expenses incurred by the Company will be covered by the electricity rate throughout the periods of the forecast.
- 6) Weighted Average Capital Cost (WACC) - 3.7% after tax for the generation segment. This value reflects the time value of the money and the specific risks as determined in the electricity rate. With respect to the transmission and distribution segments, the rate of capitalization was assumed to be equal to the rate of return that will be granted by the Electricity Authority, in order to reflect the estimation of the Management of the Company with respect to the full coverage in these segments, as stated.

The aforementioned calculations show that the recoverable amount of the Company's assets is not lower than their value in these Financial Statements

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NOTE 14:- FIXED ASSETS (continued)

- c. Investments in land (before amortization), which are included under fixed assets include NIS 994 million for long term land leases and NIS 690 million for land owned by the Company.
A substantial portion of the land property, in which the Company has rights, is not registered in the Land Registry and the status of such properties has not been settled for various technical reasons, such as the absence of parcelization in a portion of those areas, the requirements of planning authorities to assemble master plans, and disputes with the various authorities, including the tax authorities, mainly regarding assets that were purchased many years ago and changes in registration, which prevent obtaining authorizations for registration in the Land Registry. Due to the great complexity of the matter, it is not possible to estimate the period of time which will be required to conclude registering the land, but, in the Company's opinion, this cost of registering the land, as aforesaid, is not anticipated to be substantial.
There are capitalized contracts with respect to the majority of the land leased by the Company from the Israel Land Administration.
- d. As of the date of the expiration of the Concession period (March 5, 1996), the Company had fully written off the cost of acquiring land in the amount of NIS 577 million as to which the Company's right to receive compensation at the expiration of the Concession was unclear. Land purchased in late 1995 at a cost of NIS 353 million, as to which the Company received confirmation from the Ministry of Finance and the Ministry of Energy and Infrastructure that it would receive adequate compensation, was not written off.
- e. See Note 20 g for liens related to fixed assets.
- f. See Note 34 a 6) for fixed asset investment commitments.
- g. Accumulated financial costs, net, capitalized as part of the cost of fixed assets (before depreciation) were NIS 5,812 million and NIS 5,367 million as of December 31, 2014 and as of December 31, 2013, respectively (see Note 32 a).
- h. The Company's Financial Statements include assets, primarily networks and lines located within Judea, Samaria (including the Palestinian Authority territories) ("the territories") with a net book value of approximately NIS 1,089 million as of December 31, 2014. In the opinion of the Company's Management, the utilization of these assets for the purpose of electricity supply will continue and they will remain in the possession of the Company.
In the event that the possession of the balance of the assets, as a whole or partially, located in the territories is taken from the Company, the Company cannot estimate if it will be indemnified in a full or partial amount, if any, for these assets.
- i. According to the American SFAS 90 Standard, the Company examined a need of provision for impairment as of December 31, 2014. A revaluation was performed of the differences between the recognized building costs of generation units and the costs to the Company, consisting of the actual costs paid up to December 31, 2014, and the forecast of costs for completing the unit, for the purpose of determining the provision for impairment as of December 31, 2013 according to American Standard SFAS 90. The valuation for this report also included an updated estimate of the Company's costs, according to the updated valuation of the forecast completion of the projects. In 2014, the reduction decreased by NIS 153 million.

Calculation of the differences relates to units operated on and operated from January 1, 2003 onwards. The estimated difference includes, updating linkage to relevant indices, and also excessive costs in units under construction, which according to the Company's estimates, are highly likely to be recognized by the Electricity Authority after they are operated. The costs incurred by the Company include estimated investments up to the completion of the investment in the unit, according to Company estimates.

- 1) The provision included in the financial statements was calculated according to the percentage of performance out of the gaps of each component in the cost of the generation units.
- 2) In light of the estimates of the Management regarding the success prospects of the appeal against the decision of the Electricity Authority, this accounting provision is not a waiver made by the Company of its requests to cover the non-recognized costs.
- 3) In the event of a change in the decisions of the Electricity Authority and the costs for which a provision for impairment was recorded will eventually be recognized, or in the event that the best estimate of Company's cost will be updated according to updated Company costs according to an updated estimate of projects completion, these costs will be returned to the fixed assets costs.

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NOTE 14:- FIXED ASSETS (continued)

- j. According to the circular of the Companies Authority (see Note 2 a1 above) the Company is required to provide disclosure in the Financial Statements of the implementation of the directives of the Government Companies Authority regarding control and reporting rules for land and attached assets in Government companies in accordance with the Financial Statement Circular 2006-3 of September 17, 2006. The information required above was not included in the Financial Statements. In a letter to the then Director of the Government Companies Authority dated January 10, 2007, the Company's CEO states that back in 1998, the Company stated that it was preparing to collect the extensive amounts of material required. Furthermore, in 1998, a list of the Company's assets was transferred to the Ministry of Finance as of the date of the expiration of the concession and since then and, to date, the list of added assets is immaterial in relation to total assets and is irrelevant with relation to the assets arrangement prescribed by the Electricity Sector Law.

The former CEO also mentioned that in meetings held with the Government Companies Authority and representatives of the Company's Management in negotiations regarding the structural change, the representatives of the employees' organization announced that they would not allow giving out information to the State or transferring any documents in connection with the Company's assets, etc.

In recent years, a focused and continuous process is conducted for gathering and coordinating all the information of all the Company's assets and arranging them in all that relates to book of assets, registering rights, management and regulation. The Company has 320 major sites and a book of secondary sites which is being completed at present.

- k. Regarding the draft of recommendations of the steering committee published on March 23, 2014, see Note 1 e above.

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NOTE 15:- INTANGIBLE ASSETS, NET

	Balance as of January 1, 2014	Additions in 2014	Deductions in 2014	Balance as of December 31, 2014
	NIS in millions			
Cost of software	4,020	172	(99)	4,093
Accumulated amortization of software	(3,074)	(140)	95	(3,119)
Intangible assets, net	946	32	(4)	974

	Balance as of January 1, 2013	Additions in 2013	Deductions in 2013	Balance as of December 31, 2013
	NIS in millions			
Cost of software	3,848	172	-	4,020
Accumulated amortization of software	(2,929)	(145)	-	(3,074)
Intangible assets, net	919	27	-	946

The Company annually examines the useful lifespan of the software it uses.

NOTE 16:- CREDIT FROM BANKS AND OTHERS

Composition:

	As on December 31	
	2014	2013
	NIS in millions	
Short term loans	456	186
Current maturities of loans and debentures *	7,469	6,640
Current maturity of a liability to the State of Israel*	300	250
Maturities for forward and swap transactions	126	28
Total	8,351	7,104

* With respect to interest rates for current maturities, see Note 20.

NOTE 17:- OTHER CURRENT LIABILITIES

Composition:

	As on December 31	
	2014	2013
	NIS in millions	
Employees	220	198
Institutions	166	314
Interest and accrued expenses	1,284	1,134
Other payables	129	93
	1,799	1,739

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NOTE 18:- CUSTOMER ADVANCES, NET OF WORK IN PROGRESS

Represents receipts from customers, net of work in progress with respect to attachments to buildings and works for others (see also Note 2(q) above).

Composition:

	Connections to buildings		Work paid for by others		Total	
	As on December 31		As on December 31		As on December 31	
	2014	2013	2014	2013	2014	2013
	NIS in millions		NIS in millions		NIS in millions	
Receipts from customers	418	416	469	362	887	778
Less: expenses with respect to work in progress	(148)	(175)	(286)	(206)	(434)	(381)
	270	241	183	156	453	397

NOTE 19:- PROVISIONS

Composition:

	Provision for legal claims (1)	Provision for vacation pay	Municipal tax	Others	Total
	NIS in millions				
Balance as of January 1, 2014	355	302	64	8	729
Additional recognized provisions	29	-	4	13	46
Updated current provisions	14	230	12	-	256
Amounts used during the year	-	(225)	(37)	(1)	(263)
Amounts canceled during the year	(49)	-	-	-	(49)
Balance as of December 31, 2014.....	349	307	43	20	719

	Provision for legal claims (1)	Provision for vacation pay	Municipal tax	Others	Total
	NIS in millions				
Balance as of January 1, 2013	378	270	74	9	731
Additional recognized provisions	29	-	9	-	38
Updated current provisions	(4)	261	19	-	276
Amounts used during the year	-	(229)	(38)	(1)	(268)
Amounts canceled during the year	(48)	-	-	-	(68)
Balance as of December 31, 2013.....	355	302	64	8	729

(1) In 2014, the Company recorded net revenues of approximately NIS 20 million resulting from the settlement of legal claims as existed on December 31, 2013 in amounts smaller than the provisions recorded for them.

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NOTE 20:- DEBENTURES AND LIABILITIES TO BANKING CORPORATIONS AND OTHERS

a. Composition of the long-term debentures and liabilities and hedging transactions, net

Linkage Basis:	December 31, 2014						December 31, 2013	
	Unlinked NIS	Linked to the CPI		Denominated in U.S. Dollars		Denominated in Japanese Yen	Total	Total
Interest rates (%)	8.5	5-6.9	0.7-1.2	2	6.7-9.4	3.6-4.1		
(1) <u>Debentures:</u>								
Debentures traded on the Israel Stock Exchange	-	629	3,056	-	-	-	3,685	6,194
Debentures not traded in Israel	657	11,170	-	-	-	-	11,827	11,505
Debentures issued abroad	-	-	-	972	20,865	2,441	24,278	17,595
	657	11,799	3,056	972	20,865	2,441	39,790	35,294
Less: deferred charges	-	(5)	(4)	(1)	(61)	(17)	(88)	(92)
(Discount)/premium	16	624	-	-	(62)	(5)	573	614
	673	12,418	3,052	971	20,742	2,419	40,275	35,816
Current maturities:								
Debentures	-	4,473	-	-	-	-	4,473	2,972
Deferred charges	-	(1)	(2)	-	(11)	(1)	(15)	(16)
(Discount)/premium	6	120	1	-	(5)	-	122	156
Total current maturities	6	4,592	(1)	-	(16)	(1)	4,580	3,112
Total debentures, net.	667	7,826	3,053	971	20,758	2,420	35,695	32,704

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NOTE 20:- DEBENTURES AND LIABILITIES TO BANKING CORPORATIONS AND OTHERS (continued)

a. Composition of the long-term debentures and liabilities and hedging transactions, net (continued)

Linkage Basis:	December 31, 2014								December 31, 2013
	Unlinked NIS	Linked to the CPI		Denominated in U.S. Dollars		Denominat ed in Euro	Denominated in Japanese Yen	Total	Total
	NIS in millions								
	0.7-1.9	4.5	0.1	0.6-2.8		0.5-2.7			
(2) <u>Liabilities to banks:</u>									
Loans from banks	2,650	283	96	-	1,142	2,101	-	6,272	9,528
Less: Deferred charges	(1)	-	-	-	(38)	(146)	-	(185)	(223)
	2,649	283	96	-	1,104	1,955	-	6,087	9,305
Current maturities:									
Loans from banks	2,400	-	48	-	104	370	-	2,922	3,569
Deferred charges	-	-	-	-	(6)	(31)	-	(37)	(42)
Total current maturities	2,400	-	48	-	98	339	-	2,885	3,527
Liabilities to banks, net	249	283	48	-	1,006	1,616	-	3,202	5,778
Hedging transactions:									
Deposits	(2,269)	-	-	-	(15,605)	(477)	(2,272)	(20,623)	(15,800)
Loans	3,123	18,899	-	-	-	-	-	22,022	18,602
Total swap transactions	854	18,899	-	-	(15,605)	(477)	(2,272)	1,399	2,802
Forward transactions	948	-	-	-	(952)	-	-	(4)	3
Total hedging transactions	1,802	18,899	-	-	(16,557)	(477)	(2,272)	1,395	2,805
Current maturities of swap transactions	(11)	1,522	-	-	(757)	(370)	(358)	26	25
Current maturities of forward transactions	948	-	-	-	(952)	-	-	(4)	3
Total current maturities	937	1,522	-	-	(1,709)	(370)	(358)	22	28
Total hedging transactions, net	865	17,377	-	-	(14,848)	(107)	(1,914)	1,373	2,777
Transfer of hedge transactions to long-term receivables, net	2,174	(8,385)	-	-	6,373	-	-	162	-
Payables balance with respect to long term hedging transactions	3,039	8,992	-	-	(8,475)	(107)	(1,914)	1,535	2,777
Total liabilities to banking corporations (including hedge transactions)	3,288	9,275	48	-	(7,469)	1,509	(1,914)	4,737	8,555

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NOTE 20:- DEBENTURES AND LIABILITIES TO BANKING CORPORATIONS AND OTHERS (continued)

a. Composition of the long-term debentures and liabilities and hedging transactions, net (continued)

Linkage Basis:	December 31, 2014							December 31, 2013
	Unlinked NIS	Linked to the CPI	Denominated in U.S. Dollars		Denominat ed in Euro	Denominated in Japanese Yen	Total	Total
	NIS in millions							
Interest rates (%)	5-5.75							
(3) Debentures to the State of Israel	-	2,534	-	-	-	-	2,534	2,531
(see Note 23 below)								
Interest rates (%)	6.7-7.4							
(4) <u>Liabilities to the State of Israel</u>								
Loans from the State of Israel (see Note 33 b (2)(d) below)	-	-	-	-	3,224	-	3,224	3,127
Less deferred expenses	-	-	-	-	(22)	-	(22)	(27)
	-	-	-	-	3,202	-	3,202	3,100
Current Maturities:								
Loans from the State of Israel	-	-	-	-	304	-	304	255
Deferred expenses	-	-	-	-	(4)	-	(4)	(5)
Total current maturities	-	-	-	-	300	-	300	250
Loans from the State of Israel net	-	-	-	-	2,902	-	2,902	2,850
Interest rates (%)								
(5) <u>Other Liabilities</u>								
Liabilities for finance leases	-	18	-	-	-	-	18	20
Long-term payables	106	499	-	-	46	18	669	671
	106	517	-	-	46	18	687	691
Current maturities:								
Current maturities	3	1	-	-	-	-	4	1
Total other liabilities, net	103	516	-	-	46	18	683	690
Total debentures, liabilities to banks and other liabilities	4,058	20,151	3,101	971	16,237	1,527	46,551	47,330

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NOTE 20:- DEBENTURES AND LIABILITIES TO BANKING CORPORATIONS AND OTHERS (continued)

b. Composition of the long-term debentures

1) Negotiable series in Israel:

- a) Negotiable debenture Series 22 which was issued in 2002 and listed for trade on the Tel-Aviv Stock Exchange (hereinafter: the "TASE"), is linked (principal and interest) to the known CPI, was paid in full after the balance date on February 20, 2015.
- b) Negotiable debenture Series 24, which was issued in 2012 and listed for trade on TASE, is linked (principal and interest) to the known CPI, is due for redemption in 2015.
- c) Negotiable debenture Series 25, which was issued in 2012 and listed for trade on the TASE, is linked (principal and interest) to the known CPI, is due for redemption in 2017.

2) Non-negotiable series in Israel:

- a) Debentures Series listed for trade on the TASE at the institutional continuous floor are: "Series XI", "Series XII", "Series XIII", "2018 Linked Electric", "2018 NIS Electric", "2015 Linked Electric", "2020 Linked Electric", "2022 Linked Electric", "2029 Linked Electric" and "2024 USD Electric". These series are due for redemption in 2015 to 2029.
- b) Debentures Series not listed for trade on the TASE are: "Series X" and private debentures that were issued in 1991 and 1996. These series will be redeemed in 2015-2020.

3) Non-negotiable series abroad:

The Company has non-negotiable debenture series issued in USD, Euro and Japanese Yen. These series will be redeemed in 2017 to 2096.

c. Raisings and Substantial Payments:

1) Material raisings during the reporting period

- a) On May 1, 2014, the Company conducted a tender for issuance of CPI linked (non-negotiable) private debentures of the series "Electric Linked 2029", to entities mentioned in section 15 a (b) (1) or (2) of the Securities Law, 1968. The scope of this issue, including issue of additional debentures on May 8, 2014 and on May 13, 2014, is in the amount of approximately NIS 766 million par value in consideration for an amount of approximately NIS 939 million (122.1 price), with nominal interest of 6% (3.8% effective interest). The debenture principal will be paid in six equal annual payments starting from May 7, 2024 until May 7, 2029.
- b) On June 2, 2014, the Company raised a sum of NIS 400 million from two Israeli banks through on call type short term loans that are not linked to the CPI.
- c) On September 23, 2014, the Company raised a sum of NIS 200 million from two Israeli banks by realization of short term credit lines for a sum of NIS 800 million.
- d) On November 12, 2014, the Company completed the issue of debentures by the Barclays and Citi investment banks to qualified institutional buyers in the U.S.A. and elsewhere, in a total amount of U.S.D. 1.25 billion par value from a comprehensive plan (GMTN) for debenture issue in a total amount of up to U.S.D. 5 billion par value. The accumulated sum issued so far within the GMTN is U.S.D. 4.65 billion par value. The debentures issued as aforesaid within the plan were listed for trading in the "institutional continuous trading" system at the TASE as debentures of series Electric Dollar 2024. The debentures were issued at a price of 99.031% and the consideration of the issue (gross) was approximately USD 1,238 million. The nominal interest is 5% (effective yield to maturity 5.125%) and will be paid in semi-annual installments. The debenture principal will be paid in one payment on November 12, 2024.

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NOTE 20:- DEBENTURES AND LIABILITIES TO BANKING CORPORATIONS AND OTHERS (continued)

c. Raisings and Substantial Payments: (continued)

2) Material payments during the reporting period

- a) On February 20, 2014, negotiable debentures of series 22 in the amount of NIS 500 million par value (a total of approximately NIS 626.2 million including linkage differentials) were paid.
- b) On March 19, 2014, private (non-negotiable) debentures of the series "Electric Linked 2014" issued to institutional bodies on March 19, 2008, in the amount of NIS 169.7 million par value (a total of approximately NIS 197.5 million including linkage differentials), were paid.
- c) On May 20, 2014, additional negotiable debentures of series 22 in the amount of NIS 500 million par value (a total of approximately NIS 627.5 million including linkage differentials), were paid.
- d) On June 27, 2014, loans in a total amount of NIS 2 billion that are not linked to the CPI and backed by State Guarantee, that were received on December 27, 2012 from four Israeli banks, were paid in full.
- e) On August 20, 2014, additional negotiable debentures of series 22 in the amount of NIS 500 million par value (a total of approximately NIS 630.5 million including linkage differentials), were paid.
- f) On September 8, 2014, on call loans in the sum of NIS 400 million, that the Company raised in June 2014, were paid.
- g) On October 23, 2014, loans in the amount of NIS 200 million, raised by the Company from short term credit lines in September 2014, were paid.
- h) On November 20, 2014, additional negotiable debentures of series 22 in the amount of NIS 500 million par value (a total of approximately NIS 629.9 million including linkage differentials), were paid.
- i) On December 5, 2014, private (non-negotiable) debentures in the amount of NIS 158 million par value (a total of approximately NIS 192.1 million including linkage differentials), issued to the institutional bodies on December 5, 2002, were paid.
- j) On December 15, 2014, an index-linked loan of NIS 1 billion (a total of approximately NIS 1,033.8 million including linkage differentials), received from Bank Hapoalim on December 15, 2011, was paid.

3) Material raisings after the balance sheet date

On January 15, 2015, a loan was received from the Bank Hapoalim in the amount of NIS 1 billion. The loan is not linked to the CPI and will be paid in one payment on January 15, 2018.

4) Material payments after the balance sheet date

- a) On February 20, 2015, additional negotiable debentures of series 22 (final repayment) in the amount of NIS 500 million par value (a total of approximately NIS 623.0 million including linkage differentials) were paid.
- b) On March 20, 2015, private (non-negotiable) debentures of series J in the amount of approximately NIS 1,362.9 million par value (a total of approximately NIS 1,664.0 million including linkage differentials) that were issued to institutional bodies in 2005, were paid in full.

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NOTE 20:- DEBENTURES AND LIABILITIES TO BANKING CORPORATIONS AND OTHERS (continued)

d. Terms of the Company's financing agreements that might result in immediate repayment

The financing contracts of the Company include provisions that provide the lender with the right to demand immediate repayment of the unpaid balance of the loan and the accrued interest on the occurrence of the following main events:

- 1) As is customary in financing contracts, events such as a material violation of the Company's liabilities to the financiers, the granting of a liquidation order, stay of proceedings, issuing an attachment order in a considerable amount as to Company assets, expropriation of a material asset or the appointment of a receiver for material assets of the Company, provide the lenders with the right to demand immediate repayment. Therefore, according to the majority of the bills of charge entered into by the Company, when such events occur, a lender, in whose favor the Company recorded a floating or a fixed charge on its assets, is entitled to realize this charge, subject to certain conditions, if and insofar as these apply to the exercise of the charge.
- 2) In all of the loan agreements, the failure to pay principal or interest on time (or after a period of deferral of repayment as defined in the contract) constitutes a breach that provides the lender with the right to demand immediate repayment. In all of the financing contracts denominated in foreign currency, the Company is obligated to pay the principal and interest in the denominated currency. The Company's inability to purchase foreign currency at the required time and in the required amount may constitute a breach that provides the lender the right to demand immediate repayment.
- 3) In some financing contracts it was determined that the existence of the right to demand immediate repayment of the debt, granted to one lender (namely, even when this lender does not demand immediate repayment), grants the right to another lender, with whom the contract was not breached, to demand immediate repayment (cross default). The volume of financing contracts of the Company, that include a cross default condition, amounts to approximately NIS 26,619 million, as of December 31, 2014. In addition, it was determined in some of the financing contracts that if the Company shall breach its liabilities toward a certain lender and that lender demands immediate repayment as a result of that breach, this will grant the right to another lender, with whom the contract was not breached, to demand immediate repayment (cross acceleration). These financing contracts of the Company that include a cross acceleration condition amount as of December 31, 2014 to approximately NIS 5,521 million. It is clarified that notwithstanding that some of the financing contracts that include a cross default condition also include a cross acceleration condition, in any case the sections of cross default also include, by implication, cross acceleration sections, and therefore when calculating the volume of financing contracts of the Company that include cross acceleration sections, only the financing contracts that include cross acceleration sections were taken into account, and not those with cross default sections.
- 4) The majority of the financing contracts determine that nonpayment pursuant to a ruling against the Company in excess of a certain amount (in the majority of cases, USD 25 million or more) provides the lender with the right to demand immediate repayment.
- 5) In the majority of financing contracts where the Company's liabilities are secured by a State guarantee, the cancellation of the State guarantee or the insertion of changes to it without the lender's consent constitutes a breach that provides the lender with the right to demand immediate repayment.
- 6) In part of the financing contracts, there is a blanket prohibition against the transfer of assets that are the subject of the specific financing. In other financing contracts, the Company has the right to transfer assets subject to conditions/restrictions included therein, including obtaining the lender's consent. Certain contracts allow the transfer of assets to subsidiaries of the Company, on condition that these assets constitute less than 5% of the Company's assets. Certain financing contracts prescribe that the Company is entitled to transfer assets when the following accumulated conditions are fulfilled:
 - a) The transfer is made at market value (according to the determination of an appraiser or the Company),
 - b) At least 75% of the proceeds were received in cash or cash equivalents,
 - c) The Company shall invest the proceeds in active assets.

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NOTE 20:- DEBENTURES AND LIABILITIES TO BANKING CORPORATIONS AND OTHERS (continued)

d. Terms of the Company's financing agreements that might result in immediate repayment (continued)

- 7) In some of the financing contracts, the Company was provided the right to transfer its liabilities that are the subject of the contract, conditional upon the receipt of the lender's consent. It should be pointed out that pursuant to Israeli law, it is not possible to assign a charge without the creditor's consent. An action by the Company contrary to these provisions constitutes a breach that provides the lender with the right to demand immediate repayment.
- 8) In the majority of financing contracts, the Company is obliged to exhibit presentations of various matters, such as the accuracy of its financial statements, its right to use its assets and its ownership of them, the existence of the required licenses and their timely renewal, etc. In some of these contracts it is stipulated that in a case where it will be determined that the Company's representations were materially misleading (or incomplete), the lender has the right to demand immediate repayment.
- 9) In some of the financing contracts, the existence of a Material Adverse Change" (hereinafter: "MAC") in the business or financial condition of the Company, that poses a risk to the Company's ability to fulfill its obligations to the lenders, entitles the lender to demand immediate repayment of the debt. The financing contracts of the Company include three types of MAC provisions: (1) a MAC provision which can only be enacted subject to a reasonableness test according to the stipulations of the agreement; (2) a MAC provision that leaves the question of the existence of a material adverse change to the discretion of the lender; and (3) a MAC provision that leaves the question of the existence of a material adverse change to the discretion of the lender, but is subject to a reasonableness test. The volume of the financing contracts that include a MAC stipulation amounts as of December 31, 2014, to approximately NIS 27,506 million.
- 10) In some financing contracts, in the case of non-disclosure of material details that are likely to cause an adverse change in the business of the Company or its repayment ability, or failure to provide current updates regarding events (including a change in legislation and decisions by the Government, and including structural changes in general) that affect or are likely to adversely affect the Company's operations and/or financial strength, the lender is granted the right to demand immediate repayment.
- 11) In some of the financing contracts, the lenders have the right to change the conditions of the contract or to demand immediate repayment, due to a decline in the State's holding percentage in the Company to below 51%, or a change in the control of the Company.
- 12) In the financing contracts insured by the companies that insure credit risks, cancelling the insurance constitutes cause for immediate repayment as well as cancellation of the insured purchase contract.
- 13) Under the terms of debentures issued through the Goldman Sachs and Dexia investment banks in the amount of USD 250 million from January 2008, and the framework agreement for issuing debentures in an amount of USD 2 billion from April 2008, the Company undertook that once another company will be engaged in all or most of the electricity transmission operations, the Company will transfer the debt to that other company ("the Transmission Company"). In such circumstances, holders of the debentures have an option to demand immediate pay-off of the debt, when the following accumulated conditions are fulfilled.
- a) The State of Israel is rated at an Investment Grade.
 - b) The Company is rated at a lower than an Investment Grade rating; and
 - c) The Company does not act as best as it can to achieve an Investment Grade rating.
- Moreover, holders of the debentures have to option to demand immediate repayment of the debt in the following events:
- (1) The Company will not complete its determining obligations (in debentures) for the purpose of transferring the debt to the Transmission Company.
 - (2) The State will cease to be a controlling shareholder in the Company prior to transferring the debt to the Transmission Company.
 - (3) The Company will cease to act legally in transmission operations or after the transferring of the debt to the Transmission Company, the main activity of the Transmission Company will not be in the field of electricity transmission.
 - (4) An event or circumstances that may have a material negative effect on the Company.

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NOTE 20:- DEBENTURES AND LIABILITIES TO BANKING CORPORATIONS AND OTHERS (continued)

d. Terms of the Company's financing agreements that might result in immediate repayment (continued)

- 14) Negative charge – In some of the foreign financing contracts the lenders have the right to demand immediate repayment in the event that the Company grants a senior charge to other lenders which will affect their ability to realize the charge they received.
- 15) According to the general terms of the debentures (series 2022) issued by the Company in January 2011, as well as according to the trust deed of the debentures (series 2029) issued by the Company in May 2014, holders of debentures are entitled to demand immediate repayment of the principal and interest of the debentures, inter alia in a case in which rating of the debentures will cease for a period exceeding 60 consecutive days, due to circumstances under the Company's control (except as a result of replacing the rating company).
- 16) Some of the financing contracts grant the lenders an immediate repayment right in the event that licenses of the Company' required to manage its business are cancelled, or in the event that the Company fails to fulfill the terms of these licenses.
- 17) Some of the financing contracts grant the lenders an immediate repayment right in the event of a breach of the directives of the law applied to the Company (including environmental protection laws), which have a material adverse effect on the Company.
- 18) According to the trust deeds of the debentures, issued by the Company in July 2012 (series 24 and 25), including expansions of these series in September and November 2012, the debenture holders are entitled to demand immediate repayment of the debentures, in case of a merger that results in a surviving company that is not the Company, without receiving advance approval for this from the debenture holders by special resolution. However, the debenture holders will not have cause to demand immediate repayment of the debentures as stated above, as long as one or more of the following conditions will exist:
- a) The Company or the absorbing company declared to the debenture holders that the absorbing company will bear the liabilities of the Company towards the debenture holders and there is no reasonable doubt that due to the merger, the absorbing company will not be able to fulfill its obligations towards the debenture holders;
 - b) The State delivered a written notice to the trustee in which it ratifies that the State's obligations towards the trustee and the debenture holders will remain in force;
 - c) The merger was executed with respect to the structural change in the Electricity Sector.
- 19) According to the loan agreement with foreign banks entered into by the Company in the month of November 2012, the lenders will have the right to demand immediate repayment of the loan in case legal proceedings (including arbitration proceedings or administrative proceedings) or an official inquiry have been initiated against the Company, and it is expected that they will adversely and materially affect the Company, in the event that their outcome will be negative as concerns the Company (except for a pending legal proceeding that has been detailed in the Financial Statements of the Company or in its Immediate Reports).
- 20) According to the loan agreement the Company entered into with foreign banks, in the month of April, 2013, the lenders will have the right to demand immediate repayment of the loan, inter alia, in the event that one or more of the loan documents has ceased to be legal or valid, or in the event that one of the transaction documents is the object of legal proceedings (including arbitration proceedings). Additionally, the lenders will have the right to demand immediate repayment of the loan in the event that proceedings (including legal proceedings) have been initiated, regarding the:
- a) Liquidation or reorganization of the Company, delay in any payment by the Company or compromise or settlement with a creditor of the Company not under sections 350 and/or 351 of the Companies Law.
 - b) Appointment of a receiver or liquidator for the Company or any of its assets whose value exceeds USD 25 million, or realization of a mortgage or lien with regard to such an asset.
- 21) Under the terms of the debentures issued by the Company abroad in the months of June and July 2013 and in November 2014 (within the GMTN plan of April 2008 that was increased from USD 2 billion to USD 5 billion), the debenture holders will be entitled to redeem the debentures, inter alia, in the event that the two following cumulative conditions are fulfilled:
- a) The debentures are rated both by S&P and Moody's two rating levels below the Company's international long-term corporate credit rating and the senior debt of the Company for 3 continuous months;
 - b) The rating level determined by S&P is lower than the BB+ rating and the rating level determined by Moody's is lower than the rating Baa3.

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NOTE 20:- DEBENTURES AND LIABILITIES TO BANKING CORPORATIONS AND OTHERS (continued)

d. Terms of the Company's financing agreements that might result in immediate repayment (continued)

To the best of the knowledge of the Company, at the time these financial statements were signed, none of the lenders with whom the Company entered agreements have a reason to demand immediate repayment of the Company's debt to them, including the subject of fulfilling the MAC provisions.

e. State Guarantee

The balance of the State guarantee that was provided to various financial institutions for loans and debentures raised by the Company adds up to approximately NIS 6.2 billion as on December 31, 2014.

f. Credit Rating

- 1) On July 3, 2014, the local rating company "Standard and Poor's Ma'alot" and the international rating company "Standard and Poor's" announced that they are raising both the local and the international credit rating of the Company to 'iIAA' and '-BBB', respectively, with a stable outlook. According to the rating companies, raising the rating reflects stabilization of the financial position of the Company.
- 2) On October 13, 2014, the international rating company "Moody's" announced it was leaving intact the international rating of the company, Baa3, and a rating of Baa3 (P) for the global debt raising plan (GMTN), which is in the amount of 5 billion dollars. The rating outlook remains stable. According to the rating agency, the current rating reflects, inter alia, improvement in the financial status of the company in 2014 as a continuation of the good performances in 2013 as well as a commitment on the part of the Company's management to cost-cutting and efficiency.

On the other hand the rating agency noted the uncertainty following the impasse reached in the negotiations between the government, the New National Labor Federation and the employees' organization regarding the reform of the electricity sector and the increase in the production capacity of private electricity producers. In addition' the credit company noted that although there is an improvement in the Company's liquidity management it continues to define the Company's liquidity profile as weak.

g. Securities and Liens

To ensure full repayment of the payments with respect to part of the above mentioned debentures and loans (principal, interest and linkage differentials) and to ensure the fulfillment of the remainder of the stated debenture and loan terms, the Company has pledged all its property (including property under construction) that can be pledged according to law and all its rights to this property of any type and nature whatsoever, existing at present and as will be in future by a floating charge - of equal rank with all the other floating charges that were created by the Company, relative (pari passu) to the amounts of obligation as will be secured, from time to time, by each of these liens. The extent of the liabilities of the Company secured by floating charges on December 31, 2014 is approximately NIS 40,805 million.

To ensure the obligations of the Company towards various lenders, the Company has created fixed charges in favor of the lenders over the following assets:

- Three gas turbines for electricity production purchased by the Company from the Siemens Company which were erected at the Ramat Hovav, Eshkol and Hagit sites.
- Six selective catalytic reduction (SCR) systems purchased by the Company from the BNG company to be installed at the "Orot Rabin: power station and at the Rutenberg power station.
- Three steam additions purchased by the Company from the Doosan company for gas turbines at the Ramat Hovav, Eshkol and Hagit sites.

The extent of the liabilities of the Company secured by fixed charges on December 31, 2014 is approximately NIS 1,885 million.

The Minister of National Infrastructures, Energy and Water is authorized to determine: "with regard to certain assets belonging to the license owner, required in the opinion of the Minister for executing the activity according to the instructions of the license, that they cannot be transferred, charged or attached, directly or indirectly, without the approval of the Minister."

According to that stated, the Minister's approval for the pledges detailed in the Note, which were created after the Electricity Sector Law entered into force, was received.

h. Fair Value of Negotiable Debentures

The fair value of the debentures traded in the Tel Aviv Stock Exchange is approximately NIS 3,731 million. The fair value of the negotiable debentures is the Stock Exchange value. Also see Note 27 i below.

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NOTE 21:- PROVISIONS FOR REFUNDING SUMS TO CONSUMERS

Based on a legal opinion, the Financial Statements include provisions amounting to NIS 2,675 million with respect to refunding sums to consumers arising from the restatement of the financial statements (in the report of June 2009) regarding the difference between calculations (mainly due to the change in the actuarial liability) which served as the basis used to determine the rate in the past and the updated calculations.

At the same time, the Company has claims against the Electricity Authority, stating that the current rate coverage for pension liabilities is lower than that required to cover these liabilities and the Company has addressed the Electricity Authority with a demand to receive them. Therefore, it is too early to estimate whether these provisions will have an eventual effect on the cash flow of the Company.

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NOTE 22:- INCOME TAXES

a. Benefits under the Law for the Encouragement of Industry

The Company is an "Industrial Company" as defined by the Law for the Encouragement of Industry (Taxes), 1969 and, accordingly, is entitled to certain tax benefits, the most significant of which is depreciation at enlarged rates.

b. Tax loss carry-forward to future years

The tax loss available for carry-forward to future years on the report date was NIS 13,236 million.

The Company recorded a deferred tax asset with regard to the loss carry-forward in the aggregate amount of NIS 3,476 million as of December 31, 2014 and NIS 3,507 million as of December 31, 2013 (section i 1 below), based on management's estimation that there is a high level of certainty that the loss carry-forward will be utilized (including realization against future liabilities for deferred tax, see section i 2 below).

c. Tax rates

The Economic Efficiency Law (Legislative Amendments for Implementing the Economic Program for the years 2009 and 2010) – 2009 ("The Arrangements Law"), published on July 23, 2009, prescribes, among others, an additional gradual decrease in the corporate tax rate to 18% in 2016 and thereafter ("2009 Amendment"). According to the 2009 amendment, corporate tax rates from 2011 onwards are as follows: in 2011 – 24%, in 2012 – 23%, in 2013 – 22%, on 2014 – 21%, in 2015 – 20% and in 2016 and thereafter – 18%.

On December 6, 2011, the Law on Changing the Tax Burden (Legislative Amendments) – 2011, ("2011 Amendment ") was published in the Official Gazette, that stopped the gradual decrease of corporate tax rate, prescribed under the aforementioned 2009 Amendment and increased the corporate tax rate to 25%, starting from 2012 onwards and raised the rate of the capital gains tax and the betterment tax to the rate of the corporate tax.

On August 5, 2013, the Change in National Priorities (Legislation Amendments for Achieving Budgetary Goals) -2013 Law was published in the Official Gazette, determining, inter alia, the increase of companies' tax rate, from 2014 onwards, to a rate of 26.5% (instead of 25%).

- d.** The tax that will apply to the shareholders due to the payment of dividends by the Company is not expected to be material since almost all of the Company's shares are held by the State of Israel.

e. Tax assessments

The Company received final tax assessments through the 2008 tax year and final deductions assessments through the 2008 tax year.

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NOTE 22:- INCOME TAXES (continued)

f. Reconciliation of tax expenses (revenues) to profit (loss):

Below is a reconciliation between the statutory tax on adjusted income before income taxes (computed as a result of the application of statutory tax rates) and the income taxes included in the statement of operations:

	For the Year ended December 31		
	2014	2013	2012
	NIS in millions		
Income (loss) before income taxes	224	(807)	1,295
Statutory tax rate	26.5%	26.5%	25%
Computed tax per statutory rate	59	(214)	(324)
Expenses disallowed net (including depreciation)	14	12	8
Effect of tax law compared to adjusted statements	(12)	(1)	23
Expenses (income) arising from change in the tax rate	-	328	-
Total income tax as presented in profit or loss	61	125	(293)

g. Tax expenses (income) for income that were recognized in the statement or operations

	As on December 31		
	2014	2013	2012
	NIS in millions		
Decrease (increase) in deferred tax assets	396	(317)	(270)
Increase (decrease) in deferred tax liabilities	(338)	438	(26)
Current taxes of subsidiary	3	4	3
	61	125	(293)

h. Taxes relating to other comprehensive profit components:

The deferred taxes that relate to other comprehensive profit components are with respect to remeasurement of a defined benefit program

Following are the components:

	Amount before tax	Tax influence	Amount less tax
For year ended December 31, 2012	(1,045)	261	(784)
For year ended December 31, 2013	344	(65)	279
For year ended December 31, 2014	1,568	(416)	1,152

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NOTE 22:- INCOME TAXES (continued)

i. Deferred taxes

(1) Composition of deferred tax assets:

	Loss carry- forward	Accrued vacation pay	Allowance for doubtful accounts income not recognized and legal	Debt to Consumers	Accrued pension pay, net	Deferred income Communic- ations Company	Total
	NIS in millions						
Long term balance as of January 1, 2013.....	3,583	42	63	612	2,823	-	7,123
Changes during 2013	225	7	58	95	(135)	-	250
Long term balance as of December 31, 2013	3,808	49	121	707	2,688	-	7,373
Changes during 2014	(301)	1	137	2	(676)	25	(812)
Long term balance as of December 31, 2014	<u>3,507</u>	<u>50</u>	<u>258</u>	<u>709</u>	<u>2,012</u>	<u>25</u>	<u>6,561</u>

The deferred taxes are calculated according to tax rates that are expected to apply at the time they are realized.

(2) Components of deferred tax liabilities:

	Adjustment of depreciable fixed assets, depreciation and other assets	Fuels and other inventories	Total
	NIS in millions		
Balance as of January 1, 2013	12,134	23	12,157
Changes during 2013.....	468	(30)	438
Long term balance as of December 31, 2013	12,602	(7)	12,595
Changes during 2014.....	(316)	(22)	(338)
Long term balance as of December 31, 2014	<u>12,286</u>	<u>(29)</u>	<u>12,257</u>

(3) Composition of deferred taxes balance presented in the statement of financial position:

	As on December 31	
	2014	2013
	NIS in millions	
<u>Long-term</u>		
Deferred tax reserves.....	12,257	12,595
Less: Deferred tax assets	6,561	7,373
Advances: for disallowable deductions.....	159	144
	<u>5,537</u>	<u>5,078</u>

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NOTE 23:- PERPETUAL DEBENTURES TO THE STATE OF ISRAEL

Pursuant to the Company's arrangement with the Ministry of Finance, perpetual debentures in a nominal amount of about NIS 15 million (the adjusted amount as of the balance sheet date is approximately NIS 2,534 million) were issued in the past to the State of Israel. The principal in respect of these debentures is unlinked and they bear annual interest at a rate of 5% and 5.75%, fully linked to the known CPI as of balance sheet date. Other than a pledge in a nominal amount, the perpetual debentures have no preference over any other loans extended to the Company.

NOTE 24:- INFORMATION IN NOMINAL VALUES

a. Share Capital

Composed as follows:

	Authorized*	December 31	
		2014	2013
		Issued and paid-up NIS	Issued and paid-up
80,167,387 Ordinary shares of NIS 0.1 par value each (issued and paid-up - 80,164,986 Ordinary shares)	8,016,739	8,016,499	8,016,499
40,053,252 Ordinary "B" shares of NIS 0.1 par value each (all issued and paid-up).....	4,005,325	4,005,325	4,005,325
39,531 special shares of NIS 0.1 par value each (not issued and paid-up)	3,953	-	-
Total	12,026,017	12,021,824	12,021,824

***As of December 31, 2014 and 2013**

b. Shareholders' Rights

1) Upon distribution of dividends:

- The first five percent to the Ordinary shareholders - Ordinary shareholders only.
- The next five percent to the Ordinary shareholders - Ordinary and Ordinary "B" shareholders - equal percentages, until the cumulative sum of dividends paid to Ordinary shareholders reaches 10% and Ordinary "B" shareholders reaches 5% annually.
- The next five percent to the Ordinary shareholders - Ordinary "B" shareholders - twice the percentage of Ordinary shareholders, until the cumulative sum of dividends paid to Ordinary shareholders reaches 15% and Ordinary "B" shareholders reaches 15% annually.
- The following percentages - Ordinary and Ordinary "B" shareholders - equal percentages.

2) Upon liquidation:

The surplus after refund of paid-up share capital to shareholders, first to Ordinary shareholders and then to Ordinary "B" shareholders, is to be allocated among shareholders on a proportional basis to the paid-up capital of shares held by each of them at the start of the liquidation.

3) On the date of the financial statements, the State of Israel held 120,033,262 Ordinary and Ordinary B shares, which represent 99.85% of the paid-up capital of the Company.

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NOTE 25:- CAPITAL RESERVES

	For the year ended December	
	31	
	2014	2013
	NIS in millions	
Capital reserve according to the Securities Regulations - transactions with controlling shareholders:		
From the sale of land to the Ports and Railway Authority	71	71
From the purchase of the Coal Company	(2)	(2)
Company's assets renewal reserve (1)	841	841
Capital redemption reserve fund	52	52
Premium on shares	30	30
Reserves from disposal of assets	36	36
Cash flows hedge fund (2)	(6)	-
	<u>1,022</u>	<u>1,028</u>
Remeasurement fund (see Note 12 n)	<u>135</u>	<u>(1,023)</u>

(1) The assets renewal reserve represents profits in excess of amounts permitted for payment of dividends under the Concession for 1985 and 1986, which has been designated by the Minister of Energy for the renewal of assets.

(2) See note 27 h below.

The Company has established various reserves pursuant to applicable laws or at the discretion of the Minister responsible for the Company at the time of their establishment. Such reserves, other than the reserves from realization of assets, cannot be distributed as dividends.

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NOTE 26:- RETAINED EARNINGS

- a. The Company is subject to section 33(c) of the Government Companies Law, which states, inter alia, that the decision of the Board of Directors on the appropriation of profits of a Government company, including a distribution, as defined by the Companies Law, is subject to the approval of the Companies Authority. However, in the event of a disagreement between a board of directors of a company and the Government Companies Authority, then a Government Company of the Company's type (which is not under privatization), will act according to the decision of the Government Companies Authority, as approved by the Government. The current policy of the Government Companies Authority (which may change from time to time) on appropriating profits for dividend distribution, as determined in the Government Companies circular on February 9, 1997, states that:

- (1) Dividends from current income of public utilities companies will be distributed at a rate of 60% of the current net annual income, before profit-based bonus payments to employees.
- (2) Dividends from accrued profits – a specific demand will be filed for each relevant company. The amount of the dividends will be determined with due consideration of the directives of the incorporation documents of that company, the directive of the law and the following data: Investment needs in the near future, liquid means, cash reserve, cash flow, current/acceptable financial leverage, required working capital and possible privatization of the relevant company.

In contrast to that which has been stated in Sections (1) and (2) above, in accordance with the provisions of Section 302 of the Companies Law, a company is entitled to make a distribution from its profits (as per its definition in Section 302 of the Companies Law) (hereinafter: the "Profit Test") as long as there is no reasonable fear that the distribution will prevent the Company from being able to fulfill its current and expected liabilities once they mature (hereinafter: the "Solvency Test"). In order to perform a required distribution, the Company must pass both the Profit Test and the Solvency Test (hereinafter together: "the Distribution Tests"). Notwithstanding that which has been stated above, the Court may, at the request of the Company, and after its Board of Directors has confirmed that the distribution fulfills the Solvency Test, allow the Company to make a distribution that does not fulfill the Profit Test, as long as it is convinced that the Solvency Test is fulfilled. In accordance with the Articles of Incorporation of the Company, each distribution must be approved by the Board of Directors of the Company and by a meeting of the shareholders of the Company. The Companies Law and the Articles of Incorporation of the Company prescribe that a meeting of the shareholders of the Company cannot resolve to distribute a dividend in an amount in excess of the amount that was recommended by the Board of Directors. The Company maintains, based on a legal expert opinion that it received, that a government company will not be required or allowed to make a distribution if it does not satisfy the distribution tests, and any distribution is subject to the distribution tests (unless the approval of the Court to make a distribution even if only the Solvency Test is fulfilled has been given, as mentioned).

- b. As understood by the Company, the directives of the Government Companies Law as well as the instructions of the circular of the Companies Authority on designating profits for paying dividends do not impose a duty on the board of directors of a Government company to decide to distribute dividends, but oblige it, to receive the approval of the Companies Authority of the decision of the board of directors on this subject and in the event of a conflict between the company's board of directors and the Companies Authority, the Company will act according to the decision of the Companies Authority, as approved by the Government.
- c. The calculated amount of the dividends according to this policy for 2004-2006 was about NIS 2.5 billion. No dividends were calculated for 2007, since according to the former reporting standards, the Company recorded a loss in that year. According to this policy, the dividends for 2008 amount to about NIS 370 million (after an update with respect to the restatements, the calculated sum would have amounted to approximately NIS 566 million). The amount of dividends for 2009 is NIS 804 million (after an update with respect to the restatements, the calculated sum would have amounted to approximately NIS 870 million).
- d. The Company's Board of Directors decided in 2005 to recommend to the General Meeting the distribution of dividends in the amount of NIS 118 million with respect to earnings for 2004, despite that its current profit for that year amounted to NIS 2,847 million. This is based on the opinion of the Board of Directors that dividends should not be distributed out of the earnings deriving from an accounting change and from an amount deriving from a decrease in the tax rate. These dividends were not paid as yet.
- For the time being, the Board of Directors does not recommend the distribution of dividends for the years 2005, 2006, 2008, 2009, 2014. The Company has not distributed dividends with respect to 2004 and onwards. See details in section f below.

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NOTE 26:- RETAINED EARNINGS (continued)

- e. Under the bonus policy in Government Business Companies, as stipulated in the Government Companies Authority circular, dated July 15, 2008, (which was in effect until June 2, 2013, and is therefore relevant to the years mentioned in sections c-f), bonus payments to employees are not allowed when no dividends were paid for the year for which the bonus is requested. The Company did not pay bonuses to employees in years where no dividends were paid.
- f. In April 2005, the Company applied to the Director of the Companies Authority to receive his approval to the recommendation of the Company's finance committee concerning the distribution of dividends out of the profits for 2004. The Company also applied to the Director of the Companies Authority requesting approval for non-appropriation of dividends from accrued profits with respect to the years 2005 – 2008, in view of the financial condition of the Company and the condition of its cash flow. According to letters of the Director of the Companies Authority to the Company on March 26, 2008 and May 5, 2009, review of the distribution of profits for the years 2004 to 2008 will be conducted with due consideration of the financing requirements of the Company, its internal sources and debt raising, required to enable the Company to fulfill the instructions of the Electricity Sector Law, 1996 (hereinafter: "the Electricity Sector Law") and its amendments, including all instructions regarding the preparation for implementing the structural change of the Electricity Sector, the development plan and the emergency plan of the Electricity Sector. In his letter of March 26, 2008, the Director of the Companies Authority notified the Company that the Companies Authority does not intend to demand a dividend distribution in 2008 by the Company for the years 2005-2006.

In his letter of May 5, 2009, the Director of the Companies Authority notified the Company that the Companies Authority does not intend to demand a dividend distribution in 2009 by the Company for the years 2004-2008. Moreover, in view of the financial and cash flow condition of the Company, the Company's Board of Directors decided that the Company will not appropriate dividends with respect to profits in 2009. The Company addressed the Director of the Companies Authority in April 18, 2010 to inform the Companies Authority on the decision of the Board of Directors to refrain from appropriating dividends with respect to profits in 2009 and receive its approval. On May 23, 2012, the Director of the Companies Authority notified the Company that the appropriation of dividends of profits in 2009 will be considered with due attention, inter alia, to the financing needs of the Company from its own sources and from funds raising, required to enable the Company to fulfill the directives of the Electricity Sector Law and its amendments, including those related to the preparations for a structural change in the Electricity Sector and implementation of the development plans of the Electricity Sector. Therefore, the Director of the Companies Authority stated in its letter that in 2012 it does not intend to require the Company to appropriate dividends with respect to 2009.

The Company did not distribute and did not calculate dividends with respect to 2010– 2013, since for 2010 the Company recorded in its financial statements a profit of NIS 2 million, in 2011 the Company recorded a loss of NIS 831 million, in 2012 the Company recorded a loss of NIS 1,002 million, and in 2013 the Company recorded a loss of NIS 934 million, and in 2014 the Company recorded a profit of NIS 151 million. The Board of Directors of the Company discussed the designation of the Company's profit for 2014, and decided that considering the previous decisions of the Board of Directors of the Company about decreasing the extent and rate of the leverage of the Company, the Company will designate its profits to decrease its liabilities, and dividends will not be distributed from the Company's profit for 2014.

- g. Regarding the draft of recommendations of the steering committee that was published on March 23, 2014, see Note 1 e above.

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NOTE 27:- FINANCIAL INSTRUMENTS

a. Groups of Financial Instruments

	For the year ended December 31	
	2014	2013
	NIS in millions	
<u>Financial Assets</u>		
Cash and cash equivalents.....	4,504	3,394
Short term investments	2,559	492
Trade receivables	5,046	4,723
Hedge transactions.....	267	-
Accounts receivable.....	302	325
Long term receivables.....	1,171	788
	<u>13,849</u>	<u>9,722</u>
<u>Financial Liabilities</u>		
Trade and other accounts payable	3,556	3,460
Hedge transactions	1,660	2,804
Debentures and Financial liabilities	46,926	45,432
Debentures to the State of Israel	2,534	2,531
Liabilities to the State of Israel.....	2,920	2,872
	<u>57,596</u>	<u>57,101</u>

b. Financial Risk Management Purposes and Policies

The operations of the Company expose it to different financial risks, e.g. market risk (including currency risk and interest risk), credit risk, liquidity risk and cash flow risk with respect to interest rate. The general risk management plan of the Company includes actions to reduce possible negative effects of the financial risks of the Company. The Company employs derivative financial instruments to hedge certain exposures to risks. Mr. Tamir Polikar, Senior Vice-President of Finance and Economics, is responsible for managing the financial risks according to the policies approved by the Board of Directors. The Finance Department identifies, assesses and defines financial risks. The Board of Directors provides written principles for the overall risk management and also the specific policies for certain exposures to risks, such as exchange rate risk and interest rate risk.

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NOTE 27:- FINANCIAL INSTRUMENTS (continued)

c. Market Risk

The Company sells its products at prices determined by an external entity – the Electricity Authority. The price is based on the cost principle, as specified in Note 1 above. At the same time, in determining the recognized cost for the Company, the Electricity Authority determined costs of the different components in the rate, which do not match sometimes, the actual costs of the Company. Consequently, the major part of Company activities is not exposed to market risks, except those detailed in following items:

(1) Currency risk and variable interest in foreign currency

- a) The Company's policies for managing market risks to exposure to currency risk and variable interest in foreign currency:

The Company is exposed to currency risk mainly with respect to its financial liabilities and accounts payable, including payments to fuel suppliers.

- (1) The Company will execute hedging transactions in foreign currency in order to reduce currency exposure, aiming to fit the expenses structure, as far as possible, to the revenue structure recognized in the electricity rate.
- (2) The Company will execute hedging transactions on part of the foreign currency payments flow that are linked to foreign currency while considering the payment dates of the principal and interest payments.
- (3) The Company will hedge the exposure due to payments to suppliers in foreign currency, as far as possible.
- (4) The Company will examine the need to fixate variable interest, quarterly or upon material developments in the market.
- (5) The Company will execute a volume of hedging transactions which will limit the erosion of equity, due to accounting exposure, at a rate of up to 5% of the equity in case of the NIS weakening against foreign currencies at a rate of 10% and/or with respect to a change in the variable interest.
- (6) The Company is acting to implement IAS 39 pertaining to hedging accounts, in order to prevent fluctuations, within the restrictions of the standard, in the profit and loss account for the period.

The main principles of the accounting policies and adopted methods, including recognition conditions, measuring basis and the basis used to recognize income and expenses related to each group of financial assets and financial liabilities are detailed in Note 2 above.

- b) Analysis of sensitivity to changes in fair value:

Fair value:

- (1) Debentures

- (a) Debentures in NIS

The non-negotiable debentures issued by the Company are revalued according to individual revaluations, calculated by Mirvach Hogen Ltd., which was chosen by the Ministry of Finance as the company that calculates the individual price quotes and the interest rates for institutional organizations, from March 20, 2011 (the "Transition Date").

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NOTE 27:- FINANCIAL INSTRUMENTS (continued)

c. Market Risk (continued)

(1) Currency risk (continued)

b) Analysis of sensitivity to changes in fair value: (continued)

(1) Debentures (continued)

(b) Debentures in Foreign Currency

Debentures quoted individually on the Bloomberg system are revalued according to this quote.

Long term debentures in U.S. Dollars, which are not quoted individually on the Bloomberg system are revalued through the interest rate scheme for the longest debenture for which an individual quote exists, together with the difference between the risk-free interest rate, according to the return on the Treasury Bonds that corresponds to the life span of that debenture, and the risk-free interest according to the return on Treasury Bonds despite the life span of the debenture for which an individual quote exists.

Debentures in Japanese Yen are revalued at the return rate that is converted from a return in U.S. Dollars, using the YAX function in the Bloomberg system plus yield differentials of Japanese Government debentures.

(2) Loans

The fair value of the loans is revalued through discounted cash flow expected with respect to the loans. Discount rates are determined for the different liabilities as follows:

(a) Loans in NIS

Loans in NIS are revalued according to an interest curve, built on the basis of individual quotes for the non-negotiable debentures and according to their liability channels and guarantees given to the lenders.

(b) Loans in Foreign Currency

Loans in U.S. Dollars are revalued on the basis of the interest on U.S.A. Treasury Bonds to the relevant average duration with the addition of the CDS of the Company for the relevant period.

Loans in other foreign currencies are revalued by converting the interest on the aforementioned loans in U.S. Dollars through the SWPM function in Bloomberg system.

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NOTE 27:- FINANCIAL INSTRUMENTS (continued)

c. Market Risk (continued)

(1) Currency risk (continued)

b) Analysis of sensitivity to changes in fair value: (continued)

(3) Analysis of foreign currency sensitivity as of December 31, 2014

Market factor: Dollar	Loss (profit) from increase in market factor		Fair value	Loss (profit) from decrease in market factor	
	+10%	+5%		(5%)	(10%)
	NIS in millions				
<u>Financial assets:</u>					
Cash and cash equivalents	(302)	(151)	(3,023)	151	302
Short term investments	(247)	(124)	(2,474)	124	247
Receivables	(20)	(10)	(199)	10	20
Long term receivables	(72)	(36)	(718)	36	72
Financial liabilities:					
Payables	78	39	783	(39)	(78)
Loans and debentures	2,937	1,468	29,365	(1,468)	(2,937)
Swap transactions(*):					
NIS or NIS linked - Dollar swap	(1,656)	(828)	(16,557)	828	1,656
Total	718	358	7,177	(358)	(718)

* The fair value alone of the Dollar side of the hedge transactions is presented in the sensitivity tests. The total fair value of the hedge transactions against the Dollar is a liability of NIS 350 million.

Market factor: Euro	Loss (profit) from increase in market factor		Fair value	Loss (profit) from decrease in market factor	
	+10%	+5%		(5%)	(10%)
	NIS in millions				
Financial Assets:					
Cash and cash equivalents	(25)	(13)	(251)	13	25
Financial liabilities:					
Payables	15	8	154	(8)	(15)
Loans and debentures	210	105	2,101	(105)	(210)
Hedge transactions (*):					
NIS linked - Euro swap	(48)	(24)	(477)	24	48
Total	152	76	1,527	(76)	(152)

* The fair value alone of the Euro side of the hedge transactions is presented in the sensitivity tests. The total fair value of the hedge transactions against the Euro is a liability of NIS 47 million.

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NOTE 27:- FINANCIAL INSTRUMENTS (continued)

c. Market Risk (continued)

(1) Currency risk (continued)

b) Analysis of sensitivity to changes in fair value: (continued)

(3) Analysis of foreign currency sensitivity as of December 31, 2014 (continued)

Market factor: Yen	Loss (profit) from increase in market factor		Fair value	Loss (profit) from decrease in market factor	
	+10%	+5%		(5%)	(10%)
	NIS in millions				
Financial liabilities:					
Payables	2	1	21	(1)	(2)
Loans and debentures	259	129	2,589	(129)	(259)
Hedge transactions (*):					
NIS linked - Yen swap	(227)	(114)	(2,272)	114	227
Total	34	16	338	(16)	(34)

* The fair value alone of the Yen side of the hedge transactions is presented in the sensitivity tests. The total fair value of the hedge transactions against the Yen is a liability of NIS 1,035 million.

1. The Company is not exposed to the CPI due to an exception in accordance with the Government Companies regulations on rules for preparing financial statements of the Company (see Note 2 a above).
2. Analyzing the sensitivity does not include the effect of the hedging the rate for part of the costs with respect to exposure or linkage to foreign currency is covered in the current electricity rate. (See Note 9 c).

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NOTE 27:- FINANCIAL INSTRUMENTS (continued)

c. Market Risk (continued)

(1) Currency risk (continued)

b) Analysis of sensitivity to changes in fair value: (continued)

(4) Analysis of foreign currency sensitivity as of December 31, 2013

Market factor: Dollar	Loss (profit) from increase in market factor		Fair value	Loss (profit) from decrease in market factor	
	10%	5%		(5%)	(10%)
	NIS in millions				
<u>Financial assets:</u>					
Receivables	(20)	(10)	(197)	10	20
Long term debts	(74)	(37)	(745)	37	74
<u>Financial liabilities:</u>					
Short term loans	17	8	170	(8)	(17)
Payables	81	40	808	(40)	(81)
Loans and debentures	2,154	1,077	21,540	(1,077)	(2,154)
<u>Hedge transactions (*):</u>					
NIS or NIS linked - Dollar swap	(1,252)	(626)	(12,522)	626	1,252
Total	906	452	9,054	(452)	(906)

* The fair value alone of the Dollar side of the hedge transactions is presented in the sensitivity tests. The total fair value of the hedge transactions against the Dollar is a liability of NIS 1,718 million.

Market factor: Euro	Loss (profit) from increase in market factor		Fair value	Loss (profit) from decrease in market factor	
	10%	5%		(5%)	(10%)
	NIS in millions				
Financial liabilities:					
Payables	16	8	159	(8)	(16)
Loans and debentures	235	118	2,354	(118)	(235)
<u>Hedge transactions(*):</u>					
NIS linked - Euro swap	(97)	(49)	(971)	49	97
Total	154	77	1,542	(77)	(154)

* The fair value alone of the Euro side of the hedge transactions is presented in the sensitivity tests. The total fair value of the hedge transactions against the Euro is a liability of NIS 85 million.

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NOTE 27:- FINANCIAL INSTRUMENTS (continued)

c. Market Risk (continued)

(1) Currency risk (continued)

(b) Analysis of sensitivity to changes in fair value: (continued)

(4) Analysis of foreign currency sensitivity as of December 31, 2013 (continued)

Market factor: Yen	Loss (profit) from increase in market factor		Fair value	Loss (profit) from decrease in market factor	
	10%	5%		(5%)	(10%)
	NIS in millions				
<u>Financial assets:</u>					
Payables	2	1	21	(1)	(2)
Loans and debentures	227	114	2,272	(114)	(227)
<u>Hedge transactions(*):</u>					
NIS linked - Yen swap	(237)	(119)	(2,371)	119	237
Total	(8)	(4)	(78)	4	8

* The fair value alone of the Yen side of the hedge transactions is presented in the sensitivity tests. The total fair value of the hedge transactions against the Yen is a liability of NIS 1,000 million.

1. The Company is not exposed to the CPI due to an exception in accordance with the Government Companies regulations on rules for preparing financial statements of the Company (see Note 2 a above).
2. Analyzing the sensitivity does not include the effect of the hedging for part of the costs with respect to exposure or linkage to foreign currency is covered in the current electricity rate (see Note 9 c above).

c) Market risk with respect to interest rates

The Company is exposed to differences in the market interest rate, with respect to the financial liabilities it raised that bear variable interest.

Changing trends of the variable interest rates are monitored constantly in order to examine the need to carry out IRS transactions to reduce exposure to the risk of an increase in interest rates.

Changing interest rates risks are not material to the cash flows of the Company.

Additionally, an increase in the interest rates prevailing in the market may significantly raise the price of the debt raisings the Company is required to take.

d) Interest rates sensitivity analysis

Sensitivity analysis is determined on the basis of exposure to interest rates of derivative and non-derivative financial instruments as of the statement of financial position date. Sensitivity analysis of liabilities bearing variable interest is prepared under the assumption that the amount of the liability as of the statement of financial position date remained throughout the reported year.

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NOTE 27:- FINANCIAL INSTRUMENTS (continued)

c. Market Risk (continued)

(1) Currency risk (continued)

d) Interest rates sensitivity analysis (continued)

(1) Interest rates sensitivity analysis as of December 31, 2014

	(Profit) loss from increase in market factor			Fair Value	(Profit) loss from decrease in market factor		
Change in currency rate in %	Increase of 200 base points*	+10%	+5%		(5%)	(10%)	Decrease of 200 base points*
	NIS in millions						
Financial assets							
Long term debts	93	6	3	(868)	(2)	(5)	(112)
Financial liabilities							
Long term loans at fixed interest rate	(307)	(62)	(31)	4,957	31	63	347
Long term loans at variable interest rate	-	-	-	5,089	-	-	-
Negotiable debentures	(74)	(2)	(2)	3,731	-	1	64
Non-negotiable debentures	(3,684)	(839)	(432)	40,701	413	852	4,370
Debentures to the State of Israel	(580)	(206)	(108)	2,266	119	252	1,189
Swap transactions (see details below(**))	(195)	36	48	1,399	(48)	(96)	236
Forward transactions	-	-	-	(5)	-	-	-
Total	(4,747)	(1,067)	(522)	57,270	513	1,067	6,094

(*) The Company chose to present the extent of the change in interest for which it will conduct stress tests for financial instruments sensitive to changes in interest rates at the rate of 200 base points (2%), after examining and finding that there is no higher daily absolute change in the interest rate over the ten years prior to the report date and after estimating that a change of 200 base points is a change that may occur in a severe, yet probable scenario in the same interest.

(**) In an increase of 100 base points the total decrease in fair value of the financial instruments will be NIS 2,565 million and in a decrease of 100 base points the increase in fair value of the financial instruments will be NIS 2,892 million.

Change in interest in %	(Profit) loss from increase in market factor			Fair Value	(Profit) loss from decrease in market factor		
	Increase of 200 base points*	+10%	+5%		(5%)	(10%)	Decrease of 200 base points*
	NIS in millions						
Hedge transactions							
NIS	(218)	(64)	(27)	854	25	44	285
Linked NIS	(1,499)	147	111	18,899	(100)	(198)	1,718
Dollar	1,279	(37)	(28)	(15,605)	18	39	(1,477)
Euro	8	(2)	(2)	(477)	2	4	(9)
Yen	235	(8)	(6)	(2,272)	7	15	(281)
Total	(195)	36	48	1,399	(48)	(96)	236

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NOTE 27:- FINANCIAL INSTRUMENTS (continued)

c. Market Risk (continued)

(1) Currency risk (continued)

d) Interest rates sensitivity analysis (continued)

(2) Interest rates sensitivity analysis as of December 31, 2013

(Profit) loss from increase in market factor				Fair Value	(Profit) loss from decrease in market factor		
Change in currency rate in %	Increase of 200 base points*	+10%	+5%		(5%)	(10%)	Decrease of 200 base points*
NIS in millions							
Financial assets							
Long term receivables	90	6	3	(815)	(3)	(5)	(108)
Financial liabilities							
Long term loans at fixed interest rate	(378)	(76)	(38)	7,911	39	79	403
Long term loans at variable interest rate	-	-	-	5,295	-	-	-
Negotiable debentures	(173)	2	1	6,435	(1)	(1)	146
Non-negotiable debentures	(2,957)	(678)	(352)	33,155	326	679	3,303
Debentures to the State of Israel	(497)	(188)	(98)	2,073	110	231	955
Swap transactions(**)	(314)	3	34	2,801	(35)	(70)	370
Forward transactions	-	-	-	3	-	-	-
Total	(4,229)	(931)	(450)	56,858	436	913	5,069

* The Company chose to present the extent of the change in interest for which it will conduct extremes tests for financial instruments that are sensitive to changes in interest rates at the rate of 200 base points (2%), after examining and finding that there is no higher daily absolute change in the interest rate over the ten years prior to the report date and after estimating that a change of 200 base points is a change that may occur in a severe, yet probable scenario in the same interest.

(**)

	(Profit) loss from increase in market factor			Fair Value	(Profit) loss from decrease in market factor		
Change in interest in %	Increase of 200 base points*	+10%	+5%		(5%)	(10%)	Decrease of 200 base points*
	NIS in millions						
Hedge transactions							
NIS	(181)	(36)	(20)	818	21	43	238
Linked NIS	(1,533)	(14)	(12)	17,783	13	25	1,759
Dollar	1,130	54	67	(12,458)	(68)	(137)	(1,313)
Euro	20	(1)	(1)	(971)	(1)	(1)	(22)
Yen	250	-	-	(2,371)	-	-	(291)
Total	(314)	3	34	2,801	(35)	(70)	371

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NOTE 27:- FINANCIAL INSTRUMENTS (continued)

d. Liquidity Risk

Liquidity risk is a risk that is connected to the situation in which the Company will not have enough available cash resources to meet the current business requirements, including its financial commitments and the minimal cash requirements. The Company manages its liquidity risks by ensuring, as far as possible, an adequate liquidity level that covers its obligations on time in both normal conditions and extreme situations without incurring significant loss or affecting its reputation. The Company measures its liquidity risk, inter alia, through the liquidity ratio, which measures the Company's ability to meet its liabilities without additional debt raisings. In general, the Company's liquidity position is better when the liquidity ratio is higher. The Company is meeting the liquidity index it has set for itself and the liquidity risk had been determined as low.

In addition, the Company manages the liquidity risk by raising long-term financial resources in capital markets in order to be able to finance the development plans for the electricity sector and recycle the debt, while maintaining a current cash reserve and credit balances according to the decisions of the Board of Directors.

The following are tables that include the financial instruments of the Company according to contractual repayment dates. The tables include flows with respect to the principal and the interest.

(1) Liquidity Risk as of December 31, 2014

	First year	Second year	Third year	Fourth year	Fifth year	Sixth onwards	Total
	NIS millions						
<u>Financial Assets</u>							
Cash and cash equivalents	4,504	-	-	-	-	-	4,504
Short term investments	2,559	-	-	-	-	-	2,559
Trade receivables	4,546	500	-	-	-	-	5,046
Other receivables	192	-	-	-	-	-	192
<u>Long-term receivables</u>							
Loans in Dollars	90	71	68	65	65	506	865
Unlinked Loans	20	12	6	3	1	-	42
Total financial assets	11,911	583	74	68	66	506	13,208
<u>Derivative Financial Instruments, net</u>							
<u>Swap transactions Net:</u>							
In US Dollars	(890)	(1,737)	(2,751)	(3,592)	(4,357)	(6,671)	(19,998)
In Euro	(450)	(63)	(63)	-	-	-	(576)
In Yen	(410)	(229)	(33)	(33)	(33)	(1,880)	(2,618)
In linked NIS	1,793	1,927	2,737	3,557	4,494	7,865	22,373
Unlinked	-	-	-	-	-	1,852	1,852
Total swap transactions:	43	(102)	(110)	(68)	104	1,166	1,033
<u>Forward transactions Net:</u>							
Loans in US Dollars	(952)	-	-	-	-	-	(952)
Loans in unlinked NIS	947	-	-	-	-	-	947
Total forward transactions	(5)	-	-	-	-	-	(5)
Total derivatives	38	(102)	(110)	(68)	104	1,166	1,028

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NOTE 27:- FINANCIAL INSTRUMENTS (continued)

d. Liquidity Risk (continued)

(1) Liquidity Risk as of December 31, 2014 (continued)

	First year	Second year	Third year	Fourth year	Fifth year	Sixth onwards	Total	Effective Interest rate
	NIS millions							%
<u>Financial Liabilities</u>								
Trade payables	1,757	-	-	-	-	-	1,757	
Accounts payable and accruals	1,799	-	-	-	-	-	1,799	
Short term loans	455	-	-	-	-	-	455	
<u>Debentures</u>								
Debentures in US Dollars	1,414	1,415	3,294	5,567	4,811	17,713	34,214	2.1-2.8
Debentures in Yen	95	95	95	95	95	3,367	3,842	3.7-4.3
Debentures in linked NIS	5,209	2,147	2,992	1,423	351	6,143	18,265	1.2-7.1
Unlinked debentures	56	55	647	72	-	-	830	6.6-7.4
Total	6,774	3,712	7,028	7,157	5,257	27,223	57,151	
<u>Debentures to the State of Israel in Linked NIS</u>	132	132	132	132	132	1,874	2,534	5.1-5.8
<u>Liabilities to banking corporations:</u>								
Loans in Euro	390	378	379	184	181	707	2,219	1.3-4.4
Loans in US Dollars	122	122	119	118	116	655	1,252	1.1-4.6
Loans in linked NIS	61	61	13	13	13	289	450	0.2-4.6
Unlinked loans	2,426	5	5	5	4	252	2,697	2.2-2.4
Total	2,999	566	516	320	314	1,903	6,618	
<u>Loans from the State of Israel in \$</u>	525	521	517	514	509	1,766	4,352	7.1-8.1
<u>Other Liabilities</u>								
Other liabilities in linked NIS	2	2	3	1	2	13	23	4.5
Other liabilities in non-linked NIS	3	-	-	-	-	8	11	
Other liabilities in Euro	-	-	-	-	-	18	18	
Other liabilities in Dollars	-	-	-	-	-	46	46	
Total other liabilities	5	2	3	1	2	85	98	
<u>Total Financial Liabilities</u>	14,446	4,933	8,196	8,124	6,214	32,851	74,764	

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NOTE 27:- FINANCIAL INSTRUMENTS (continued)

d. Liquidity Risk (continued)

(2) Liquidity Risk as of December 31, 2013

	First year	Second year	Third year	Fourth year	Fifth year	Sixth onwards	Total
	NIS millions						
Financial Assets							
Cash and cash equivalents	3,394	-	-	-	-	-	3,394
Short term investments	492	-	-	-	-	-	492
Trade receivables	4,336	144	144	99	-	-	4,723
Other receivables	205	-	-	-	-	-	205
Long-term receivables							
Loans in Dollars	84	64	64	62	58	468	799
Loans in Linked NIS	9	-	-	-	-	-	9
Unlinked Loans	28	16	13	9	7	13	86
	121	80	77	71	65	481	894
Total financial assets	8,548	224	221	170	65	481	9,708
Derivative Financial Instruments, net							
Swap transactions Net:							
In US Dollars	(722)	(696)	(1,450)	(2,353)	(1,419)	(9,822)	(16,462)
In Euro	(489)	(455)	(64)	(64)	-	-	(1,072)
In Yen	(38)	(416)	(233)	(34)	(34)	(1,866)	(2,621)
Linked NIS	1,267	1,719	1,852	2,662	1,549	12,161	21,210
Unlinked	-	-	-	-	-	1,848	1,848
Total swap transactions:	18	152	105	211	96	2,321	2,902
Forward transactions Net:							
Loans in US Dollars	(64)	-	-	-	-	-	(64)
Loans in unlinked NIS	67	-	-	-	-	-	67
Total forward transactions	3	-	-	-	-	-	3
Total derivatives	21	152	105	211	96	2,321	2,905

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NOTE 27:- FINANCIAL INSTRUMENTS (continued)

d. Liquidity Risk (continued)

(2) Liquidity Risk as of December 31, 2013 (continued)

	First year	Second year	Third year	Fourth year	Fifth year	Sixth onwards	Total	Effective Interest rate %
	NIS millions							
<u>Financial Liabilities</u>								
Trade payables	1,721	-	-	-	-	-	1,721	
Accounts payable and accruals	1,739	-	-	-	-	-	1,739	
Short term loans	187	-	-	-	-	-	187	
<u>Debentures</u>								
Debentures in US Dollars	1,044	1,044	1,044	2,717	4,742	14,433	25,024	
Debentures in Yen	96	96	96	96	96	3,511	3,991	
Debentures in linked NIS	3,821	5,157	2,094	2,947	1,374	5,351	20,744	
Unlinked debentures	56	56	56	646	72	-	886	
Total	5,017	6,353	3,290	6,406	6,284	23,295	50,645	
<u>Debentures to the State of Israel in Linked NIS</u>	132	132	132	132	132	1,872	2,532	
<u>Liabilities to banking corporations:</u>								
Loans in Euro	430	392	374	368	172	775	2,511	
Loans in US Dollars	96	105	103	103	102	659	1,168	
Loans in linked NIS	1,155	61	61	13	13	303	1,606	
Unlinked loans	2,066	2,430	6	6	6	258	4,772	
Total	3,747	2,988	544	490	293	1,995	10,057	
<u>Loans from the State Of Israel in \$</u>	470	468	464	460	457	2,028	4,347	
<u>Other Liabilities</u>								
Other liabilities in linked NIS	2	1	2	2	2	11	20	
Other liabilities payable in non-linked NIS	-	-	-	-	-	15	15	
Other liabilities payable in Dollar	-	-	-	-	-	69	69	
Other liabilities payable in Euro	-	-	-	-	-	46	46	
Total other liabilities	2	1	2	2	2	141	150	
<u>Total Financial Liabilities</u>	13,015	9,942	4,432	7,490	7,168	29,331	71,378	

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NOTE 27:- FINANCIAL INSTRUMENTS (continued)

e. Credit Risk Management

Credit risk is a risk of financial loss incurred by the Company if a customer or the other party in an equity instrument will not fulfill its contractual obligations. The risk derives mainly from debts of customers and others and deposits and derivatives transactions.

The Company's cash and deposits are deposited with banking institutions. The policy of the Company is to deposit funds according to the financial strength of the banks (credit rating or minimal financial ratios).

Hedge transactions in financial instruments are entered with big and stable banking institutions, with high financial stability that have low credit risk.

The Company does not hold or sell financial instruments for trading purposes.

Customers Credit Risk - As detailed in the table in Note 6 b, the exposure to credit risks from customers is limited given the large number of the Company's customers and the fact that the Company supplies an essential ongoing service. Regarding debts of the Palestinian Authority and the East Jerusalem Electricity Company see Note 6 d.

Provisions for doubtful accounts - are adequate according to estimates of the Company.

Guarantees Provided in Israel and Abroad

As part of its normal activity, the Company opened bank guarantees/ conditional letters of credit payable for various beneficiaries. The balance of the guarantees and indemnifications as on December 31, 2014 are:

(1) Local guarantees in Israel

(a) A guarantee in the approximate amount of NIS 24 million is provided to Gas Lines Ltd., to guarantee payment for natural gas delivery according to the agreement.

(b) Other bank guarantees amounting to approximately NIS 40 million, provided during normal business operations to different authorities, e.g., courts, customs, Israel Lands Administration and local municipalities.

Total local guarantees amount to approximately NIS 64 million.

(2) Guarantees to Parties Abroad

(a) Total balance of guarantees in the form of letters of credit opened in banks, payable to Company suppliers, under contracts to import equipment from abroad, as on December 31, 2014, amounts to approximately NIS 406 million.

(b) Total balance of guarantees to parties abroad in the form of conditional bank guarantees and letters of credit as on December 31, 2014, amounts to approximately NIS 113 million.

Total letters of credit and guarantees to entities abroad as on December 31, 2014 amount to approximately NIS 519 million.

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NOTE 27:- FINANCIAL INSTRUMENTS (Continued)

f. Linkage Basis Report

	As on December 31, 2014						
	(in NIS million)						
	Linkage to US\$	Linkage to Euro	Linkage to Japanese Yen	Linkage to CPI	Un-linked	Non-financial	Total
Assets							
Cash and cash equivalents	3,023	251	-	-	1,230	-	4,504
Short term investments	2,474	-	-	-	85	-	2,599
Trade receivables for sale of electricity					4,546	-	4,546
Accounts receivable	199	-	-	23	80	130	432
current maturities hedge transactions	985	-	-	(359)	(521)	-	105
Inventory- fuels	-	-	-	-	-	1,057	1,057
Inventory - stores	-	-	-	-	-	146	146
Long term inventory fuels	-	-	-	-	-	1,539	1,539
Long term receivables	772	-	-	-	899	-	1,671
Long term hedge transactions	6,374	-	-	(8,386)	2,174	-	162
Investment in an included company	-	-	-	-	-	86	86
Assets with respect to post-employment benefits	-	-	-	-	-	6,219	6,219
Fixed assets, net	-	-	-	-	-	63,517	63,517
Intangible assets, net	-	-	-	-	-	974	974
Total	13,827	251	-	(8,722)	8,493	73,668	87,517

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NOTE 27:- FINANCIAL INSTRUMENTS (Continued)

f. Linkage Basis Report (continued)

	As on December 31, 2014						
	(in NIS million)						
	Linkage to US\$	Linkage to Euro	Linkage to Japanese Yen	Linkage to CPI	Un-linked	Non-financial	Total
Liabilities							
Short term debentures and credit from banks and other credit providers (**)	761	370	-	4,523	2,505	66	8,225
Forward transactions and current maturities hedge transactions	(723)	(371)	(358)	1,163	415	-	126
Trade payables	385	150	-	-	1,222	-	1,757
Accounts payable and accruals	398	4	21	419	957	-	1,799
Provisions	-	-	-	-	-	719	719
Advances from work orders less works in progress	-	-	-	-	-	453	453
Debentures, liabilities to banks and others (**)	22,922	1,749	2,441	10,748	907	813	39,580
Hedging transactions summary	(15,605)	(477)	(2,272)	18,899	854	-	1,399
Classification of hedging transactions into assets and/or current maturities	7,131	370	359	(9,908)	2,184	-	136
Liabilities due to long term currency swap transactions, net	(8,474)	(107)	(1,913)	8,991	3,038	-	1,535
Liability to the State of Israel	2,920	-	-	-	-	(18)	2,902
Debentures to the State of Israel	-	-	-	2,534	-	-	2,534
Liabilities with respect to post-employment benefits	-	-	-	-	-	2,930	2,930
Regulatory liabilities, net	-	-	-	-	-	661	661
Provision for refunding amounts due to restatement of the financial statements	-	-	-	-	-	2,675	2,675
Deferred taxes, net	-	-	-	-	-	5,537	5,537
Shareholders Equity	-	-	-	-	-	16,084	16,084
Total	18,189	1,795	191	28,378	9,044	29,920	87,517
Total, Net	(4,362)	(1,544)	(191)	(37,100)	(551)	43,748	-
Exposure cover through hedging mechanism recognized in the electricity rate (*)	2,332	944	-	(3,276)	-	-	-
Total	(2,030)	(600)	(191)	(40,376)	(551)	43,748	-

(*) For details of the hedging mechanism see Note 9 c to the financial statements.

(**) In the consolidated reports of the financial position, the section includes hedging transactions that were presented separately in the linkage base report.

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NOTE 27:- FINANCIAL INSTRUMENTS (Continued)
f. Linkage Basis Report (continued)

	As on December 31, 2014							
	(in NIS million)							
	Linkage to US\$	Linkage to Euro	Linkage to Japanese Yen	Linkage to other currency	Linkage to CPI	Un-linked	Non-financial	Total
Assets								
Cash and cash equivalents	3	-	-	-	-	3,391	-	3,394
Short term investments	-	-	-	-	-	492	-	492
Trade receivables for sale of electricity	-	-	-	-	-	4,383	-	4,383
Accounts receivable	257	2	-	-	-	18	51	328
Inventory- fuel	-	-	-	-	-	-	1,065	1,065
Inventory- stores	-	-	-	-	-	-	144	144
Short term regulatory assets	-	-	-	-	-	-	2,966	2,966
Long term fuels inventory	-	-	-	-	-	-	1,733	1,733
Long term debts	717	-	-	-	-	458	1	1,176
Investment in associate company	-	-	-	-	-	-	98	98
Long term regulatory asset	-	-	-	-	-	-	695	695
Assets with respect to post-employment benefits	-	-	-	-	-	-	3,741	3,741
Fixed assets, net	-	-	-	-	-	-	64,591	64,591
Intangible assets, net	-	-	-	-	-	-	946	946
Total	977	2	-	-	-	8,742	76,031	85,752

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NOTE 27:- FINANCIAL INSTRUMENTS (Continued)

f. Linkage Basis Report (continued)

	As on December 31, 2013						
	(in NIS million)						
	Linkage to US\$	Linkage to Euro	Linkage to Japanese Yen	Linkage to CPI	Un-linked	Non-financial	Total
Liabilities							
Short term debentures and credit from banks and other credit providers(**)	497	397	-	4,079	2,010	93	7,076
Forward transactions and interest swap	(64)	-	-	-	67	-	3
Current maturities currency swap transactions	(621)	(475)	(34)	1,155	-	-	25
Liabilities to suppliers and service providers	480	153	-	-	1,088	-	1,721
Accounts payable and accruals	328	6	21	445	939	-	1,739
Provisions	-	-	-	-	-	729	729
Customer advances, net of work in progress	-	-	-	-	-	397	397
Debentures, liabilities to banks and others (**)	16,170	2,003	2,475	14,486	3,315	724	39,173
Summary of hedging transactions	(12,458)	(971)	(2,371)	17,783	818	-	2,801
Classifying hedging transactions to assets and/or current maturities	621	475	34	(1,155)	-	-	(25)
Liabilities with respect to long term currency swap transactions, net	(11,837)	(496)	(2,337)	16,628	818	-	2,776
Liability to the State of Israel	2,872	-	-	-	-	(22)	2,850
Debentures to the State of Israel	-	-	-	2,531	-	-	2,531
Liabilities with respect to post-employment benefits	-	-	-	-	-	2,918	2,918
Regulatory liabilities, net	-	-	-	-	-	1,395	1,395
Provision for refunding amounts due to restatement of the financial statements	-	-	-	-	-	2,560	2,560
Deferred taxes, net	-	-	-	-	-	5,078	5,078
<u>Shareholders Equity</u>	-	-	-	-	-	14,781	14,781
Total	7,825	1,588	125	39,324	8,237	28,653	85,752
Total, Net	(6,848)	(1,586)	(125)	(39,324)	505	47,378	-
Exposure cover through hedging mechanism recognized in the electricity rate (*)	2,078	954	-	(3,032)	-	-	-
Total	(4,770)	(632)	(125)	(42,356)	505	47,378	-

(*) For details of the hedging mechanism see Note 9 c above.

(**) In the consolidated reports of the financial position, the section includes hedging transactions that were presented separately in the linkage base report.

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NOTE 27:- FINANCIAL INSTRUMENTS (Continued)

- g. The following are details of open commitments for carrying out foreign currency swap transactions in foreign currency, interest swap transactions and forward transactions designed to reduce exposure resulting from differences between linkage terms of the commitments and the structure of the electricity rate as of December 31, 2014 and 2013 respectively:

	Swap Transactions (1)		Forward Transactions (2)	
	2014	2013	2014	2013
NIS in millions				
Purchase of:				
Dollar	15,605	12,458	952	64
Euro	477	971	-	-
Japanese Yen	2,272	2,371	-	-
unlinked NIS	2,269	-	-	-
	<u>20,623</u>	<u>15,800</u>	<u>952</u>	<u>64</u>
In return for:				
Linked NIS	(18,899)	(17,783)	-	-
NIS	(3,123)	(818)	(947)	(67)
	<u>(22,022)</u>	<u>(18,601)</u>	<u>(947)</u>	<u>(67)</u>

(1) The majority of swap transactions are for a period of one up to 10 years.

(2) The forward transactions are for a period of up to one year.

Gains and losses from the financial instruments in this item:

In 2014, gains amount to NIS 1,576 million

In 2013, losses amount to NIS 2,160 million.

As stated, these gains are intended to cover the balance-sheet exposures.

The Company does not hold financial instruments for sale or profit producing purposes.

h. Cash flow hedging

The Company finances its development plan and refinances its debt, inter alia, by executing issuances and other debt raising in foreign currency. This financing exposes the Company to risk with respect to foreign currency. In order to hedge the foreign currency risk of this activity, the Company executed transactions to hedge foreign currency swap (for the term until repayment of the debt on dates and in amounts conforming to the expected payment schedules) in order to hedge the exchange rate risk deriving from those same future transactions, that are intended to hedge cash flows.

The following table details the foreign currency swap contracts intended to hedge cash flows existing on the reporting date:

As of December 31, 2014						
Swap transaction	Expiry date	Dollar purchase		NIS sale		Fair value of assets (liabilities)
		Dollar millions	Interest rate	NIS millions	Interest rate	NIS millions
300747	June 21, 2018	250	5.625%	995	4.77%	(24.5)
300749	June 28, 2018	250	5.625%	980	4.80%	(14.3)

These hedge transactions are treated in the Financial Statements as cash flow hedge transactions. As of December 31, 2014, these transactions fully hedge the exposure with respect to foreign currency risks with respect to the principal and interest of the debentures.

Regarding the accounting policy of the Company with respect to the cash flow hedging, see Note 2 o.

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NOTE 27:- FINANCIAL INSTRUMENTS (Continued)

i. Fair value of financial instruments

	Book Value		Fair Value	
	December 31		December 31	
	2014	2013	2014	2013
	NIS in millions			
Financial Assets :				
Long term debts (including current maturities)				
Fixed Interest (2)	92	102	71	76
Variable interest	836	772	797	740
Financial liabilities:				
Long term debentures and loans (including current maturities)				
Long term loans at fixed interest (2)	4,404	7,353	4,957	7,911
Long term loans at variable interest.....	4,906	5,073	5,089	5,295
Fixed interest marketable debentures (in Israel) (1)	3,682	6,212	3,731	6,435
Fixed interest non-marketable debentures (in Israel and abroad) (3)	35,621	28,738	39,729	32,288
Variable interest non-negotiable debentures (in Israel and abroad)	972	866	972	866
Perpetual debentures to the State of Israel (2)	2,534	2,531	2,266	2,073

(1) The fair value is based on quoted market prices in an active market as of the statement of financial position date.

(2) The fair value is based on fair interest rates as of the statement of financial position dates (the fair value of a long-term loan received, bearing fixed interest is based on the calculation of the present value of cash flow at an interest rate acceptable for a loan of similar characteristics).

(3) The fair value is based on individual prices, quoted by Mirvach Hogen Ltd., for non-negotiable debentures in Israel as on the statement of financial position date and on individual prices, calculated according to the aforementioned non-negotiable liabilities revaluation method, for non-negotiable debentures.

The carrying amount of cash and cash equivalents, short-term investments, receivables, other current assets, payables and accrued expenses is not materially different from its fair value.

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NOTE 27:- FINANCIAL INSTRUMENTS (Continued)

j. Classification of financial instruments

The financial instruments of the Company, measured at fair value through the statement of operations and comprehensive income according to levels are detailed as follows:

Financial instruments measured at fair value are classified according to the lowest level at which significant use is made to measure the fair value of the whole instrument.

Level 1: Quoted prices (unadjusted) in active markets for financial assets and liabilities.

Level 2: Data which are not quoted prices included in level 1, expected directly (namely prices) or indirectly (data derived from prices), regarding financial assets and liabilities.

Level 3: Data of financial assets and liabilities which are not based on expected market data.

Hedging transactions included in level 2 are calculated at fair value, based on expected interest curves (see Note 2 o above).

	Year ended December 31	
	2014	2013
	Level 2	
	NIS in millions	
Financial Assets		
Swap and Forward transactions.....	267	-
Financial Liabilities		
Swap and forward transactions	1,661	2,804
Total.....	1,394	2,804

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NOTE 28:- REVENUES

a. The composition:

	For the Year ended December 31		
	2014	2013	2012
	NIS in millions		
Residential.....	8,695	8,373	8,890
Public-Commercial	8,196	8,962	9,001
Agricultural.....	846	913	831
Industrial	3,784	4,542	5,051
Water pumping	986	1,235	1,215
East Jerusalem Electricity Company and Palestinian Authority (also see Note 6)	2,007	2,054	1,879
Infrastructure services *	388	79	2
Revenues from the sale of electricity, gross	24,902	26,158	26,869
Add (less):			
Collection and provision for regulatory assets, net (also see Note 9)	(242)	1,064	1,088
Revenues from the sale of electricity, net	24,660	27,222	27,957
Other income (mainly includes income from works on account of others and yield capitalization of equity)	535	379	306
	25,195	27,601	28,263

* Infrastructure services are mainly electricity transmission and distribution services that are provided to private electricity producers.

b. The scope of sales deriving from private producers:

	For the Year ended December 31		
	2014	2013	2012
Total electricity sales of the Company (in millions kWh) (*)	49,902	53,504	57,086
Scope of electricity sales of the Company deriving from purchasing electricity from private producers (in millions kWh)	1,929	1,094	755
Their measure of the total electricity sales of the Company (in %)	4%	2%	1%

* Without infrastructure services

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NOTE 29:- SALES AND MARKETING EXPENSES

	For the Year ended December 31		
	2014	2013	2012
	NIS in millions		
Wages.....	596	592	737
Consumer services	164	170	185
Depreciation.....	142	141	143
	<u>902</u>	<u>903</u>	<u>1,065</u>

NOTE 30:- ADMINISTRATIVE AND GENERAL EXPENSES

	For the Year ended December 31		
	2014	2013	2012
	NIS in millions		
Wages.....	464	446	522
Provision for doubtful accounts and bad debts	280	271	46
Depreciation and amortization	118	123	133
Others	274	271	168
	<u>1,136</u>	<u>1,111</u>	<u>869</u>

NOTE 31:- WAGE COSTS

	For the Year ended December 31		
	2014	2013	2012
	NIS in millions		
Wage costs without remeasurements	5,010	5,025	5,988
Remeasurements	(488)	(109)	302
Total wage costs	<u>4,522</u>	<u>4,916</u>	<u>6,290</u>
Less:			
Regulatory asset with respect to supplement to operating costs recognized as a result of the entry of private electricity producers	252	47	-
Wages charged to works on account of others	86	83	73
Wages charged to fixed assets.....	<u>1,406</u>	<u>1,861</u>	<u>2,597</u>
Total wage costs included in statement of operations items, net	<u>2,778</u>	<u>2,925</u>	<u>3,620</u>

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NOTE 32:- FINANCIAL EXPENSES (INCOME), NET

a. Financial expenses (income), net

	For the Year ended December 31, 2014			For the Year ended December 31, 2013			For the Year ended December 31, 2012		
	Other financial expenses (income)	Erosion of liabilities	Total	Other financial expenses (income)	Erosion of liabilities	Total	Other financial expenses (income)	Erosion of liabilities	Total
	NIS in millions								
Financial expenses (income) on:									
Debentures.....	2,169	1,930	4,099	2,200	(2,113)	87	2,303	(1,009)	1,294
Loans	441	258	699	463	(405)	58	410	(213)	197
Hedge transactions.....	-	(1,576)	(1,576)	3	2,157	2,160	8	1,352	1,360
Loans and account receivables	78	(11)	67	(138)	25	(113)	(106)	32	(74)
	2,688	601	3,289	2,528	(336)	2,192	2,615	162	2,777
Capitalization of financing expenses, net	(271)	-	(271)	(278)	-	(278)	(277)	-	(277)
Transfer of financing (expenses) income to regulatory asset	(84)	(147)	(231)	(77)	330	253	(90)	275	185
Financial expenses, net	2,333	454	2,787	2,173	(6)	2,167	2,248	437	2,685

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NOTE 32:- FINANCIAL EXPENSES (INCOME), NET (continued)

b. Gain (loss) from erosion of liabilities, net (1)

	For the Year ended December 31		
	2014	2013	2012
	NIS in millions		
Loss resulting from the change in the CPI	1	(106)	(1)
Loss resulting from the change between the known CPI and the CPI	28	25	(68)
Loss from real depreciation (gain from the real appreciation) of foreign currency, net (2)	583	(280)	200
Loans and receivables	(11)	25	32
Total	601	(336)	163

(1) Before capitalization of financial expenses (income) and transfer of income to regulatory asset.

(2) Net of the effect of hedge transactions, after the offset of the effect of erosion of deposits and erosion of loans that were deposited in banks.

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NOTE 33:- RELATED AND INTERESTED PARTIES

The related and interested parties of the Company are as these are defined in the Securities Law - 1968, and in the International Accounting Standard 24 (IAS 24). The State of Israel is the sole interested party in the Company, therefore, the State of Israel and companies and other entities controlled by it (including Government companies, local authorities and Government ministries and other corporations in which the Government has a certain percentage of ownership), constitute related and interested parties of the Company (the data below do not include transactions with companies that are owned by local councils).

a. 1) Total Balances of Related and Interested Parties, Quoted from the Consolidated Statement of Financial Position

	December 31,	
	2014	2013
	NIS in millions	
Trade receivables for sales of electricity and others	20	90
Natural Gas Lines Ltd., see section b (1) a) below (including current maturities)	794	722
Other receivables from institutions	7	8
Liabilities to suppliers and service providers (including debt to Natural Gas Lines Ltd. and to infinity – Central Pension Fund Management)	45	44
Trade payables to institutions	52	355
Debentures to the State of Israel, see Note 23 above	2,534	2,531
Liabilities to the State of Israel (including current maturities), see section b(2) (d) below	3,202	3,101

The Company sent requests for balances confirmations at the end of 2014 to approximately 462 electricity customers, and approximately 316 suppliers and other customers who conform to the aforementioned criteria. The Company received 9 confirmations from customers and 49 confirmations from suppliers.

- 2) The total transactions with the related and interested parties, taken from the consolidated report:
The Company's revenues from those transactions carried out with interested parties, during its ordinary course of business, are: sales of electricity, electricity connections and works according to execution contracts. In the framework of its purchases, the Company primarily buys natural gas transmission, water and land leasehold services from the above interested parties. Payments to the State and its authorities as a sovereign entity, namely payments pursuant to law, such as taxes and fees, are transactions not deviating from the Company's ordinary course of business.
- a) Revenues
- (1) Revenues from related and interested parties (in accordance with invoices that were issued, and not including income receivable) – approximately NIS 2,446 million (mainly revenues from Mekorot Ltd. of approximately NIS 513 million and from the Ministry of Defense of approximately NIS 231 million and local authorities).
 - (2) Invoices issued to the Gas Lines Company for building the natural gas pipeline, of approximately NIS 7 million (see details in section b (1)(a) below).
- b) Expenses
- (1) Expenses for natural gas transmission to Natural Gas Lines – about NIS 262 million (see details in section b(2)(e) below).
 - (2) The remaining expenses (primarily local authorities, leasehold fees, transmission of fuels and water) - about NIS 573 million.

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NOTE 33:- RELATED AND INTERESTED PARTIES (continued)

b. The Company enters Several Types of Transactions with Related and Interested Parties:

1) Irregular Transactions (according to Section 270(4) of the Companies Law):

To the best knowledge of the Company, the following are details of irregular transactions with a controlling party, or in which the controlling party has a personal interest according to section 270(4) of the Companies Law, entered by the Company, that are in effect as of the date of the Financial Statement, and transactions in the two years preceding the financial statement date.

a) Project for the Establishment of a Natural Gas Transmission System ("the project"):

- (1) In November 2001, the Company was charged by the Israeli Government with funding, ordering and managing the work to set up part of the natural gas transportation system. For this purpose, an agreement was signed on November 10, 2004 between the Israel National Gas Lines Ltd ("INGL"), the Government of Israel and the Company. The responsibility cap of the Company is \$ 20 million, although the State and INGL, who are the parties to the agreement, interpret this limitation in a larger context, up to a maximum of \$ 50 million. This interpretation was studied by and is in accordance with the position of the legal advisers of the Company that the probability that the arbitrator will accept this claim is low.

The Company financed the major part of the project through a U.S. Dollar loan from Citi Bank, of approximately \$ 223 million. The balance of the financing came from the Company's own sources. INGL repays its debt to the Company parallel to the repayment of the loan. Repayment of the principal of the loan started in December 2010 and will end in 2025, in semi-annual payments.

In May 2008, an arbitrator was appointed to arbitrate the disputes that broke out between the Company on the one side and INGL and the State on the other side pursuant to several reciprocal claims between the Company and the State and INGL.

In accordance with the agreement reached between the Gas Lines, the Company and the State, that includes cancellation of the arbitration proceeding, as of the date of the report negotiations are being held between the professional entities of each of the parties, in order to try and solve the disputes, or part of them, in agreement.

Regarding the financial disputes between the parties, an agreement in principle has been reached between the Company and the Gas Lines which still requires approval by the State.

- (2) The Financial Statements include an adequate provision for covering damages that may be charged.
- (3) On July 8, 2014, a judgment was passed, which dismissed in full the claim, filed in 2007 against the Company, the State of Israel, the Natural Gas Authority, Natural Gas Lines Israel Ltd. and Yam Thetis Ltd. by Ordan Fishing and Marketing Company and others in an amount of NIS 35 million. The claim was about alleged damages caused to fishermen by the laying of the pipeline for transmission of natural gas. As stated, the claim was dismissed and costs were awarded to the Company and the rest of the defendants.
- (4) Estimated original cost of the transaction is approximately NIS 1,200 million. The balance as of the report date (including current maturities), is approximately NIS 794 million.

b) E.M.G.

See details on the agreement with E.M.G. to supply natural gas in Note 34 b 5 b) below.

c) Establishment of a Desalination Facility at the Orot Rabin site

On September 7, 2004, an agreement was signed between the State and the Company, to grant the right to use land with an area of about 71 thousand sq. m. in the proximity of the "Orot Rabin" power station, for the purpose of constructing a sea water desalination facility by the H2ID Ltd. The right is for a period of 24 years and 11 months.

Estimated original cost of the transaction is approximately NIS 69 million. The effect of this transaction on the profitability of the Company is negligible.

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NOTE 33:- RELATED AND INTERESTED PARTIES (continued)

b. The Company enters Several Types of Transactions with Related and Interested Parties: (continued)

2) Other Transactions (which are not Irregular and not Negligible):

a) State of Israel (Chartering of Tugboats)

In 1997 the Company chartered to the Hadera Port Authority two tugboats that it had purchased from the Israel Shipyards Ltd. according to a lease contract from 1995, for periods of twenty years each. The consideration for chartering the tugboats amounts to \$150,000 per month. The charter periods end is January 2017. As of the date of the report, no terms were concluded for renewing the agreement.

The balance for the charter as of December 31, 2014 was approximately NIS 15 million as compared with NIS 19 million as of December 31, 2013. The amount is linked to the U.S. dollar with the addition of interest at customary rates (see Note 2 r) above).

The estimated original cost of the transaction is approximately NIS 72 million. The effect of this transaction on the profitability of the Company is negligible.

b) The Eilat Ashkelon Pipeline Company Ltd. ("EAPC")

Pursuant to an agreement, entered in September 1997, between the Company and EAPC, EAPC allocated an area that it owns to the Company for the purpose of building a pier for the unloading of coal for the Rutenberg power plant. In the context of this agreement, the Company entered into an agreement for the building of two tugboats by the Israel Shipping Ltd. In 2000, the tugboats were chartered to the Ashkelon port for periods of 204 months each from the date of their delivery.

The monthly leasing fees for the tugboats are spread over 264 months and are with the addition of Libor interest for 10 years plus approximately 1.25% interest.

The balance of the amount of the charter fees as of December 31, 2014 is approximately NIS 39 million and as of December 31, 2013 is approximately NIS 38 million. The amount is linked to the U.S. dollar with the addition of interest at customary rates (see Note 2r) above).

The estimated original cost of the transaction is approximately NIS 70 million. The effect of this transaction on the profitability of the Company is negligible.

According to the agreement between the Company and the EAPC, at the end of 15 years from the delivery of the tugboats to EAPC (in 2015), the parties will have to decide, considering their operational status and maintenance costs, whether to continue operating the tugboats at the end of the base lease period (2017).

If the parties do not reach an agreement, the Company will be obliged to purchase 2 new tugboats and to lease them to EAPC starting 2017.

At present, the Company is negotiating with EAPC regarding this matter and the Electricity Authority has already been contacted with a request to recognize the unreturned principal expected in 2017 (approximately Dollar 7 million with respect to the two tugboats) plus the costs of purchasing the new tugboats.

c) Oil Infrastructures Ltd. ("Oil Infrastructures")

In January 1997, an agreement was signed between the Company and Oil Infrastructures, within which the Oil Infrastructures constructed an oil distillate line ("the oil distillate line") to the Gezer site, through which oil distillates are pumped for 50 years from the beginning of the regular operation of the line, namely up to May 2048.

The balance of the lease as of December 31, 2014 amounts to approximately NIS 18 million as compared with NIS 19 million as of December 31, 2013. The amortized amount as of December 31, 2014 is approximately NIS 15.1 million and NIS 17.7 million as of December 31, 2013.

Estimated original cost of the transaction is approximately NIS 31 million. The effect of this transaction on the profitability of the Company is negligible.

d) Liability to the State of Israel

In the 1990's the Company received loans in the amount of NIS 1.5 billion from the Industrial Development Bank Ltd., guaranteed by the State of Israel. In October 2009, a letter of assignment was entered between the bank and the State, assigning these loans to the State (see Note 20 a below). Pursuant to the assignment there was no change in the conditions of the loans. The balance of the loan as of December 31, 2014 is NIS 3,202 million (including current maturities). The interest rate of this loan was lower than the interest in the market, but it has an immaterial effect on the profitability of the Company.

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NOTE 33:- RELATED AND INTERESTED PARTIES (continued)

b. The Company enters Several Types of Transactions with Related and Interested Parties: (continued)

2. Other Transactions (which are not Irregular and Negligible): (continued)

e) Commitment for the Transmission of Natural Gas

In June 2006, the Company and the Gas Lines Company signed an agreement for the transmission of natural gas according to the version published by the Natural Gas Authority, which is applicable to all gas consumers. In January 2009, the agreement of 2006 was replaced by a new agreement with a validity of 15 years from the date of connection of each site to the gas transmission system. The Company's Board of Directors approved the agreement on February 2, 2008.

The original cost of the transaction for the period of the agreement was estimated at approximately NIS 2,520 million. Within the electricity rate, the Electricity Authority grants the Company recognition for the capacity and energy costs in accordance with the gas quantities calculated by it in the fuels basket.

Following the update of the transmission rate in accordance with the decision of the Natural Gas Authority in the Ministry of Infrastructures, Energy and Water, the capacity cost that is paid by the Company to Natural Gas Lines starting from December 1, 2013, amounts to approximately NIS 22 million every month, or an aggregate amount of approximately NIS 264 million a year.

f) Israel Ports Company

The Israel Ports Company – Assets and Development Ltd. (hereinafter “IPC”) wants to establish a new marine terminal for container conveying in the Port of Ashdod adjacent to the premises of the Company.

A need to shift these infrastructures arose because the infrastructures of the Company are also situated at present in the area of IPC and in other areas along the coastal strip, and infrastructures and facilities belonging to third parties are also situated there.

On February 26, 2014, the contract was signed, within which the Company will execute the general and detailed planning as well as the construction works for the changes in the infrastructures of the Company as are required by the construction of the new marine terminal that will be constructed by IPC in the port of Ashdod.

The project will be financed by the IPC on the basis of actual costs of the Company or of sub-contractors, with the addition of 17.5% (of the total price that will be paid to sub-contractors) for planning, preparation and execution of acquisition, management, supervision of the construction and overall supervision. During July, 2014, the IPC notified the Company of its intention to construct a small port and accordingly it wishes to change the agreement with the Company, which was based on the implementation of a full scale port. The Management of the Company clarified that it will examine the implications following the proposed change. The subject is undergoing a prolonged technical discussion and a joint examination with the Technion. The Company estimates that the examination will end by June 2015. The scope of the original contract is estimated at approximately NIS 230 million.

g) Establishing solar power stations at Ashalim

Within the framework of a Government tender for a solar power station in the Ashalim area, the Company is promoting the construction of a joint switching array for intaking the energy that will be created to serve the entire site, at a cost of approximately NIS 26.8 million. The State, through the Government of Israel, will constitute a party to the engagement agreement between the Company and each of the winners of the tenders. Within the engagement between the Company and the State, it was agreed that the Company will constitute the agent for transferring the range of payments to the franchisee, both payments recognized by the Electricity Authority and payments that originate from the State budget.

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NOTE 33:- RELATED AND INTERESTED PARTIES (continued)

b. The Company enters Several Types of Transactions with Related and Interested Parties: (continued)

3) Negligible Transactions according to Regulation 41 (a) (6) to the Securities Regulations

Negligible Transactions Procedure

The Company and its consolidated companies carry out or may carry out, as part of their normal business activities, transactions and/or obligations to carry out transactions with a controlling party, or in which the controlling party has a personal interest ("Controlling Party Transaction"), as well as transactions with interested parties, as defined in section 1 of the Securities Law – 1968, and transactions with related parties of the Company as defined under International Accounting Standard 24.

Usually, these transactions are not material to the Company or its consolidated companies, from both the quantitative and qualitative aspects and are generally carried out under similar terms to terms of transactions with third parties. Moreover, from the Company's point of view, these transactions are mostly integral to its current activity, since the Company is on the one hand a Government Company, where the controlling party is the State, and on the other hand, a supplier of an essential and central service to the Israeli economy.

- a) On March 29, 2012, the Company's Board of Directors approved a procedure that determines in advance guidelines and rules for classifying controlling party transactions as minor transactions, as stated in regulation 41(a)(6) to the Securities Regulations (Annual Financial Statements) 2010, that will serve to examine the required extent of the disclosure in the periodic and quarterly reports and in the prospectus of a controlling party transaction, as stated in regulation 22 of the Securities Regulations (Periodic and Immediate Reports) 1970 (hereinafter: the "Regulations of the Reports") and in regulation 54 of the Securities Regulations (Details of the Prospectus and Draft of the Prospectus – Structure and Shape), 1969, respectively and also examine the need for filing an Immediate Report on such a transaction, as stated in regulation 37(a)(6) in the Regulations of the Reports (hereinafter: the "Procedure").
- b) On February 28, 2013, the Company's Board of Directors approved an amendment to the quantitative test within the Procedure (described in section (b) below). In addition, the Board of Directors approved the adoption of the Procedure with respect to the disclosure that will be provided to transactions with related parties and to transactions with interested parties within the framework of the Notes to the Financial Statements.

These guidelines and rules were determined, inter alia, after weighing the types and characteristics of transactions by the controlling party in the Company, transactions with interested parties and transactions with related parties of the Company, noting the scope of activity of the Company, which is one of the largest companies in the economy, the volume of the Company's assets, liabilities and revenues. These guidelines may be examined from time to time by the Company's Board of Directors, which is entitled to change them from time to time and/or add other guidelines.

According to these guidelines and rules, it was determined that a Controlling Party Transaction and/or an Interested Party Transaction and/or a Related Party Transaction will be considered as a minor transaction if it passes the following two-stage test:

(1) Qualitative Test:

The transaction is part of the normal business activity of the Company and is inherent to its current activity, carried out at market conditions and from its type, nature and effect on the Company it is immaterial to the Company and there are no special considerations arising from all the circumstances of the transaction, indicating the materiality of the transaction.

(2) Quantitative Test:

The scope and/or value of the transaction are less than NIS 10 million.

In multi-annual transactions (for example: an agreement for a period of several years) the transaction will be examined to decide if it is minor on an annual basis (namely, does the annual financial amount deriving from the agreement exceed the amount stated in the aforementioned rule).

Each transaction will be inspected separately, however combined or conditional transactions (which are actually part of the same agreement, will be examined on aggregate).

The Audit Committee reviews the negligible transaction procedure in the Company every year.

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NOTE 33:- RELATED AND INTERESTED PARTIES (continued)

c. Benefits to Interested Parties

Group	Year Ended December 31,			Year Ended December 31,		
	2014	2013	2012	2014	2013	2012
	Number of Individuals			NIS in millions		
1) Salary of interested parties employed by the Company *	3	4	4	1.8	1.9	1.8
2) Directors not employed by the Company	12	15	16	1.1	1.6	1.5
3) Other interested parties not employed by the Company**	-	-	-	-	-	-

* In 2012 and 2013, two directors were in office, who do not receive salary for their participation in meetings of the Board of Directors on behalf of the employees. In 2014 one director was in office on behalf of the employees.

** The Company does not have benefits to other interested parties who are not employed by the Company.

d. Compensation to Key Management Personnel

- Key management personnel in the Company include: Chairman of the Board of Directors, CEO, members of Company Management, directors (the data in the table below does not include remuneration to directors. See details of remuneration to Directors in section c above) and the supervisor in charge of the load, a total of 35 persons in 2014.
- In December 2012, the Companies Law (Amendment No. 20), 2012 came into effect (hereinafter in this paragraph: "the Amendment"). The Amendment is designated to regulate the compensation to officers (as defined in the Companies Law) in public companies and debenture companies.
The Amendment changes the method of approval of the terms of service and employment of the officers in the Company. Within this framework, the Company is required to formulate a compensation policy for the terms of service and employment of the officers and to establish a Compensation Committee under the Board of Directors which would, inter alia, recommend a compensation policy with updates and decide on the approval of terms of service and employment where such approval is required by law.
- In January 2013, the Minister of Justice published the Companies Regulations (Exemptions Concerning the Requirement to Define a Compensation Policy), 2013 and the Companies Regulations (Exemptions in Transactions with Interested Parties (Amendment), 2013, which allow for certain exemptions to government companies in implementing the Amendment. Thus, for example, the compensation policy of a government company is not subject to the approval of the general meeting to the extent that it complies with certain conditions as prescribed in the Regulations.
- In December 2012, the Company's Board of Directors appointed a Compensation Committee from among its members. On January 9, 2014, the general meeting of the Company approved the Company's compensation policy, after it was previously approved by the Compensation Committee and the Board of Directors of the Company, as was requested by the committee. The approval is in effect for 3 years from the approval date. On February 9, 2015, after previously receiving approval for it from the Compensation Committee and the Board of Directors of the Company, the general meeting of the Company approved an amendment to the compensation policy of the Company. According to this, the Company made a provision in the amount of NIS 1.5 million for a bonus to seven senior officers with a personal contract. This amount is not included in the salary data in sections c and d.

	For the year ended December 31	
	2014	2013
	NIS in millions	
Total salaries cost.....	32.4	34.1
Of which, costs due to the pension plan.....	2.0	2.1
Five key Management personnel retired during the year 2014, for which payment of compensations and retirement grants were made.....	4.1	3.3
Balance of pension liability	171.0	155.2
Balance of vacation reserve	2.1	2.1

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NOTE 33:- RELATED AND INTERESTED PARTIES (continued)

- e. Regarding details of transactions with related parties of investee companies, see Note 11 above.
- f. Several Indemnification Letters furnished by the Company:

1) Indemnification of Directors and Officers of the Company

Following the approval of the audit committee and the Board of Directors of the Company from November 1, 2012, on November 22, 2012, the general assembly of shareholders, approved the issuance of a letter of indemnity to the Directors of the Company, the CEO of the Company, the VP Finance and Economics of the Company and the Legal Consultant and Secretary of the Company (hereinafter: "**the Officers**"), who served in the Company on the relevant determining date that will apply to the events detailed below, even if the date of occurrence of the event to be indemnified took place prior to the date of issuing the letter of indemnity:

- a) A resolution regarding private placements and raising of debts by the Company, not by way of or based on a prospectus and the responsibility arising from such resolution, with respect to private placements and debt issuances that will be carried out from the date of the approval of the letter of indemnity by the Company's Audit Committee and Board of Directors up to June 2013, provided that the proceeds of the said debt raised will be allocated, in accordance with a written prior approval to be provided by the Director General of the Companies Authority, to the financing of fuel costs in excess of those that will be recognized as part of the rate, in accordance with the Outline published by the Electricity Authority for the gradual increase in electricity rates over a period of three (3) years (hereinafter: "the Electricity Authority's Outline").
- b) Preparation, approval, signing and publication of a prospectus by the Company, including the disclosure under the prospectus and the issuance of debentures by the Company based on the prospectus (including an agreement with the State of Israel on the provision of a guarantee and the receipt of the State of Israel's guarantee for the issuance and including the resolution to issue securities by the Company for the purpose of covering fuel costs in excess of those which will be recognized in the rate as part of the Electricity Authority's Outline), provided that the proceeds of the securities to be issued by the Company are allocated to the financing of fuel costs in excess of those that will be recognized on the date of publication of the prospectus as part of the rate in accordance with the Electricity Authority's Outline for the gradual increase in electricity rates, namely, not later than June 30, 2012. In this context, "the prospectus" means the prospectus of June 26, 2012 (as amended July 2, 2012).

The "Relevant Determining Date" means, in relation to the prospectus– the date of publication of the prospectus; in relation to a private placement of debentures – the date of the Resolution by the Board of Directors of the Company regarding the execution of the private placement.

The amount of indemnification the Company may have to pay for all the Officers, cumulatively, under the Indemnity Letter, and pursuant to any other undertaking and letter of indemnity issued to the Officers (within their meaning in the Companies Law) and the employees of the Company (including commitments and letters of indemnification issued by the Company to Officers and/or employees of the Company, in connection with the preparation, approval and publication of the Financial Statements of the Company as of June 30, 2009), or insofar as they will be issued by the Company in the future, including, if and insofar as the Company will provide indemnification in connection with a restructuring in the Company and/or privatization, shall not exceed 25% of the Company's equity as of June 30, 2009, linked to the Israeli Consumer Price Index on July 2009.

To the publication Date of the Report, other than the aforesaid, the State has not approved an undertaking by the Company to indemnify its Directors and Officers.

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NOTE 33:- RELATED AND INTERESTED PARTIES (continued)

f. Several Indemnification Letters furnished by the Company: (continued)

2) Other Indemnification Letters Provided by the Company

- a) The Company furnished a letter of indemnification to the Caesarea Development company in connection with the damages likely to be caused due to the emissions reduction project performed at Orot Rabin power station, on lands in which the Caesarea Development company is the holder of the rights.
- b) The Company furnished a letter of indemnification to the Nes Ziona local municipality in connection with damages likely to be caused due to the Nes Ziona sub-stations works, which may cause damage to the land and impair its value, in accordance with section 197 to the Planning and Building Law.
- c) The Company furnished a letter of indemnification to the Rishon Le-Zion local municipality in connection with damages likely to be caused due to works in the Gan Sorek logistic center plan, which may cause damage to the land and impair its value, in accordance with section 197 to the Planning and Building Law.
- d) The Company furnished a letter of indemnification to the Caesarea Development company against receiving a permit for firefighting works in the "Caesarea" sub-station in connection with the damages likely to be caused to the Caesarea Development company due to these works.
- e) The Company furnished a letter of indemnification to the administrator general in connection with the damages likely to be caused to land of absentee owners, on which a fuel container of the Company is located. Under the letter of indemnification, the Company will be obliged to incur expenses of an environmental survey and land cleaning in the event of damage.
- f) On November 18, 2013, a letter of undertaking to indemnify was signed by the Company and the Municipality of Rishon Le-Zion in favor of the Israel Land Authority with respect to payment of lease fees for the advancement of land allocation for the "Victoria" sub-station.
- g) On November 25, 2013, the Company signed a letter of undertaking and indemnity in favor of the municipality of Tel Aviv as part of the construction of the "Tel Aviv University" sub-station.
- h) On April 13, 2014, the Company signed a letter of undertaking to indemnify in favor of the Israel Lands Authority for the purpose of signing a building permit before allocation of land for the "Ashalim" substation.
- i) On April 13, 2014, the Company signed a letter of undertaking to indemnify in favor of the Israel Lands Authority for the purpose of signing a building permit before allocation of land for the "Shfayim" substation.
- j) On May 27, 2014, the Company signed a letter of undertaking to indemnify in favor of the Israel Lands Authority for issuance of a building permit for construction of the "Victoria" substation.

g. State Guarantees

For details of guarantees received from the State, see Note 20 e above.

h. Central Provident Fund

For additional information see Note 12 | 1 above.

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NOTE 34:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES

a. Agreements

1) Agreement on the Supply of Gas from the Tamar Field

a) Tamar field

In March, 2012, the Company signed an agreement with the holders of the rights of the "Tamar" license (Nobel Energy and the limited partnerships Isramco Negev 2, Delek Drillings, Avner Oil Exploration and Dor Gas Exploration (all together in this section: the "Sellers" or "Tamar Partnership") under which the Company undertook to purchase natural gas at a total minimal volume of approximately 42.5 Billion Cubic Meters ("BCM") natural gas and a total maximal volume of approximately 77 BCM (hereinafter: the "Agreement").

The Company was given an option to increase the contractual quantity supplied during the period of the agreement to a maximal volume of approximately 99 BCM, after updating the array for supply of gas from the reserve through a system of compressors and/or construction of a second pipeline for gas supply from the Tamar reserve (hereafter: the "Option").

The price of gas in the agreement was determined by a formula that includes a base price and linkage to the U.S. CPI with the addition of 1% in each of the years 2012 to 2019 and a reduction of 1% each year from 2020 and until the end of the period of the agreement.

The agreement includes a mechanism of "Take or Pay" under which the Company is obliged to pay for the right to purchase a minimal amount of natural gas, even if it did not use it, at an amount of 3.5 BCM a year in the first five years and afterwards at an amount of 2.5 BCM a year, and during the option period, if exercised, the annual quantity will increase to 5 BCM a year (subject to adjustments of the sale of the gas of the Tamar Partnership to private electricity producers and volume of electricity production of the Company).

Moreover, two dates were set in the agreement, on which each side will be permitted to demand, in case it thinks the purchase price does not appropriately reflect the gas purchase price in the Israeli market, the adjustment of the purchase price "Price Re-Opener" as follows: after eight years have passed from the date of commencement of supply of gas from the "Tamar" reserve, the parties will discuss (at the request of either of the parties) the adjustment of the purchase price at a rate of up to 25% (addition or reduction), after eleven years have passed from the date of commencement of supply of gas, the parties will discuss (at the request of either of the parties) the adjustment of the purchase price at a rate of up to 10% (addition or reduction). In case of lack of agreement as to the rate of adjustment of the stated purchase price, the issue will be decided in an arbitration proceeding that will be held in accordance with the rules of the Israeli Institute of Arbitration if the amount in dispute is less than the amount set in the agreement, and in accordance with the rules of the London Court of International Arbitration if the amount in dispute exceeds the amount set in the agreement.

The agreement is in effect until the end of fifteen years from the beginning of the supply of gas or until the complete contractual quantity under the agreement is supplied, whichever is earlier. In the case that by the end of the thirteenth year from the date of signing the agreement the Company will inform the sellers that it expects it will not be able to consume the full contractual quantity during the period of the fifteen years, then the agreement will be extended until the earlier of two additional years beyond the period of fifteen years and consumption of the full contractual quantity.

The parties will be permitted to terminate the agreement under certain circumstances (liquidation, insolvency, assigning rights in favor of creditors, appointing a receiver, etc.) by written notice a hundred and twenty (120) days in advance.

The agreement was approved by the Electricity Authority, the General Director of the Antitrust Authority, the Companies Authority and the Socio-Economic Cabinet (the Government).

On April 19, 2012, the Company submitted an application to the Antitrust Authority, requesting an exemption from an arrangement in restraint of trade due to the agreement (in this section: the "Application"). On June 15, 2012, the Antitrust Authority delivered its decision to the Company, under which it exempted the agreement under section 14 of the Antitrust Law, subject to a series of conditions detailed in its decision, the major of which is splitting the option (whose last date for exercise was postponed from April 2, 2013 to April 15, 2013), according to the following outline:

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NOTE 34:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES

a. Agreements (continued)

1) Agreement on the Supply of Gas from the Tamar Field (continued)

a) Tamar field (continued)

- (1) The option will be split into two stages. The first option exercise date will be in coordination with the Tamar Partnership and will be submitted not later than April 15, 2013. The date of termination of the option period will be December 31, 2019.
- (2) At the second stage, the Company can extend the option beyond the month of December, 2019, by notice to the Tamar Partnership until April 15, 2015. The validity of the extension of the second option, if realized, will be until the end of the period of the agreement with the Tamar Partnership.

According to the decision of the Electricity Authority of June 14, 2012¹, the Company can increase the rate of change of gas supply on an hourly basis beyond that set in the agreement, as long as it is possible to increase the hourly rate of change, according to the system, in coordination with the system manager. Additionally, according to the stated decision of the Electricity Authority, for gas quantities that will be supplied within the option, the mechanism under which the increase/decrease of 1% will be executed in the price adjustment formula was cancelled within Amendment no. 1 to the option. In addition, the linkage to the U.S. CPI was reduced to a linkage rate of 30%, as of January 1, 2013, and until the end of the option period, including insofar as the Company will extend the option as stated above.

On April 11, 2013, the Audit Committee and the Board of Directors of the Company, in their separate meetings, approved the exercise of the option and the Company informed the Tamar Partnerships of its decision to exercise the first option that will end on December 31, 2019. If and when the option will be exercised, the Company will be able to increase its hourly quantity of use by 50% and decrease the use of more expensive and more polluting fuels.

At the end of March, 2014, the General Director of the Antitrust Authority published a draft for a public hearing under which it is proposed to postpone the date of the notice to continue to exercise the option beyond 2019 from April 2015 to June 2016 (at least) prior to the filing of a consent decree in this matter to the Antitrust Tribunal. The General Director is of the opinion that the postponement is required in order to enable the sale of the "Tanin" and "Karish" gas fields and to enable the new owner to prepare for the process of gas sale from these reserves to potential gas consumers.

On April 23, 2014, the Company sent its response in a letter to the General Director of the Antitrust Authority, expressing its support with regard to the postponement of the option exercise date, as stated.

At the end of December 2014, the Antitrust Authority published an update to the public regarding the decision not to submit the above mentioned consent decree for approval by the Tribunal.

On January 14, 2015, the Company announced in a letter to the General Director that in light of the gas sector being at a critical decision crossroads, the Company sees great benefit in postponing the date of the decision regarding the extension of the option by an additional year, as a step that promotes competition, but if the Company will not receive any other instruction in the matter, the Company regards April 15, 2015 as the binding date for reaching a decision with respect to the extension of the option.

Another application to the General Director to postpone the date of the notice to extend the option was executed on March 5, 2015.

On March 9, 2015, in response to the aforesaid application, the General Director of the Antitrust Authority sent a request to receive data from the Company.

¹ The Electricity Authority's decision of June 14, 2012, on the issue of: "Principles for recognition of costs with respect to agreements to purchase natural gas 2012".

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NOTE 34:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES

a. Agreements (continued)

1) Agreement on the Supply of Gas from the Tamar Field (continued)

b) Regulation of the use of the gas pipeline capacity from the "Tamar" rig to the exit of gas from the Ashdod reception terminal

On December 9, 2012, the Company received the decision of the Natural Gas Authority Council of November 29, 2012 from the Ministry of National Infrastructures, Energy and Water, with respect to regulation of the use of the natural gas pipeline capacity from the Tamar rig to the gas exit from the Ashdod reception terminal. This decision was reached due to the limitations and inability of the gas pipeline's capacity to supply all the expected hourly demands of the sector in the coming years.

This decision determines that:

- (1) The "Tamar" owners will not refuse to sign contracts for sale or marketing of natural gas with consumers who wish to enter contractual engagements with it, only due to the fact that entering a contractual engagement with them means that the total amount of natural gas to be supplied through the pipeline exceeds the maximum capacity (as defined in the stated decision) in a certain hour or year.
- (2) A mechanism that determines the capacity that a marketer in the distribution grid and/or a consumer of the distribution grid will receive during a capacity exhaustion event (every hour in which the aggregate hourly demand of all the consumers and marketers for conveying natural gas through the gas pipeline is expected to surpass the maximum capacity) ("Excess Capacity"), and the total Excess Capacity to be allocated to all consumers and marketers during a capacity exhaustion event. Every hour in which the aggregate hourly demand of all the consumers and marketers for conveying natural gas through the pipeline is expected to surpass the maximum capacity (namely, a capacity exhaustion event), the gas consumers and marketers will reduce the volume of their natural gas consumption under the pro rata principle, according to the relative part of their capacity in the national transmission system, according to the formula detailed in the decision. In any case, the hourly maximum capacity of each of these consumers will not exceed the hourly maximum capacity signed for by the consumer with the Tamar reserve owners.

It is noted that the Company estimates that the above mentioned decision will increase the damage to the Company and all the electricity consumers and the sector in general as it will force the Company to increase the use of alternative, expensive and polluting fuels. As a result, a material increase in electricity generation costs is expected, commencing from 2015, at an estimated magnitude of tens of millions of NIS a year. In addition, the Company estimates that the decision creates significant difficulties in constructing a second pipeline from the Tamar reserve and additional new gas fields and an additional gas entrance into Israel's shore. The Company believes that supplying gas from the Tamar reserve through a single pipeline undermines the reliability of the gas supply and the electricity supplied with the use of this gas, and therefore increases the risk that as a result of any failure or damage to this pipeline, there will be a significant rise in the duration of power failures.

On June 23, 2013, the Government of Israel decided to adopt the main points of the recommendations of the committee for examining the Government policy regarding the natural gas sector in Israel. Within this framework, the Government determined that in order to increase the reliability of the natural gas supply and to increase the quantity of supply to the local economy, action must be taken to establish piping for natural gas transmission from the "Tamar" reserve to the Ashkelon region, including an installation for handling natural gas, and to determine that the Mari B reserve will be an active storage reserve. For this purpose, the Minister was entrusted with imposing an obligation on the partners of the "Tamar" holding to establish piping for the transmission of natural gas to the Ashkelon region, including an installation for handling natural gas, by December 31, 2016. This is in addition to installation of the compressors by July 1, 2015, in accordance with the approval given by the Minister. Furthermore it was determined that a storage license should be granted to the owners of the Ashkelon holding with respect to the Mari B reserve for a period to be determined. The license will be conditional on the establishment of the stated piping, and that upon termination of the license the Ashkelon holding will terminate, and the Mari B reserve will be handed over to the State at the same time as an active and proper storage reserve.

The "Tamar" partners are working to establish a compressor array in Ashdod, which will enable to increase the quantity of gas supplied to the local economy, through the present gas transmission pipe system. The completion of the establishment of the compressor array is expected during the second quarter of 2015.

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NOTE 34:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)

a. Agreements (continued)

1) Agreement on the Supply of Gas from the Tamar Field (continued)

b) Regulation of the use of the gas pipeline capacity from the "Tamar" rig to the exit of gas from the Ashdod reception terminal (continued)

An increased gas supply to the Company will be possible through this array, insofar as the option of the Company will be realized, as stated above.

The Ministry of National Infrastructures, Energy and Water has not yet approved the use of the Mari B reserve as a storage reserve.

2) L.N.G.

In order to bridge the periods of shortage in natural gas until the beginning of production of gas from the "Tamar" field, and as an answer to peak demands and reliability of the gas supply, after the beginning of production as well, the Minister gave the Company approval, in February 2011, to promote an infrastructure project for the acquisition of liquefied natural gas (L.N.G.). The execution and promotion of the project will be conducted by the Gas Lines Company, which has erected a buoy and bears the responsibility of operating it. In accordance with the aforesaid decision by the Minister, the Gas Lines Company constructed a buoy approximately 10 kilometers west of the Hadera coast, and it was connected to the national gas transmission system. An LNG ship connects to the buoy, having capability to gasify the liquid natural gas aboard it and supply it through the buoy to the national transmission system.

Following the regular supply of natural gas from the "Tamar" field, LNG is only used when there is a break or malfunction in the supply of gas from the "Tamar" field, when the quantities of gas available to the Company from the "Tamar" field are not enough to produce electricity in order to meet the electricity demand of the Company and during times of peak demand that may damage the survivability of the electricity system.

The Electricity Authority decided to recognize the costs of leasing a gasification ship and the cost of purchasing liquefied natural gas by the Company, as well as additional direct and auxiliary costs that are expressed in agreements with suppliers, subject to controlling the costs.

The Company has an agreement to lease and operate an LNG ship with gasification capability with the Hadera Gateway LLC until the month of October 2017.

3) Agreement with the Palestinian Authority on the Construction of Sub-Stations

In February 2012, the Company entered into an agreement with the Palestinian Energy Authority on the construction of four sub-stations in the Judea and Samaria region (in Tarqumiya, Jenin, Ramallah and Nablus) (in this section: "Sub-Stations"). As well as for the purpose of electricity transmission and subject to entering a financing agreement between the Palestinian Authority and the European Investment Bank, the Company will connect the sub stations to high voltage transmission lines of 161 kV. Transmission lines will be constructed within the framework of the development of the Company, and will be financed by it. The construction of the four sub-stations is progressing in accordance with the original planning.

According to the agreement, the parties will conduct negotiations for the purpose of entering a commercial agreement for a long term supply of electricity, under the schedules determined in the agreement. If the parties will not sign the commercial agreement, the Palestinian Energy Authority will pay the Company the rate of connection to the transmission grid, according to the rate determined by the Electricity Authority and will pay with respect to electricity according to the high voltage consumer rate, as prescribed by the Electricity Authority. The Company has started execution of the project. The Company provided the Palestinian Energy Authority with performance guarantees and advance payment guarantees as is customary in contractual engagements of this kind.

The construction of the Jenin sub-station and the Tarqumiya sub-station is expected to end by the end of March, 2015.

At this stage, due to the debts of the Palestinian Authority to the Electric Company as electricity consumers (see Note 6 d above), these stations will not be electrified.

It is emphasized that as regards financing of the aforesaid substations construction projects, the Palestinian Authority has no debts towards the Company.

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NOTE 34:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)

a. Agreements (continued)

4) Contractual Engagements by the Company with Private Producers

Following are details of engagements of the Company with private producers as of December 31, 2014:

The scope of production capacity of active private producers:

Name of Producer	Status	Technology	Capacity (megawatts)
Dorad Energy Ltd.	Active	Conventional	860
Rotem O.P.C	Active	Conventional	466
Etgal Investments Ltd.	Active	Conventional	28
IPP Delek Ashkelon	Active	Cogeneration	87
Mashav Initiating and Development Ltd.	Active	Conventional	122
Paz Ashdod Oil Refineries Ltd.	Active	Cogeneration	109
Others	Active		374
Total			2,046

The following is the scope of production of entrepreneurs with conditional licenses who have signed an agreement with the Electric Company

Name of Producer	Status	Technology	Capacity (megawatts)
Dalia Power Energy Ltd.	Inactive	Conventional	870
Others	Inactive		911
Total			1,781

To the best of the Company's knowledge, there are producers with conditional licenses who have not yet signed agreements with the Company. The additional potential capacity adds up to approximately 3,863 megawatts.

On May 19, 2014, the Dorad Company began to produce electricity commercially.

To the best of the Company's knowledge, the Dalia Power Energy Ltd. power station is expected to begin commercial operation towards the middle of 2015.

As of the date of the statement of financial position, the generation capacity installed in the economy (including self-producers) is 14%. The entrance of private producers with significant capacity is affecting and is expected to continue to affect the scope of revenue in the Company.

In 2014, 2013 and 2012, the electricity production by private producers constituted approximately 15.8%, approximately 7.3% and approximately 3.7%, respectively, of the total production of the sector.

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NOTE 34:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)

a. Agreements (continued)

5) Agreements of the subsidiary

- a) The subsidiary, The National Coal Supply Company Ltd. ("the Coal Company") entered into long term agreements with suppliers and international shipping companies for the purchase and transportation of coal consignments. The commitment to purchase coal is made according to the same long term agreements with coal suppliers, where the price of the major quantity of coal is linked to international indices of the coal price. Some of the coal purchasing and marine shipping agreements are at fixed prices, in accordance with the Coal Company's policy. In coal purchasing agreements, fixed prices are determined for a maximum period of 12 months in advance while marine shipping agreements are for various periods, and as to periodic leasing agreements, even for several years in advance. As of the publication date of the Financial Statements, shipping prices in the market are lower than the prices of shipping agreements at fixed prices entered into by the Coal Company and most of the coal purchasing agreements entered by the Coal Company are linked to international coal price indices, therefore, current market prices of coal are the same as prices of the aforementioned coal purchasing agreements and there are no differences between the market prices and the agreements prices. Due to the agreement with the Electric Company that determines, inter alia, that the price of coal sold is determined on the basis of cost plus calculated as a fixed rate yield on equity, differences with respect to the coal agreements and differences with respect to transportation and lease agreements and the prices quoted in the market, if any, will be included in the price of coal and the Coal Company has no exposure with respect to them.
- b) The Coal Company entered into agreements with shipping companies to ship coal up to 2016 in the amount of Dollars 29 million and for long term leasing of ships, up to 2020, in an approximate amount of \$ 153 million. The Coal Company also entered long term agreements to purchase coal up to 2015, in a total quantity of 9.5 thousand tons.
- c) On January 16, 2013, an agreement was signed between the Company and the Coal Company for the giving of various services in all the activities accompanying import of liquid natural gas shipments. This agreement is effective from September 2012. As part of the agreement, the Coal Company provides the Company with ship border services and various consulting services in the shipping area and carries out on behalf of the Company commitments with suppliers and service providers in the field of shipping. The services are provided to the Company since September 2012. The total revenues of the Coal Company, mainly following this agreement, for 2014 and 2013 are approximately NIS 1.1 million and NIS 1.6 million, respectively.
- d) On March 3, 2013, a lease agreement was signed between the Coal Company and Port of Hadera (Ministry of Transport). In accordance with this agreement, the Coal Company leases a tugboat that was purchased by it on December 4, 2012, to the Port of Hadera, for a period of 5 years in return for agreed leasing fees. At the end of the lease period, the Port of Hadera will be able to extend the lease by one additional year each time, up to an additional accumulated period that will not exceed 15 years. The tugboat will return to the Coal Company at the end of the lease period and the extended period. The total investment in net lease as of December 31, 2014 and December 31, 2013 are approximately NIS 24 million and approximately NIS 26 million, respectively.
- e) On December 25, 2013, the Coal Company entered an agreement with an Israeli company to lease a bulk ship for 10 years.
- f) On June 9, 2014, the Coal Company entered an agreement with a foreign company to execute a transaction combining a purchase of a new bulk ship that will be built in a shipyard in Japan, and its long-term lease by the Coal Company. The cost of the ship is USD 55 million and the lease period is 10 years. The ship will be delivered in 2016. The Coal Company's part in the transaction is 49%.

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NOTE 34:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)

a. Agreements (continued)

- 6) As of December 31, 2014, the Company has entered into commitments to procure fuels, purchase and ship raw materials, purchase equipment and services, construct facilities and ship leasing, which are not expressed in the Financial Statements, as follows:
- a) Ordering, planning, consulting and equipment from suppliers in various currencies which, at their exchange rates as of the statement of financial position date amount to approximately \$152 million, € 157 million, £0.7 million and 0.6 million Swiss Francs. These orders will be financed, among others, by existing long-term credit lines from banks and foreign suppliers.
 - b) Contracts regarding construction, equipment supply, and current activities with local suppliers amounting to approximately NIS 2,747 million.
 - c) The contractual engagements of the Company with respect to fuels purchase and transmission costs (mainly natural gas) in different currencies under their rates of exchange as of the balance date in the amount of approximately Dollar 8,082 million and NIS 2,058 million.
 - d) The Company has contractual engagements with ultra high, high and low voltage private electricity producers for future purchase of electricity in a comprehensive annual amount of approximately NIS 4,105 million. The above mentioned amount is based on production forecasts and payments to private producers (existing producers and those that will enter the sector in the coming years) with respect to contracts signed by December 31, 2014, for a period of 15-20 years.

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NOTE 34:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)

b. Contingent Claims and Liabilities

There are approximately 473 contingent claims, including applications to recognize the claims as class actions, filed against the Company in the ordinary course of its business, mainly with respect to: financial claims (with respect to the electricity rate, among others), labor relations and bodily injury, amounting as of December 31, 2014, to approximately NIS 31,004 million, of which NIS 25,245 million with respect to applications to recognize the claims as class actions and applications for class actions that were accepted (as of December 31, 2013, a sum of approximately NIS 28,047 million, of which NIS 25,175 with respect to claims requiring recognition as class actions). A net provision (less income due from insurance companies with respect to insured claims) with respect to part of these contingent claims was recorded in the Financial Statements as on December 31, 2014, amounting to approximately NIS 340.2 million (the net provision as on December 31, 2013 amounted to approximately NIS 354.5 million) as follows:

- 1) A provision of approximately NIS 85.5 million was recorded with respect to insured claims for which the insurance indemnification is virtually certain up to the amount of the deductible component.
- 2) Approximately NIS 234 million with respect to uninsured claims (that do not include claims for bodily injury) and as to which no provision was recorded at all, or for which only a partial provision was recorded.
- 3) Approximately NIS 7.7 million with respect to uninsured claims for which a full provision was recorded.
- 4) Approximately NIS 13 million with respect to uninsured claims for bodily injury that, as is customary, are not specified by amount.

The Company's Management is of the opinion, based on the opinion of its legal and professional advisors, that the Company is not expected to incur other expenses with respect to the outcome of the claims, exceeding the aforementioned provision, which was recorded in the Financial Statements.

1) Claims requested to be recognized as class actions and claims that have been recognized as class actions

- a) On August 30, 2000, a request was filed with the Tel Aviv District Court against the Company and the State, to approve a claim as a class action (hereinafter: "The Request for Approval"), later amended, inter alia, after the Class Actions Law – 2006 (hereinafter: "Class Actions Law") came into force. Under the amendment, the request for approval was later divided into two requests, one against the State in the Administrative Affairs Court and the other in a Civil Court, heard by the judge.

The request for approval dealt with the collection of the special surcharge to the electricity rate. The claimant claimed, inter alia, that this special surcharge is a "hidden tax" that is being unlawfully collected, and that the Company must return it, together with interest and linkage, in the amount of approximately NIS 2,847 million in values of the date on which the claim was filed. It should be noted that the special addition which was intended to finance the Company's liability for pension of active employees and pensioners who started working in the Company up to March 31, 1975 and accumulated up to March 5, 1996, is an addition to the electricity rate which was fully collected from consumers, from 1997 to 2005 inclusive (by force of the pension agreement in June 1996 between the Government and the Company and by force of section 62(e) to the Electricity Sector Law). At the end of 2005, the collection of the special surcharge ended.

The Company had collected a nominal sum of NIS 9 billion on account of the special surcharge.

The parties completed filing their complementary pleas during 2010.

On September 12, 2013 and June 26, 2014, the claimant submitted applications for a decision in the application for approval. Up to the date of these Financial Statements, a decision has not been provided in the application for a decision or applications for approval.

The Company's legal advisors believe that the Company has good defense arguments both for dismissing the request for approval in limine and for dismissing it in its own merits and they believe that it is more likely than not that the request for approval will be rejected.

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NOTE 34:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)

b. Contingent Claims and Liabilities (continued)

1) Claims requested to be recognized as class actions and claims that have been recognized as class actions (continued)

- b) (1) On July 8, 2009, a request was filed with the Tel Aviv District Court to approve a claim as a class action against the Company claiming causes of misleading consumers and utilizing consumers distress according to the Consumer Protection Law - 1981 (hereinafter: the "Consumer Protection Law"), abusing the status of a monopoly according to the Anti-Trust Law, enrichment by force of the Unjust Enrichment Law - 1979 and deceit and negligent wrongs in the Damages Act [new version] - 1968 (hereinafter: the "Request for Approval on the subject of salary payments"). The claimant alleges that the Company collects through electricity bills illegal amounts from electricity consumers, as part of the price of the electricity it supplies, to cover excessive, illegal and invalid salary (according to the claimant's claim) of Company employees. The claimant claims that the accrued amount of the allegedly illegal salary payments, collected in contrast with the Government Companies Law, and the Foundations of Budget Law - 1985, amounts to NIS 5 billion over the seven years that preceded the submission of the action. The claim also claims that the Company submits misleading data to the Electricity Authority.

In addition, on August 30, 2009, a request to approve a class action against the Company was filed with the Central District Court for causes based on the Consumers Protection Law, the Trade Limitation Law, Unjust Enrichment Law, Damages Law and Contracts Law (hereinafter: "The Request for Approval on the subject of pension"). The claimants claim, that an error in the actuarial calculations of the pension to which Company employees are entitled led to the increase of the Company's pension liabilities. The claimants also claim that the cost of the increased pension liability was allegedly passed on to the consumers through setting higher than required electricity rates and alleged excessive payments for electricity consumption, estimated at approximately NIS 6 billion during the seven years preceding the filing date of the claim and during the proceedings of the claim. The claimants also claim that the Company was aware of the said error, but refrained from correcting it and even presented erroneous data to the Electricity Authority.

The hearing of the two applications was united and on May 17, 2010, all the applicants, together, submitted a joint application for approval (hereinafter: the "Joint Application").

On April 17, 2013, the District Court gave its decision approving the request for approval (hereinafter: the "Decision of Approval").

The Company's legal advisors are of the opinion that the Decision of Approval is erroneous and on May 13, 2013, the Company filed a request for leave to appeal the decision with the Supreme Court. At the same time, the Company filed a request for a stay of performance of the Decision of Approval. On June 9, 2013, the Supreme Court gave its decision, under which the Decision of Approval will be delayed until another decision is made. Additionally, on August 12, 2013, the respondents (the applicants of the request for approval) submitted a response to the request for leave to appeal.

In accordance with the decision of the Supreme Court, on January 20, 2014, the Attorney General of the Government submitted his position in the application for leave to appeal, within which the Attorney General of the Government supported the position of the Company, i.e. the acceptance of the request for leave to appeal and cancellation of the Decision of Approval. In accordance with the decision of the Supreme Court, the respondents (applicants in the request for approval) submitted their response to the position of the Attorney General of the Government on March 26, 2014, and the Company submitted its response on May 15, 2014. A hearing of the leave to appeal has been scheduled for October 28, 2015.

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NOTE 34:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)

b. Contingent Claims and Liabilities (continued)

1) Claims requested to be recognized as class actions and claims that have been recognized as class actions (continued)

- b) (2) An additional application for approval was submitted by the applicants "solely for the sake of caution" (as claimed by them) in view of the arguments of the Company within the procedure of application to approve, and it is based on the Joint Application and constitutes an expansion of it, both by the aspect of the period of time the Additional Application relates to and the scope of issues the Additional Application relates to. The amount of the class action whose approval is requested in the Additional Application is not explicitly specified (in view of the fact that the applicants claim that the Joint Application also includes the causes of action of the Additional Application), and they estimate that it is an addition of approximately NIS 2-3 billion to the Joint Application (that derives from the passage of time from the date of submission of the first application to approve until today).

The Company submitted an application to postpone the date for filing its response to the additional application and delay of the proceeding for as long as the Decision of Approval is delayed. On March 2, 2014, the Court approved the stated stay of proceedings until the Supreme Court will give its judgment in the application for leave to appeal that was submitted by the Company with regard to the approval decision of April 17, 2013 (see section (1) above).

The Company's legal advisors estimate that the arguments of the Company to dismiss the Joint Request (both in limine and the request itself), as well as its arguments regarding the request to grant leave to appeal, are good arguments and that it is more likely than not that the request for leave to appeal will be accepted, and the claim will be dismissed. Regarding the Additional Application, since the response of the Company to the application has not yet been submitted, all that can be noted at this stage is that this application is completely dependent on the Joint Application, and in any case, insofar as at the end of the day the Joint Application will be dismissed, so the Additional Application will be dismissed.

- c) On July 6, 2009, a claim and a request was filed with the Tel Aviv District Court against the Company, (hereinafter: "The Request for Approval") to approve a claim as a class action.

This claim was filed by a group of 512 claimants, residing in Gush Etzion dealing in granting adequate compensation to group members for alleged pecuniary and non-pecuniary damages caused by repeated disruptions and faulty electricity supply to villages in the Gush Etzion district.

Consequently, the amount of the claim which the Court is requested to approve as a class action is approximately NIS 39 million.

On October 14, 2012, a decision was given on the Request for Approval, in which the Court approved the submission of the claim as a class action (hereinafter: the "Decision of Approval"). However, the Court determined that it was not proven that the Company was negligent, and noted that therefore the claimants do not have cause of action in torts.

On November 13, 2012, the Company filed a request for leave to appeal the Decision of Approval with the Supreme Court. On January 22, 2014, a hearing of the request for leave to appeal was held, and a judgment was passed, within which the Supreme Court accepted the request for leave to appeal and cancelled the Decision of Approval. The Court remanded the case to the Tel Aviv District Court for a new decision to be given in the application for approval.

After remanding the case to the District Court as stated, the claimants submitted an application to the District Court, requesting to submit additional evidence. The Company objected to the stated application and requested to set the case for summaries. The District Court dismissed the application to submit additional evidence and determined that oral summaries will be heard on December 8, 2014. The claimants submitted to the Supreme Court a request for leave to appeal the decision not to allow them to submit additional evidence, and to the best of the Company's knowledge this leave to appeal is pending and a decision has not yet been reached. In view of the submission of the leave to appeal, the District Court postponed the date of oral summaries and in the last decision it was determined that this date will occur after a decision is reached in the application for leave to appeal.

The legal advisors of the Company estimate that it is more likely than not that the application for approval will be dismissed.

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NOTE 34:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)

b. Contingent Claims and Liabilities (continued)

1) Claims requested to be recognized as class actions and claims that have been recognized as class actions (continued)

- d) On November 10, 2009, a request to approve a class action against the Company and ten other respondents was filed with the Central District Court, by force of principles in the Damages Law and Consumers Contracts Law in the amount of approximately NIS 24 million ("The Request for Approval" "The Respondents", respectively).

The claimants claim that each of the respondents violated their obligation to provide free of charge telephone services to the customers to be used for calls on matters of faults, defective goods or faults in services provided by the respondents to their customers, all according to section 18 b of the Consumer Protection Law.

Regarding the Company, the claimants claim that a consumer that calls the call center (103) from a mobile phone pays the full charge for this call and similarly, also a consumer who calls one of the direct telephone numbers of the Company from any telephone (both mobile and land-line) pays the regular price for a call.

On August 11, 2013, the Court gave its decision on the application for leave, within which the Court gave its approval to conduct the claim as a class action with the causes of breach of sections 18b and 31 to the Consumer Protection Law, in that the respondent does not enable free calls to the call center, and breach of statutory duty as stated in the Torts Ordinance with respect to breach of the provision of section 18 b to the Consumer Protection Law. However, the Court decided that the applicant did not prove that it has a personal cause of action against the Company, and instructed the representative of the applicant to locate another class action claimant who has personal cause of action against the Company.

On August 7, 2014, the Court gave its ruling, within which the Court accepted the application of the representative of the claimants to change the class action claimant with the Israel Consumer Council and instructed it to file an amended statement of claim. The Consumer Council submitted an amended statement of a class action on September 7, 2014, and the Company submitted a statement of defense on November 2, 2014. Efforts for mediation between the parties are being carried out at this stage, and at the same time, the Consumer Council is permitted to submit a statement of response to the statement of defense.

In light of the decision to approve the class action, the legal advisors of the Company estimate that it is more likely than not that the action will be accepted. However, it is possible to estimate that the Company is not expected to bear the expenses with respect to this claim, beyond a negligible amount that is attributed in its books as a provision.

- e) On February 15, 2011, a request to approve a class action against the Company was filed at the District Court of the Central District, in the amount of NIS 166 million (hereinafter: "The Request for Approval"). The request for approval claims that the Company collects, contrary to the law, two separate fees, one for disconnecting a consumer from the electricity supply (for any reason) and the other for reconnecting the consumer.

Moreover, the applicant claims that the Company collects illegal charges for disconnection and connection, performed, allegedly "in the premises" as if these actions were performed "outside the premises" (where the fixed commission is higher). Additionally, the applicant has additional claims regarding the calculation of the interest that the Company charges its customers for payment in arrears and the manner in which the Company interprets "invoice generation date", mentioned in the criteria book, in a manner that decreases the period for paying the electricity bill, while damaging the consumers, but these are claims that require declaratory reliefs and mandatory injunctions only.

A compromise agreement was signed between the claimant and the Company on September 7, 2014, under which the claimant will withdraw the causes of action detailed above, except for the cause of connection and disconnection outside premises, regarding which the Company will partially return the surplus sums that were allegedly collected. According to the law, a compromise agreement has to be approved by the court, and at this stage the proceedings for granting an approval for the compromise agreement have not yet ended.

The opinion of the legal advisors of the Company is that it is more likely than not that the court will approve the compromise agreement reached by the parties, and that the Company will not be obligated to pay the group of claimants a sum exceeding the negligible sum attributed as provision in the books.

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NOTE 34:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)

b. Contingent Claims and Liabilities (continued)

1) Claims requested to be recognized as class actions and claims that have been recognized as class actions (continued)

- f) On January 31, 2013, two claimants (hereinafter: "the Claimants") filed a petition to the District Court for the approval of a class action against the Company in an amount of approximately NIS 178 million (hereinafter: "the Request for Approval"). Some of the claims in this application for approval are largely similar to claims raised in another application for approval that was stricken off on January 5, 2014

The Claimants claim that the Company is in violation of its duties under the Criteria Guide of the Electricity Authority, since instead of physically reaching the location of the meter in order to read it, the Company conducts "initiated skipping" and as a result, in more than a few cases, allegedly, the consumption assessment that is made due to the "initiated skipping" is inaccurate. According to the Claimants, if in the billing period that follows the consumption assessment the price of electricity rises, the Company charges the consumers for electricity consumption at the higher price, as if the consumers had consumed the electricity in the billing period subsequent to the rise in the electricity rate, although in practice, the electricity was consumed during the billing period that preceded the rise in the electricity rate. Additionally, the Claimants allege that as a result of the performance of the consumption assessments, the diagram that appears on the electricity bills that are sent to the Company's customers does not reflect actual consumption, and consequently the consumers are unable to examine the reasonability of their current consumption charges based on that diagram.

An evidentiary hearing took place on June 1, 2014. The Company and the applicants submitted their summaries by September 11, 2014. The parties are awaiting the court's ruling in the application for approval.

The legal advisors of the Company estimate that it is more likely than not that the application to approve the claim as a class action will be dismissed.

- g) On May 6, 2013, three applicants (hereinafter – the "Applicants") filed an application to approve the filing of a class action against the Company (hereinafter – the "Request for Approval") at the District Court (Central District), on behalf of all the Company's customers who were debited with arrears interest, warning expenses or other debit with respect to delay in payment during the seven years that preceded the filing of the claim, when the bill to be paid reached them less than five days before the deadline for payment, on the deadline date or after it.

The Applicants noted that they cannot estimate the exact damage that was allegedly caused to the group of claimants, but they estimate that it is an amount of "tens of millions of NIS, and maybe even more".

On September 23, 2014, an application to strike off two applicants from the Ginar application, an application for abandonment and an application to remove their depositions from the Court file was submitted. The Court accepted the application and the application for approval has therefore remained with one applicant, Mr. Dan Ginar (hereinafter: the "Applicant").

Evidentiary hearings were held on October 7 and 22, 2014, within which the court announced it is considering to request the position of the Electricity Authority and/or the position of the Attorney General on the issue discussed.

On December 30, 2014, the Applicant submitted to the Court an application for discovery of specific Company documents and requested a postponement of the date for submitting summaries on his behalf. On January 13, 2015, the Company submitted a response to the application, objecting to the document disclosure. On February 12, 2015, the Court rejected the application for discovery of documents and instructed the applicant to submit summaries on his behalf. On February 20, 2015, the applicant submitted summaries on his behalf in the application to approve. The Electric Company has to submit summaries on its behalf by May 3, 2015, and response summaries will be submitted on behalf of the applicant by May 24, 2015.

It is the estimate of the legal advisors of the Company that it is more likely than not that the application for approval will be approved with regard to the Company's conduct regarding the delivery of bills in the future. It is not possible to estimate the prospects of acceptance of the application for approval pertaining to the claim for compensation with respect to damages caused by the delays in delivering the electricity bills in the past, but in any case, the legal advisors of the Company estimate that even if the application for approval is accepted, it is more likely than not that the Company will ultimately not be obligated to pay with respect to delays that occurred in the past (inter alia, due to absence of proof of damage).

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NOTE 34:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)

b. Contingent Claims and Liabilities (continued)

1) Claims requested to be recognized as class actions and claims that have been recognized as class actions (continued)

h) On May 8, 2013, an application to approve a class action was filed against the Electric Company.

The application to approve concerns the engagements of the Company in agreements with the Siemens Company, in the years 2001-2003, to purchase combined cycle gas turbines ("CCGT") and related services. The sum of damage claimed in the application for approval is based on the sum of damage claimed by the Company in the action it submitted against Siemens, Dan Cohen and others (hereinafter: the "Company Action against Siemens").

According to the claim, the damage to the Company was "rolled over" to the electricity consumers within the determination of electricity rates by the Electricity Authority for the consumers. According to the arguments in the application to approve (based, inter alia, on the decision of the Tel Aviv District Court of April 21, 2013), the Company has exclusive influence on the determination of the rate. Therefore, the applicant claims that the electricity consumers were excessively charged within the framework of the electricity rates in the amount of NIS 200 million.

On September 1, 2013, the Company submitted an application for a stay of proceedings of the application to approve until a decision is reached in two proceedings: (1) the application for leave to appeal mentioned in section b above; (2) the Company Action against Siemens. On November 3, 2013, a hearing was held regarding the Company's application for stay of proceedings, following which the applicant announced, on November 6, 2013, that it agrees to the stay of proceedings in the application to approve until a decision is reached in the application for leave to appeal mentioned in section b) above. On November 11, 2013, the Court instructed a stay of proceedings in the application to approve until a decision is reached as stated.

On October 29, 2013, the applicant submitted an application for unification of the hearing of the application to approve and the Company Action against Siemens, arguing that the two proceedings raise joint questions of fact and law.

On November 18, 2013, the Company submitted its objection to the application for unification of the hearing. The application is still pending.

It is the opinion of the legal advisors of the Company that the Company has good defense arguments for dismissing the application for approval and it is more likely than not that the request for approval will be dismissed.

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NOTE 34:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)

b. Contingent Claims and Liabilities (continued)

1) Claims requested to be recognized as class actions and claims that have been recognized as class actions (continued)

- i) On September 30, 2013, an application to approve a class action against the Company and five other companies (hereinafter: the "Cartel Companies") was submitted to the Central District Court, in the amount of approximately NIS 2.4 billion and an additional amount of approximately NIS 412 million against the Company alone, NIS 2.8 billion in total.

The application deals with the global cartel in the GIS (Gas Integrated Switchgear - hereinafter: "GIS") array market between the years 1988-2004, in which the Cartel Companies took part, and within which they coordinated a tender that was published by the Company for the purchase of dozens of GIS arrays. The application is based, inter alia, on the determination of the General Director of the Israel Anti-Trust Authority of September 16, 2013, with regard to the implementation of the cartel in Israel (hereinafter: the "Determination of the General Director").

Within the application for approval it is argued that the Cartel Companies, that maintained among themselves a restrictive arrangement contrary to the restrictive trade practices law, are responsible for the damage in the amount of NIS 2.8 billion, as well as the Company itself, which, according to the argument in the application for approval, conducted itself negligently and in breach of duties from the administrative law, by "surrendering" to the cartel out of indifference to damages that were "rolled over" on to the consumers (although the applicants note that in their opinion the Cartel Companies are the direct and major damagers, and insofar as liability will be imposed on the Cartel Companies, they do not demand that the Company compensate them with respect to this liability). It is further argued in the application for approval that the Company even increased the consumers' damage beyond the damages by the cartel, with unjust enrichment at the expense of the consumers, in the amount of NIS 412 million, because of a gap between the interest for the damages by the cartel and the interest for the electricity rate.

On September 4, 2014, the court accepted the Company's request for a stay of proceedings in the application for approval submitted against it due to a proceeding pending at the Supreme Court that the Company is party to (mentioned in section b) above). The Court even ordered a stay of proceedings in the application for approval against the other defendants until a decision is reached in the stated proceeding. On October 19, 2014, the Claimants submitted an application for leave to appeal the above mentioned decision to the Supreme Court (hereinafter: the "Application for Leave to Appeal").

On February 19, 2015, the Company and the Cartel Companies submitted their responses to the application for leave to appeal. In its decision of March 11, 2015, the Court proposed an outline for consolidation of the proceeding of the Company's claim (see section 5) a) below) with the this application for approval and an additional application for approval (that was not filed against the Company) in order to clarify the issue of whether the Cartel Companies committed a civil wrong under the antitrust laws. On March 19 2015 the parties submitted their reaction to the court's proposal. The court's decision is yet to be given.

It is the opinion of the legal advisors of the Company that the Company has good defense pleas for dismissing the application for approval and it is more likely than not that the application for approval will be dismissed.

- j) On December 16, 2014, an application to approve a class action against the Company (hereinafter: the "Application for Approval") was submitted to the Central District Court, in the amount of approximately NIS 19 million on grounds of breach of statutory duties on the part of the Company, deception under the Consumer Protection Act and unjust enrichment . The Application for Approval is a claim that the Company denies the rights of discount in the electricity rate for consumers that are entitled to it by law, at the time of changing a place of residence. In addition, the applicant alleges that the company avoids paying its customers the compensation that it undertakes to pay them if it does not meet the criteria specified by it and published by it to the public, concerning compensation for delay in response to requests sent to the company.

The Company has to submit a response to the application to approve the action as a class action by May 1, 2015. A pretrial is scheduled for July 14, 2015.

At this preliminary stage, the legal advisors of the Company cannot estimate the prospects for the approval of the application.

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b. Contingent Claims and Liabilities (continued)

2) Claims for the pollution of the Kishon River

In the framework of a claim filed against "Haifa Chemicals Ltd.", "Oil Refineries Ltd.", the Association of Municipalities (Haifa region - Sewage) and the municipality of Haifa (hereinafter: "The Defendants"). by 95 soldiers of the IDF and soldiers' estates (the current number of claimants is 74), claiming that the soldiers allegedly became ill with various types of cancer as a result of their exposure to the water of the Kishon, Haifa Port, Shemen Shore and the surrounding water during their military service, in 2005, a joint notice was filed on behalf of the defendants against multiple third parties, among whom is the Company ("The First Claim").

In 2007, another claim was filed, consolidating 17 claims by soldiers and estates (at present, the number of claimants in this case is 16), against the same defendants in the first claim and against their insurers (The Second Claim"). In this claim also, a joint notice was filed by the defendants against multiple third parties, among them the Company (due to the claim that the power station at Haifa contributed to the pollution of the Kishon water).

After the evidence of the parties regarding the question that was to be discussed within the first stage of the claim was heard, the parties filed their summations in writing. On June 17, 2013, a judgment was passed dismissing the first claim without order for costs, after it was determined that the existence of a causal connection between the materials they claimed were present in the Kishon waters was not proven by the claimants. On September 8, 2013, the claimants submitted an appeal to the Supreme Court. At the same time the Company submitted a notice of cross appeal with regard to not receiving an adjudication of costs despite the dismissal of the action. A hearing for the appeal in the Supreme Court of Justice was scheduled for September 7, 2015. After submission of the summaries of the appellants, the respondents, including the Company, submitted their summaries on January 21, 2015.

With respect to the second claim that was heard separately, a procedural arrangement was reached, under which the discussion of the claim is frozen until a decision is reached in the appeal regarding the judgment of the first claim.

Regarding the scope of the risk, since the case involves bodily injury claims, in the framework of which no defined aggregate cash amount was asserted on the date that the claims were filed, as the different parameters of which are the basis for the calculation of the damage for each plaintiff are determined in a clarification procedure of the claim, and since these are complex claims that raise complex scientific and legal issues, it is not possible to know at this stage what the damage that was caused to each of them is, all the more so what the relative part of each defendant and third party being sued in this claim is.

In the assessment of the Company's attorneys, a general assessment of the extent of the risk in the appeal is in the range of between NIS 650 million and NIS 800 million, including recovery of expenses. The reference is only to a general estimate, based on the assumptions that they make in the absence of data at this stage.

In view of the complexity of the action, the Company's attorneys will be able to update their assessment only in the future if and in case the appeal is allowed. In the Company's opinion, based on the opinion of its attorneys, data that would enable evaluating the Company's risk is unavailable at this stage. Nevertheless, and in view of the judgment of the District Court, the Company estimates that it is highly unlikely that the Company will incur a material sum.

3) Claim on Pollution from the "Ramat Hovav" Industrial Zone

Three actions (in which the hearing was enjoined) were lodged in the Beer Sheva District Court in 2007, amounting to NIS 250 million, against the Ramat Hovav Local Industrial Council (hereinafter: The "Council") and the State of Israel (hereinafter: "The State"). The action was originally included 82 claimants, whose number as of the Financial Statements date is 73, was lodged by Bedouin inhabitants of the northern Negev, who live near the council and inhabitants of Omer and southern neighborhoods of Beer Sheva, residing near Ramat Hovav site, because of different diseases, including respiratory diseases (including asthma) and cancer, allegedly caused by their prolonged exposure to hazardous materials emitted from Ramat Hovav site and/or from high voltage lines of the Company.

On May 21, 2008, the Council (without the State) filed a statement of defense against the actions and a notice to a third party, inter alia against twelve plants operating at Ramat Hovav site, including the Company.

On January 9, 2013, a ruling was issued that rejects the claims and orders the payment of expenses to the respondents/third parties, having determined that the existence of a causal connection has not been proven between the illnesses of the overall claimants and the materials that they allege have been released from the Ramat Hovav site. The claimants filed an appeal, appealing the ruling, with the Supreme Court.

On September 29, 2014, the appeal was heard by the Supreme Court. The appeal was dismissed and a compromise arrangement was reached on the issue of the sum of expenses to be paid by the claimants according to the ruling of the District Court.

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b. Contingent Claims and Liabilities (continued)

4) Derivative Claims

- a) On September 10, 2009, a letter was sent to the Chairman of the Board of Directors by Mr. Dov Zelinger, who is, according to him, a shareholder of the Company. Within the aforesaid letter, Mr. Zelinger related to two issuances of debentures executed by the Company, abroad, in May 2008 and January 2009 (hereinafter: the "Debentures"). Mr. Zelinger claims that during the months of August and September 2009, the Company published that a mistake occurred in the actuarial calculation of the pension funds that the Company employees are entitled to, leading to the increase of the pension liabilities of the Company. Mr. Zelinger claims that due to the aforesaid mistake in the actuarial calculation, the interest rate paid by the Electric Company on the Debentures is higher than the rate it would have paid had the aforesaid mistake not occurred, and thus damage is caused to the Company.

In light of the aforesaid, Mr. Zelinger requested the Chairman of the Board of Directors to ensure that the Company files a claim with respect to the aforesaid damage, against the relevant members of the Board of Directors for each of the aforesaid Debenture issuances, and against the actuary of the Company, who, according to Mr. Zelinger, violated their duties towards the Company, and, as he claims, are responsible to the damage caused to the Company with respect to the aforesaid mistake. Mr. Zelinger announced that the aforesaid letter constitutes a preliminary application, in accordance with the Companies Law, before submitting an application to the Court, requesting permission to submit a derivative claim on behalf of the Company against the members of the Board of Directors and the actuary of the Company.

On October 21, 2012, Mr. Zelinger again approached the Company, and claimed, considering the publication of the Annual report number 63A of the State Comptroller on October 17, 2012, that the contents of the report of the State Comptroller strengthen the claims of Mr. Zelinger that were raised in the previous correspondence between the parties. Mr. Zelinger noted that considering the new findings (as he claimed) the Company is requested to "reexamine and reconsider its position not to file a claim against those responsible for the financial damage caused to the Company as a result of capital raisings" the object of the first letter, and that if it refuses to file a claim as aforesaid, Mr. Zelinger will consider filing a derivative claim in its name. On November 26, 2012, the Company replied to Mr. Zelinger's latest letter and once again rejected his claims.

At this stage, it is not possible to estimate the risk to the Company as a result of the aforesaid, inter alia because an application to approve the filing of a derivative claim (which in general is not even a claim against the Company, but rather a claim by the Company) was not submitted, and therefore it is not possible to know what claims will be presented in it (if any), and against who will the derivative claim be, or what scope will it have, and also because the complete relevant facts have not yet matured at this stage.

It is the estimate of the Company, even if a derivative claim by the plaintiff (in the name of the Company) against the office holders will be filed and accepted, that there is no direct financial exposure to the Company due to this claim, except for possible exposure with respect to deductible to the insurance company, at a negligible amount.

- b) In December, 2013, Mr. Dov Zelinger who, according to him, is a shareholder of the Company submitted a letter of demand in accordance with section 194 of the Companies Law ("Letter of Demand"). Mr. Zelinger claims that the engagement of the Company in an administrative enforcement arrangement with the Securities Authority, within which the Company paid a financial fine of NIS 5 million (the "Financial Fine"), is under the responsibility of the CEO of the Company and those who were at the time in office as Deputy CEO Finance of the Company and Head of the Financial Division of the Company. In light of the above, Mr. Zelinger requests in the Letter of Demand that the Company will submit an action in the amount of the financial fine against the persons mentioned above. Additionally, according to the Letter of Demand, if the Company refuses to submit an action as stated, Mr. Zelinger will consider submitting a derivative action in his name. On February 13, 2014, the Company replied that it does not intend to submit a claim against the office holders.

At this stage, it is not possible to estimate the risk to the Company as a result of the aforesaid, inter alia because an application to approve the filing of a derivative claim (which in general is not even a claim against the Company, but rather a claim by the Company) was not submitted, and therefore it is not possible to know what claims will be presented in it (if any), and against who will the derivative claim be, or what scope will it have, and also because the complete relevant facts have not yet matured at this stage.

Even if a derivative action of the claimant (in the name of the Company) against the office holders aforementioned is filed and accepted, there is no direct financial exposure to the Company with respect to this claim, except for a possible exposure with respect to the deductible of the insurance company, of a negligible amount.

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b. Contingent Claims and Liabilities (continued)

5) Other Legal Proceedings

a) Legal Proceedings on the Subject of GIS Arrays

On December 29, 2013, the Company submitted a claim to the District Court of the Central District against foreign companies that supplied the company with GIS arrangements (gas insulating voltage arrangements): ABB Ltd. (hereinafter: "ABB"), Siemens AG (hereinafter: "Siemens"), Alstom Societe Anonyme (hereinafter: "Alstom"), Alstom Grid AG and Alstom Grid SAS (hereinafter together: the "cartel Companies " or the "Defendants"). Regarding the application to approve a class action against the company on this subject see section 1) i) above.

The claim is based on the determination of the General Director of the Israel Anti Trust Authority of September 16, 2013, that exposed that the global cartel that was conducted in the GIS arrangement market between the years 1988 - 2004 was also implemented by the Cartel Companies in Israel towards the Electric Company, and that the acquisition proceedings conducted by the Company to purchase GIS arrangement during the active years of the cartel were coordinated in advance by the Cartel Companies, who presented to the Company a fraudulent representation of competition between them.

Within the claim, damages caused by the Cartel Companies to the Company are being claimed, as well as the return of illegitimate profits extracted by the Cartel Companies at its expense, within the framework of approximately 20 acquisition proceedings conducted by the Company during the active years of the cartel. The Company estimates that the damage caused it by the actions of the cartel amount, as of the date of submission of the claim, to approximately NIS 3.8 billion.

On March 6, 2014, the defendant, Siemens, submitted an application for dismissal in limine and alternatively to stay the proceedings of the claim (hereinafter: "Siemens' Application for Dismissal") due to the existence of another proceeding that is pending - a claim for negative declaratory relief, which was submitted by Siemens in Germany against the Company. In it, Siemens requests the German Court to declare that the Company will not be entitled to raise arguments against Siemens that derive from claimed breaches of the Antitrust Laws in the GIS arrangement market in Israel(hereinafter: the "Claim in Germany"). Within the Claim in Germany, the Company submitted a statement of defense, within which the Company requested to dismiss the claim in limine (hereinafter: the "Company's Request for Dismissal"). On March 11, 2015, the German Court accepted the Company's request and dismissed the claim in limine. Siemens has a right to appeal this decision within 30 days. Regarding the application for dismissal and stay of proceedings by Siemens, a hearing was held on November 17, 2014, within which the Court was of the opinion that it is worthwhile to wait for the decision of the German Court in the application for dismissal submitted by the Company in Germany, as it may have implications on the hearing of the application in Israel. The legal advisors of the Company are of the opinion that the prospects for the Siemens' Application for Dismissal to be dismissed are higher that its prospects to be accepted, and that these prospects have even increased in light of the decision of German Court.

On October 16, 2014, Siemens, Alstom and ABB submitted amended statement of defense on their behalf, denying that stated in the statement of claim, and in addition raising preliminary arguments against the Company's claim.

The Company submitted statements of response on its behalf on March 3, 2015.

An additional pretrial hearing in the Company's claim has been scheduled to April 29, 2015.

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b. Contingent Claims and Liabilities (continued)

5) Other Legal Proceedings (continued)

b) E.M.G

In August 2005, the Company entered an agreement with E.M.G. (the Company's supplier of natural gas from Egypt) for the supply of natural gas, according to which the total gas quantity to be purchased (approximately 25 billion cubic meters) will have an annual average rate of approximately 1.7 billion cubic meters during fifteen (15) years, starting from July 2008, until 2023, and the Company had an option to extend the agreement by five (5) additional years, until 2028, under the same conditions and for the same annual quantities. Additionally, the Company has signed a tripartite agreement with EMG and the gas owners, the Egyptian companies EGAS and EGPC, under which the Egyptian companies have undertaken towards the Electric Company to place the gas it has undertaken to supply to the Electric Company at the disposal of EMG. From the beginning of the supply of gas by E.M.G., E.M.G. has not met its full contractual liabilities.

Upon the change of the regime in Egypt in the beginning of 2011, the supply of the Egyptian natural gas was significantly damaged, up to the complete cessation of the supply of natural gas from Egypt in April 2012, with the notification by the Egyptian Government gas companies, who supply natural gas to E.M.G., of the cancellation of their agreement with E.M.G. for the sale of natural gas.

Due to the continuing disruptions in the supply, the Company's Board of Directors decided already in September 2011, that the Company will enter an international arbitration process versus the national Egyptian gas supply companies and EMG, to receive compensation for the heavy damages incurred and that will be incurred by the Company by non-delivery of the gas from Egypt due to their breach of the agreements with the Company.

The arbitration started in September 2011 and in April 2012, the International Chamber of Commerce in Paris appointed the arbitrators for the arbitration against EMG and the Egyptian companies. The first hearing was conducted on May 31, 2012 in Paris, before the arbitrators, attended by the parties. At the end of October 2012, the arbitrators notified that after studying the letters of claim that were submitted, they have decided to cancel the evidence hearing with respect to the jurisdiction which was set for November 2012. Additionally, the arbitrators issued an order cancelling their decision of May 31, 2012, regarding the separation between the stage of arguments regarding the jurisdiction and the stage of arguments regarding the dispute itself, and determined that the procedure will be conducted as a single unit. The claim of the Company regarding the dispute itself, including all the evidence of the Company pertaining to the arbitration proceeding, was submitted in February 2013. The Company is claiming compensation of approximately USD 3.9 billion with respect to the heavy damages incurred and that will be incurred by the Company in future.

Simultaneously with the filing of the claim, and after consulting with its international legal advisors in London, the Company announced that in view of the unilateral cancellation of the agreement between it and the Egyptian government gas companies and E.M.G., and in view of the behavior of the Egyptian government gas companies and the fundamental breaches on their part of the tripartite agreement between the Company, the Egyptian government gas companies and the EMG Company, the Company has no choice but to accept its position as a fait accompli and to regard the tripartite agreement as an agreement that has reached its end. At the same time, and according to the opinion of its legal advisors in London, the Company decided to notify E.M.G. of the cancellation of the agreement between it and the Company.

The response of the Egyptian Government gas companies to the Company's claim was submitted in June 2013, and after another round of responses from the Company in September 2013 and from the Egyptian companies in December 2013, a hearing in front of the arbitrators was held in January 2014, in Paris, attended by all the witnesses and experts in order to testify on behalf of the parties. After two weeks of hearings, the arbitrators decided that the parties will submit summaries in writing at the beginning of April, 2014, and a concluding hearing will be held afterwards in Paris in the middle of May, 2014.

The updated amount claimed by the Company is approximately USD 4.15 billion compensation with respect to the heavy damages incurred and that will be incurred by the Company in the future and that include an application for additional interest in the amount of approximately USD 300 million.

The summaries in writing were submitted by the parties and the summarizing hearing was conducted as planned, and an application for recovery of legal expenses was submitted in the middle of June, 2014.

The arbitration has ended and the Company is waiting to receive the arbitration award.

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NOTE 34:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)

b. Contingent Claims and Liabilities (continued)

6) Claim on the Subject of a Collective Sale Rate

The cause of the claim that was filed against the Company on February 3, 2010 is the electricity rate that is payable to the Company by collective settlements that consume electricity collectively and at a high voltage.

Following several proceedings that were held in relation to the claim, the statement of claim has been amended several times and currently the claim includes 150 collective settlements.

In the current amended format of the claim, the claimants claim financial relief in the amount of NIS 96 million (plus interest and linkage) for charging higher rates than required and declaratory relief regarding the claimants' right to purchase electricity in accordance with the collective sale rate - high voltage.

On January 14, 2013, the Court ordered that the Electricity Authority would be added as an additional respondent in the class action. The aforesaid resolution also determined that the claims included in the statement of claim, will be deemed as having also been addressed against the Electricity Authority. On May 12, 2013, the Electric Authority filed a statement of defense on its behalf, within which the Authority claims, inter alia, that the collective sale rate - high voltage was intended to apply only to bodies holding a legal distribution license, or historic electricity distributors that joined the outline for regulating the legal operation of historic electricity distributors, and that as long as the claimants do not fulfill these conditions, the correct rate for them in accordance with the criteria is the high voltage LTR.

The Company submitted initial affidavits of evidence and an expert's opinion on its behalf on January 14, 2015. Evidentiary hearings of the claim are scheduled for June 24, 2015 and July 6, 2015.

In light of the arguments of the Company, as detailed in the amended statement of defense, and in light of the position of the Electric Authority, as detailed in the statement of defense on its behalf, and after confronting these arguments with the claims of the claimants alone, as detailed in the amended statement of claim, the legal advisors of the Company believe, as of this date, that the Company has good defense arguments against the claim and it is more likely than not that the claim will be dismissed.

7) Claims for Payment of Municipal Taxes

As of the statement of financial position date, there are demands against the Company for municipal taxes in amounts exceeding the relevant provision that was recorded in the Financial Statements by about NIS 153 million. These demands derive from the changes in classification of lands held by the Company, the demand to increase the areas being billed and the demand with respect to municipal tax rates.

The Company estimates (based in part on the opinion of its legal advisors), that there is a low probability it will be required to pay these amounts, for which the Company did not make a provision in its Financial Statements.

8) The Planning and Building Law

The Planning and Building Law prescribes that the holders of rights in land who were adversely affected by a zoning plan are entitled to indemnification from the local committees for the sectors to which that zoning plan applies. In order to set up 400 kilovolt lines and 161 new kilovolt lines (except for a list of lines that was excluded and maintenance work and upgrading to 161 kilovolt lines), zoning plans are required. The Company undertook to indemnify the local committees for the sectors to which approved zoning plans that determined the establishment of 400 kV lines apply for the full amounts that the committees will be obliged to pay to the landowners who will be adversely affected, as stated above (aside from one plan, in which the burden of indemnification will be divided among the institutional bodies that are involved in the plan).

These undertakings for indemnification were delivered after it was made clear to the Company that not providing them would result in the failure to approve the plans or their suspension.

As of the statement of financial position date, claims are pending in an amount of about NIS 576 million, in excess of the provisions that were recorded in the Company's Financial Statements.

In the Company's opinion, based on the opinion of its attorneys, which takes into consideration the opinion of the real estate assessor advising the Company with regard to the above claims, if all of its arguments shall be rejected and the Company shall be forced to expend funds for these claims, then the Company's exposure for these claims will not exceed the provision that was recorded in the Financial Statements. The Company is of the opinion that should any amounts whatsoever be paid, these amounts will be part of the cost for setting up the relevant transmission lines, and due to the indispensability of the transmission lines, and based on the opinion of its attorneys, if and when the Company pays indemnification with respect to the indemnity letters, the Electricity Authority will be obligated to recognize them in the electricity rate.

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NOTE 34:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)

b. Contingent Claims and Liabilities (continued)

9) Other Contingent Liabilities

a) The Israel Lands Administration

The Company held and is holding discussions and clarifications with the Israel Lands Administration from time to time, as needed, with respect to the lease fees for certain real estate properties at different sites.

As of the statement of financial position date, the Company is unable to estimate if it will be required to pay the usage fees for these sites and, if required, what amounts will be demanded. However, if the Company will be eventually required to pay with respect to all these sites, it is probable that the total amount will not exceed NIS 15 million. The Company did not record any provision with respect to these demands in its Financial Statements.

b) Project D

In December, 2010, the development plan was approved by the Minister for National Infrastructures. According to the plan, the Company has to construct and operate two generation units with a capacity of 630 megawatts each, in a gas-coal configuration. In July, 2011, the National Council for Planning and Building gave instructions to prepare National Outline Plan ("NOP") 10 for a station that will be powered by natural gas as a primary fuel and coal as backup fuel only, and approved the instructions for preparing a review of the impact on the environment.

On March 10, 2013, the development plan for project D was changed and the Minister approved as follows: "Construction of two steam thermal units with a natural gas-coal configuration, each combined with a gas turbine operated by natural gas with diesel oil as backup, at the Rothenberg site (Project D). The capacity of each steam thermal unit will not exceed 550 megawatts and the capacity of each gas turbine will not exceed 180 megawatts". The project was updated following the amendment of the development plan by the Minister. On January 1, 2014, the Company received a letter from the Antitrust Authority, according to which the General Director of the Antitrust Authority is considering to make use of the authority vested in him and instruct the Company to refrain from increasing, directly or indirectly, its electricity production capacity beyond 13,307 megawatts, and this as long as the electricity production capacity of the Company exceeds 50% of the total sectorial production capacity in the electricity sector. In the letter, it was noted that the above mentioned does not prevent the Company from executing works to improve the efficiency in the electricity production stations it owns, but if these works can increase the electricity production capacity beyond the maximal production capacity mentioned above, it will have to receive approval for this in advance from the General Director of the Antitrust Authority. The Company will have an opportunity to state its position to the General Director of the Antitrust Authority before a decision is made.

On March 4, 2014, the Company submitted its position to the General Director of the Antitrust Authority within a written hearing held for the Company, and presented legal and economic arguments against issuing an order as stated.

On March 17, 2014, an oral hearing was held for the Company. On May 26, 2014, following the hearing, the Company delivered to the General Director of the Antitrust Authority its complementary comments to the position that was presented to the General Director.

As of the date of the report, the final decision of the General Director of the Antitrust Authority on the issue has not yet been published.

Additionally, in view of the decision of transition to new technology and configuration of project D as a dual fuel station that will be operated by gas with coal backup, in 2013, a provision was recorded for impairment under accounting standard SFAS90.

Due to the financial position of the Company and until clarification with the regulators and finding budgetary resources, the Company has decided to stop the planning proceedings (including preparation of a review, advancing an emission permit and outline plan), the preparations for financial closure and all the investments associated with project D, and to remove the project from the five-year financial plan of the Company. The Company is examining, inter alia, the possibility that Project D will be executed in cooperation with a strategic partner, subject to receiving approval from the Board of Directors of the Company and approval from the relevant State entities as required by law.

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NOTE 34:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)

b. Contingent Claims and Liabilities (continued)

9) Other Contingent Liabilities (continued)

c) Fees, Betterment Levies and Others

Alon Tavor

On November 28, 2013, the Company received a betterment levy assessment with respect to the Alon Tavor power station in the amount of approximately NIS 680 million with respect to NOP 10/b/9, which allegedly added an amount of 370 megawatts to the generation output capacity of the power station. On May 21, 2014, the Company filed an appeal on its behalf, and within the legal proceedings, the Company argued its arguments against the obligation of betterment levy itself and against the obligation sum.

On December 7, 2014, the Appeals Committee held a hearing, during which the parties presented oral summaries, at the end of which the Appeals Committee instructed the parties to submit summaries in writing regarding the significance of extending the building permits in 2007 on the issue of limitation.

The Company has real arguments against the betterment levy assessment, both for the obligation itself and with regard to its sum, but since it is a precedence case in terms of assessment, and given the complexity of the assessment data infrastructure and complexity of the fundamental assumptions that serve as basis for the betterment levy assessment, and given the fact that the Appeals Committee did not express its opinion as to the arguments of the Company the legal advisors of the Company cannot estimate the prospects of the legal proceedings at this stage and/or reliably estimate at this stage the sum of the final betterment levy by a judicial decision.

The Company is of the opinion that if it will be required to pay any sums with respect to this levy, these sums will be part of the fixed assets cost of the Company, and are expected to be recognized in the electricity rate by the Electricity Authority.

Tzafit

After the balance sheet date, on July 13, 2014, the Company received a betterment levy assessment with respect to the Tzafit power station in the amount of approximately NIS 660 million with respect to approval of NOP 10/b/10, which allegedly added a quantity of approximately 370 megawatts to the generation output capacity of the power station.

On December 22, 2014, the Company submitted an appeal on its behalf and within the proceeding the Company presented its arguments against the betterment levy charge itself and a consensual request for exemption from submitting a counter assessment. The Appeal Committee decided on that day to exempt the Company from submitting a counter assessment at this stage.

On February 1, 2015, the Appeals Committee decided to combine the Company's appeal with other appeals, all of which raise the judicial question of whether the Planning Committee has a right according to law to collect betterment levy by virtue of a national outline plan approval, and to request the position of the Attorney General in this matter.

The Attorney General is expected to deliver his position by April 1, 2015.

Since this case is precedential both judicially and in terms of appraisal, and in view of the complexity of the appraisal data infrastructure and complexity of the premises used as basis for the betterment levy assessment, and in view of the fact that the position of the Attorney General has not yet been delivered and even a hearing has not yet been held by the Appeals Committee, there is great difficulty to estimate the prospects of the legal proceedings at this stage and/or to reliably estimate the sum of the final charge of the betterment levy by a judicial decision.

The Company is of the opinion that if it will be required to pay any sums with respect to this levy, these sums will be a part of the fixed assets cost of the Company, and they are expected to be recognized in the electricity rate by the Electricity Authority.

Others

As of the statement of financial position date, the Company has demands with respect to levies and other fees in amounts exceeding the provision existing in the financial statements by approximately NIS 145 million. In the opinion of the legal advisors of the Company, as on the date of the report, the Company does not have the ability to estimate the exposure to these demands.

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NOTE 34:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)

b. Contingent Claims and Liabilities (continued)

10) Guarantees

Regarding guarantees provided by the Company, see Note 27e above.

11) Indemnification Letters

Regarding details of indemnification letters furnished by the Company to related parties see Note 33 f above.

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NOTE 34:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)

c. Labor disputes

- 1) On December 5, 2012, the Chairman of the Trade Union Division of the New National Labor Federation announced a labor dispute. The disputed matters are:
 - a) One-sided actions of the Company's Management, that in practice constitutes the initiation of a reform, overlooking discussions that have been held between the parties. In the opinion of the Federation, these processes have a significant adverse effect on the position of the Company and its financial strength as well as implications on the rights of the employees and their employment security.
 - b) The demand by the employees' representatives to refrain from one-sided actions, to hold negotiations for the purpose of reaching understandings and to sign a comprehensive collective agreement, detailed and sweeping, to regulate the rights of the employees and the rights of the parties, in view of the aforementioned state of affairs, including the regulation of a safety net to secure the rights of the employees.
 - c) The employer is not holding collective negotiations and is ignoring the repeated demands of the employees' representatives.

It is clarified that the actions taken by the Company are not intended to prejudice the rights of the employees. The Company is operating in accordance with the instructions of the regulators, the law and labor agreements between it and the employees' organization and the National Labor Federation.

- 2) On February 28, 2013, an application was filed with the Regional Labor Court to instruct the employees to cooperate in all that pertains to the implementation of the decisions of the Electricity Authority in the issue of aggregators within the arrangement of "Smart Consumption", which enables an aggregator consumer, representing a bulk of electricity consumers, to divest during peak hours as will be so defined by the system management. In a hearing held on July 15, 2013, the hearing of the claim was postponed without a date being scheduled. And in the decision of August 8, 2013, it was determined that until utilization of the date allotted by the government for the ending of the Yogev Committee discussions, it does not seem fit to conduct a hearing of the application.
- 3) In its decision of May, 2013, the Electricity Authority determined a temporary rate for the services of managing the electricity system, and its application as regards all the consumers of the electricity in the economy (including consumers of electricity produced by private producers) is from June 1, 2013.
The Authority noted, inter alia, that one of the conditions for recognizing the system management costs is the reporting of revenues and expenses from services with respect to management of the system as a separate operations segment in the Notes to the Financial Statements.
Due to instructions by the employee organization not to cooperate with the move, a claim was submitted to the Haifa Regional Labor Court. On September 17, 2013, the Court ruled that there is no justification to issue an injunction against the sanctions regarding the addition of the stated Note to the Financial Statements, and that there is no justification to insert changes whose significance is actual implementation of the reform as long as the public committee headed by Uri Yogev is discussing the structure of the electricity sector.

In its decision of January 21, 2015, the Electricity Authority recognized the temporary cost borne by the Electric Company with respect to the system management service on condition that the Company will report the income and expenses involved with the service in the Notes to the Financial Statements by July 1, 2015 (see Note 3 a. 3) above). Due to the instruction of the employee union not to cooperate with the move, a claim was submitted to the Haifa Regional Court of Labor on March 2, 2015. In its decision of March 5, 2015, the Court dismissed the Company's request to oblige the employees to enable publication of the Note required by the Authority in the Financial Statements.

On March 11, 2015, an appeal of the decision was submitted to the National Court of Labor and on March 22, 2015 the Court instructed the respondents, including the Electricity Authority that was added as a party to the case, to react to the Company's appeal by March 26, 2015.

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NOTE 34:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)

c. Labor disputes (continued)

- 4) On May 20, 2013, the Company applied to the Central District Court to request the implementation of the decision of the Board of Directors of March 21, 2013, regarding the transfer of money from the Trust Account in which money with respect to non-budgetary components of the Company employees that are included in the actuarial liability of the Company is deposited, to cover the deficit in the Central pension fund and/or to execute a repayment to the Company.
It should be noted that the application to the Court does not concern the money accumulated in the trust account with respect to the non-budgetary components detailed in Annex A of the 1996 agreement with respect to the generation A employees, and that are intended to cover the said payments for these employees and pensioners. These funds will remain in the trust account and will serve the stated purpose.
On October 10, 2013, the said application of the Company was heard in Court, and at present the proceeding is still pending in Court.
- 5) The employees' organization has instructed not to cooperate in all that pertains to the decisions of the Public Services Authority – Electricity in the following subjects: aggregator consumers (a claim in this matter was filed with the Labor Tribunal – see section 2 above), historic distributors, consumers changing to consumers of private electricity producers, preparing final accounts and providing invoice data to the private electricity producers. On July 29, 2013, the Company applied to the Labor Court with an application for temporary relief in these matters. On September 17, 2013, the Court ruled that there is no justification to issue an injunction against the sanctions regarding the expansion of the arrangement regarding historic distributors and settling the account with customers of private producers, and that there is no justification to insert changes whose significance is actual implementation of the reform as long as the public committee headed by Uri Yogev is discussing the structure of the electricity sector.
- 6) On August 14, 2013, sanctions were taken in the South District due to the Company's intention to execute a deduction from the salary of 2 district employees who participated in earlier sanctions. Deduction from the salary of the employees due to these sanctions was arranged within a special collective agreement between the Company and the New National Labor Federation and the employee union, which was signed on February 25, 2015 (see Note 12 above), and as of the date of signing the financial statements, the collective agreement is still subject to the approval of the Supervisor of Wages and the Companies Authority.
- 7) On October 10, 2013, the Company received the decision of the Commissioner of Wages regarding 4 wage deviations by the Company: payment for overtime not according to actual performance for external employees, board and lodging payments, command increment and paying pension global overtime to management members. According to the decision of the Court of Labor, the stated decision of the Supervisor of Wages will not enter into force until a decision is reached in the principal case in this matter, and the employee representatives will not take organizational steps. Following the completion of the hearing proceeding pursuant to the decision of the Court of Labor, the Supervisor of Wages published an updated decision on December 11, 2014. At present, the parties are in the midst of negotiations to agree on the authorization of the Court as arbitrator for them, such that it will render a judicial decision in the proceeding superfluous. (See also Note 12 g above).
- 8) On October 14, 2013, the chairman of the trade union section of the National Labor Federation announced a labor dispute. The following issues are in dispute:
- a. A demand to sign a collective agreement that will regulate the total employee rights and their terms of employment, while taking unilateral steps including due to the structural change and the demand of the Supervisor of Wages at the Ministry of Finance to reduce rights.
 - b. Unacceptable and in bad faith behavior regarding labor relations in general and collective labor relations in the public service in particular.

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NOTE 34:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)

c. Labor disputes (continued)

- 9) On March 25, 2014, the Company submitted an application for an injunction against sanctions taken by employees following the publication of the draft of the Steering Team's recommendations and the CEO decisions, with regard to halting automatic promotion and freezing professional courses, due to the indicated economic position of the Company.

On April 3, 2014, the Court gave its decision, providing relief against the sanctions, while determining that during the period that negotiations are being held between the parties regarding the implementation of the recommendations concerning the structural change, unilateral steps that may lead to a fait accompli in the field will not be taken by the Electric Company and the State Authorities.

The State submitted an application for leave to appeal the decision and the National Court ruled on July 16, 2014 that as long as the order preventing the employees from taking sanctions is in effect, the State and the Company are obligated to conduct intensive negotiations with the employee representatives, in a manner that will not create a fait accompli in the field that unilaterally and irrevocably prejudice the rights of the employees, their working conditions and employment security.

On July 28, 2014, the National Federation of Labor and the Employees' Organization applied to the Haifa Regional Labor Tribunal with an urgent party application within the collective dispute requesting to permit them to exercise the right to strike. On September 16, 2014, the Court determined that considering that the State is not willing to continue to conduct the negotiation regarding the structural change, it is reasonable to enable the employee representatives to take sanctions, but they cannot do so before submitting an outline detailing the sanctions they intend to take to the Court. It was further determined that until another decision is reached, the decision of the Court preventing the employees from taking sanctions against private producers will remain in effect, as follows:

- a) To refrain from sanctions whose significance is non-cooperation with instructions of the authorized entities in the Company regarding action against private producers that are up to the stage of a conditional license, including execution of feasibility studies, and private producers that have already received a conditional license in the past.
- b) Additional private producers will not be connected to the electricity grid and the State will not grant a conditional license to a producer who is not yet holding such a license.

The State and the employee representatives submitted to the National Court of Labor an application for leave to appeal the stated decision.

On October 19, 2014, the National Court of Labor determined that there is no reason that the State of Israel, including its various entities, will not be allowed to use its authority to grant the new conditional licenses and connect private producers to the electricity grid, and therefore previous decisions of the Regional Court of Labor do not prevent the State of Israel from acting as stated.

Following reminder hearings at the National Court of Labor, the parties reached agreement in various matters that were formulated into a special collective agreement (see Note 12 above).

The National Court of Labor has not yet ruled on the appeals over the stated decision of the Regional Court of Labor of September 16, 2014. A hearing for reminding has been scheduled for May 13, 2015.

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c. Labor disputes (continued)

10) On May 15, 2014, the Chairman of the Professional Union Division of the New National Federation of Labor announced a labor dispute on the following subjects:

- a) The Company's "revolving door" policy under which instead of appointing a permanent employee for a job that requires such an employee, an employee that is not permanent is appointed to the job.
- b) Not providing tenure for temporary employees that are waiting many years for tenure, despite the existence of standards for tenure.
- c) A unilateral change in tenure quotas for 2014 that was approved and agreed upon during negotiations between the parties.
- d) Implications of work load on employees due to shortage of manpower deriving from not manning standards.
- e) Behavior of the employer in bad faith and in a manner unacceptable in labor relations in general, and in collective labor relations in public service in particular.

This labor dispute will be cancelled upon the entry into effect of the special collective agreement between the Company and the New National Labor Federation and the employee union, that was signed on February 25, 2015 (see Note 12 above), and as of the date of signing the financial statements, the collective agreement is still subject to the approval of the Supervisor of Wages and the Companies Authority.

11) On October 7, 2014, the Chairman of the Trade Union Division of the New National Labor Federation announced a labor dispute over the following issues:

- a) A unilateral decision regarding the privatization of the Electric Company.
- b) Despite the significant implications that this decision has on the working conditions of the employees, their status, rights, salary and occupational security, it was reached without conducting negotiations and formulating agreements with the employee representatives, in an attempt to unilaterally dictate dramatic changes while ignoring the employee representatives.
- c) This conduct constitutes breaking the rules and trampling accepted norms customary for decades within the framework of collective labor relations, in violation of the representative organization, the employee representatives and their standing.
- d) Demand by the employee representatives to conduct negotiations regarding the implications of the above mentioned decision.
- e) Acting in bad faith and in a manner unacceptable in labor relations in general and in collective labor relations in particular.

12) On October 7, 2014, the Chairman of the Trade Union Division of the New National Labor Federation announced a labor dispute regarding the following issues:

Employer's intention to establish a large scale organizational change and efficiency plan with significant and critical implications for the employees in all aspects, including but not limited to: employment and salary conditions, rights, status, job security. Within the organizational change and efficiency plan, the employer intends to massively increase efficiency, including, inter alia, dismissals and early retirements of thousands of employees. The employer is acting in bad faith as it tries to oppress the employees' organization and present it with a fait accompli.

13) On January 11, 2015, the Chairman of the Trade Union Division of the New National Federation of Labor announced two labor disputes regarding the following:

- a) The employee union's demand to conduct negotiations regarding the salary agreement for 2015.
- b) The demand of the employees' representatives to conduct negotiations and to sign a collective agreement for increasing the Company's provisions for cumulative pension for employees who began their employment commencing from January 1, 2004.

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NOTE 35:- SEGMENTAL REPORTING

a. General

The Company implements the International Financial Reporting Standard 8 (hereinafter: "IFRS 8") from January 1, 2009.

b. Detailed Reportable Operation Segments

The operations of the Company are comprised of three main operational segments making up the entire electricity chain. These operations are:

- Generation Segment - includes the operations at 17 sites of the electricity generating power stations, derives its revenues according to its share in the electricity rate, as determined by the regulator (Electricity Authority).
- Transmission Segment - includes the transmission and transformation system of the ultra-high, long distance electricity, generates its revenues according to its share in the electricity rate, as determined by the Electricity Authority.
- Distribution Segment – includes the electricity grids system and the transformation stations which supply the electricity to the end consumers, except a limited number of customers that purchase high voltage electricity directly from the transmission systems, as well as the customers service and collection system of the Company, the segment generates its revenues according to its share in the electricity rate, as determined by the Electricity Authority.
- For additional details regarding the requirement to report with respect to the system management services see Note 34 c 3).

c. Income and Results according to Operational Segments

Segmental revenues are calculated on the basis of the electricity rate for the segment, published by the Electricity Authority, multiplied by the sold quantity (kW/h) of that segment. Segmental expenses that can be specifically identified are charged directly to the appropriate items. In addition, certain indirect expenses are recorded according to an allocation, which serves as a reasonable estimate for attributing these expenses, while adjusting to the electricity rate base. The CODM (Company CEO) receives the operational results of each segment up to the yearly profit (loss) level. See detailed information in Note 38 below.

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NOTE 35:- SEGMENTAL REPORTING (continued)

c. Analysis of Income and Results according to Operational Segments (continued)

For the Year ended December 31, 2014				
	Generation segment	Transmission segment	Distribution segment	Total Company
	NIS in millions			
Revenues	19,263	2,857	3,075	25,195
Operating income from ordinary operations	2,699	216	96	3,011
Profit (Loss) before income tax	1,438	(394)	(820)	224
Profit (Loss) for the year	1,405	(404)	(850)	151
Additional Details				
Depreciation and amortization	2,356	943	1,221	4,520
Financing expenses, net	1,261	610	916	2,787

For the Year ended December 31, 2013				
	Generation segment	Transmission segment	Distribution segment	Total Company
	NIS in millions			
Revenues	21,441	3,090	3,070	27,601
Operating income from ordinary operations	373	771	216	1,360
Profit (Loss) before income tax	(608)	286	(485)	(807)
Profit (Loss) for the year	(703)	331	(562)	(934)
Additional Details				
Depreciation and amortization	2,819	927	1,171	4,917
Financing expenses, net	981	485	701	2,167

For the Year ended December 31, 2012				
	Generation segment	Transmission segment	Distribution segment	Total Company
	NIS in millions			
Revenues	22,582	2,654	3,027	28,263
Operating income from ordinary operations	1,405	546	(561)	1,390
Profit (Loss) before income tax	191	(55)	(1,431)	(1,295)
Profit (Loss) for the period	148	(43)	(1,107)	(1,002)
Additional Details				
Depreciation and amortization	2,660	853	1,162	4,675
Financing expenses, net	1,214	601	870	2,685

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NOTE 35:- SEGMENTAL REPORTING (continued)

d. Assets and Liabilities according to Operational Segments

The CODM monitors the tangible, intangible and financial assets of each segment for purposes of controlling the segments and resources allocation among the segments. All Company assets are allocated to the different segments. Investments for the year include investments in fixed assets and in intangible assets and exclude financial instruments and deferred taxes assets. The CODM also receives data of the total liabilities of the Company, divided into the three segments.

As of December 31, 2014				
	Generation segment	Transmission segment	Distribution segment	Total Company
NIS in millions				
Assets	44,325	16,954	26,238	87,517
Investments in the year	2,016	687	917	3,620
Liabilities	37,063	13,565	20,805	71,433

As of December 31, 2013				
	Generation segment	Transmission segment	Distribution segment	Total Company
NIS in millions				
Assets	44,142	16,611	24,999	85,752
Investments in the year	3,491	665	939	5,095
Liabilities	37,448	13,406	20,177	70,971

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NOTE 36:- EXPLANATION OF THE IMPACT OF THE TRANSITION TO IMPLEMENTATION OF FULL INTERNATIONAL STANDARDS (IFRS)

a. General

Under the directives of the Government Companies Regulations, the Rules for Preparing the Financial Statements of the Company are as follows:

- 1) The Financial Statements will be prepared in accordance with the IFRS and their interpretations as published by the International Accounting Standards Board (IASB), including IFRS 1 which, for its purposes, the date of transition to International Financial Reporting Standards is January 1, 2007.
- 2) Notwithstanding any of the instructions of Section 1) above, the Company has not implemented the IFRS in full, due to the rules for preparing financial statements that are detailed below:
 - (a) The Company will prepare its Financial Statements with adjustment for changes in the general purchasing power of the NIS (according to the rules established in Opinion No. 36, including the provisions set in Opinions Nos. 40, 50 and 56, of the Institute of Certified Public Accountants in Israel), see details in Note 2 a. 3) above.
 - (b) The Company is a regulated company and therefore, prepares its Financial Statements under the standards of Chapter RE6.
- 3) As of the Financial Statements for the first quarter of 2015, the Company has to prepare its financial statements in accordance with the IFRS.

According to the provisions of IFRS 1, that deals with the initial adoption of the IFRS, and according to the Government Companies Regulations (see above), a company that is preparing its financial statements according to the IFRS for the first time is required to include, in its annual financial statements for the year ending on December 31, 2014, the data of the statement of financial position as of December 31, 2014 and the data of the comprehensive profit for the year ending on the same date, prepared according to the IFRS. Additionally, the Company is required to present the estimated impact of the implementation of the international financial reporting rules in comparison with the accounting principles implemented by the Company before implementation of IFRS, and the disclosure format will be according to the principles set by the Securities Authority as part of questions and answers (FAQ 6).

It is further noted that on August 21, 2013, the Securities Authority provided its reply to the preliminary application of the Company according to which the Company was given an option for an exemption from the duty to include comparative figures for two years in its first financial statements that are prepared according to IFRS (the annual financial statements of 2015), and the Company will be permitted to include, in these statements alone, comparative figures for one year only (the year 2014), and to determine accordingly the date of transition to the IFRS to January 1, 2014.

The interim financial statements of the Company for 2015 will also be prepared according to the IFRS, including their comparative figures.

This Note is prepared on the basis of international accounting and financial reporting standards, and their clarifications that are presently known, which have been published and will enter into force or can be adopted early at the date of the first annual reporting by the Company according to IFRS, i.e. December 31, 2015. Accordingly, the management of the Company determined accounting methods that are expected to be implemented upon the first preparation of the annual financial statements according to the IFRS for the year ending December 31, 2015.

The IFRS standards that will be in force or that can be adopted in the financial statements for the year that will end on December 31, 2015, are subject to changes and the publication of additional clarifications. Accordingly, the principles of the accounting policies that will be implemented with respect to the presented periods will be finally determined only at the time of the first preparation of the annual financial statements according to the IFRS as on December 31, 2015.

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NOTE 36:- EXPLANATION OF THE IMPACT OF THE TRANSITION TO IMPLEMENTATION OF FULL INTERNATIONAL STANDARDS (IFRS) (continued)

a. General (continued)

As part of the statement of financial position as of January 1, 2014, the Company executed the following actions:

- Recognition of every asset or liability for whom recognition in the statement of financial position is required according to the IFRS.
- Non-recognition of assets or liabilities that are not to be recognized in the statement of financial position according to the IFRS.
- Classification of asset items, liabilities and equity according to the IFRS (mainly as a result of publication of IFRS 14).
- Measuring all assets and liabilities that were recognized according to the IFRS.

Implementation of the provisions of IFRS 1 regarding the initial adoption of IFRS and selecting relief from the effect of the standard at the date of transition determines that implementing the IFRS in the opening balance will be executed retrospectively. However, IFRS includes relief to which the retrospective implementation obligation does not apply. The Company used the relief for regulated companies to set the "deemed cost" of the fixed assets and other assets as the adjusted cost that was presented in the financial statements as of January 1, 2014.

The impact of the changes in the accounting policies retrospectively implemented by the Company in the statement of financial position as of January 1, 2014, according to the IFRS compared to the accounting policies according to the Government Companies Regulations is directly recognized in the retained earnings item.

In January, 2014, IFRS 14 was published. The standard enables to initially adopt the provisions of the IFRS and to continue implementing the existing practice with regard to recognition of regulatory assets and liabilities. Therefore, the Company will recognize regulatory deferred accounts in its financial statements that will be prepared according to the IFRS. (See Note 2 z 4 above).

Before the implementation of the international standardization, the Company implemented the principles of RE 6, particularly ASC 980, and the Company therefore recognized regulatory assets in its statements. It is important to note that the presentation requirements under the IFRS 14 are different than those existing under the existing standardization concerning the recognition of regulatory assets.

b. Qualitative disclosure with regard to the gaps between the financial reporting principles implemented in these Financial Statements as detailed above and the IFRS

Following are the main points of the gaps between the financial reporting principles implemented in these Financial Statements as detailed in Note 2 above and the IFRS, which will apply to the Company as of January 1, 2015, including in light of the decision of the Company to implement IFRS 14, as detailed below:

1) Asset Impairment

The international standards do not include a standard which is parallel to SFAS 90 and when testing asset impairment there is no differentiation between assets completed recently and the other assets. According to SFAS 90 rules, the Company tests a provision for impairment of assets completed recently and in addition, implements the provisions of the IAS 36.

According to the IFRS, the test of attributing the provision for assets impairment is tested according to the provisions of IAS 36 only, i.e. the Company will examine all its fixed assets items, including assets whose construction has been completed recently, as a total impairment in accordance with the provisions of IAS 36 since they constitute one cash yielding unit.

According to the last rate update (see Note 3 above), the Company cancelled part of the impairment it executed in the past under the rules of SFAS 90.

The recoverable amount of the assets is not lower than their value under the IFRS.

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NOTE 36:- EXPLANATION OF THE IMPACT OF THE TRANSITION TO IMPLEMENTATION OF FULL INTERNATIONAL STANDARDS (IFRS) (continued)

b. Qualitative disclosure with regard to the gaps between the financial reporting principles implemented in these Financial Statements as detailed above and the IFRS (continued)

2) Investments in Operational Power Stations (including Renovations)

The Electricity Authority determined that the cost of investments in operational power stations includes significant renovations (except for investments that cause an increase of output and/or improved availability and/or life span extension or for purposes of meeting environmental quality standards), will not be recognized as an addition to fixed assets and will be recognized instead as operational expense occurring once a year according to a formula determined in the rate.

Consequently, as of February 15, 2010, the Company depreciates its investments in operational power stations including significant renovations, upon their formation, in accordance with the principles of the American Standard SFAS 90.

Under the IFRS, the investment cost in operational power stations is capitalized to the cost of the fixed assets, since under the international standardization principles there is no parallel standard to the SFAS90 and these investments will be depreciated in accordance with their useful life span.

3) Capitalization of Financing Costs and Return of Capital

According to the standards of RE 6, the Company capitalizes for assets under construction financing and return on capital costs recognized in the rate to asset costs.

According to IAS 23 it is possible to capitalize borrowing costs (financing costs) that can be directly attributed to an asset under construction, in case it constitutes a qualifying asset. However, the stated standard does not enable to capitalize the return to capital component to an asset under construction.

Additionally, in view of the provisions of IFRS 14, it is necessary to recognize a deferred regulatory account balance with respect to a component of deemed interest that includes sums recognized for financing the construction, that provide the entity with return for the owner's equity as well as the foreign capital. Therefore, the gap between the sum of the borrowing costs that can be capitalized with respect to the qualified assets under the provisions of IAS 23, and the sum of the deemed interest that is recognized for the Company within the rate, will be recognized as a deferred regulatory account balance instead of presenting sums as stated as part of the fixed assets costs as is currently practiced.

It is noted that as part of the relief by virtue of IFRS 1, the Company has used the relief for regulated companies to set the "deemed cost" of the fixed assets and other assets including the capitalization of financing costs, as an adjusted cost that was presented in the Financial Statements as of January 1, 2014, and did not retrospectively implement the IAS 23, but rather from the date of the transition and onwards.

4) Preparing Adjusted Financial Statements

Under the Company's financial reporting principles as based on the Government Companies Regulations, the Company applies the provisions of Opinion No. 36 with regard to the preparation of Financial Statements adjusted by changes to the general purchasing power of the Israeli currency, including such provisions as are covered under Opinions Nos. 40, 50 and 56 of the Institute of Certified Public Accountants in Israel, which are similar in substance to the provisions of International Accounting Standard No. 29.

According to the IFRS, the Financial Statements may not be prepared according to the changes to the general purchasing power of the currency except under conditions of high inflation (hyperinflation) (in Israel up to December 31, 2003). It is emphasized that in light of the "deemed cost" relief set in IFRS 1, as aforesaid, the fixed assets balance in the Company books before the date of the transition was adjusted with respect to changes in the general purchasing power of the Israeli currency. After the date of transition, the fixed assets balance is no longer linked with respect to changes as stated.

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NOTE 36:- EXPLANATION OF THE IMPACT OF THE TRANSITION TO IMPLEMENTATION OF FULL INTERNATIONAL STANDARDS (IFRS) (continued)

b. Qualitative disclosure with regard to the gaps between the financial reporting principles implemented in these Financial Statements as detailed above and the IFRS (continued)

5) Regulatory Assets / Liabilities

According to IFRS 14, the presentation of regulatory assets/liabilities, net and the transaction in them is different in the Financial Statements under the IFRS compared with the manner of their presentation at present. (According to the RE 6 rules) regulatory assets will henceforth be defined as "regulatory deferred accounts". The total regulatory deferred accounts in credit and the total regulatory deferred accounts in debit will be presented as separate items in the statement of financial position and will be separated as a separate category and not as regulatory assets/liabilities that have been presented as current or long-term regulatory assets/liabilities. The change, net, in regulatory assets/liabilities was presented to date, in the statement of profit and loss, as a decrease in income or decrease in operating or financing costs, according to the rules of RE 6. The transaction in regulatory deferred accounts will be presented in a separate item in the statement of comprehensive income. (See section z 4 below).

6) Cash Flow Statement

Under the financial reporting principles of the Company according to the Government Companies Regulations, the Company reports interest paid as part of its current operations in the cash flow statement. According to the IFRS, the Company will classify the interest paid as part of its financing activity and interest received as part of its investment activity.

c. The impact of the transition to IFRS - quantitative disclosure

The Company has prepared to adopt the IFRS standards and has examined the material impacts that will be caused to the Company as a result of adopting the IFRS. Following are the material financial impacts of the transition from the financial reporting principles of the Company under the Government Companies Regulations to the IFRS, to the financial position of the Company as of January 1, 2014 (date of transition), and December 31, 2014, as well as to the results of its operation and changes in equity for the period from the transition date until December 31, 2014.

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NOTE 36:- EXPLANATION OF THE IMPACT OF THE TRANSITION TO IMPLEMENTATION OF FULL INTERNATIONAL STANDARDS (IFRS) (continued)

c. The impact of the transition to IFRS - quantitative disclosure (continued)

- 1) Following are details regarding the items in the Consolidated Statement of Financial Position and the impact of the transition to reporting under the IFRS standards on them:**

Notes	As of January 1, 2014			As of December 31, 2014		
	Reporting under the Government Companies Regulations in 1.1.2014 NIS	Impact of the adoption of IFRS	Data reported under IFRS	Reporting under the Government Companies Regulations in 31.12.2014 NIS	Impact of the adoption of IFRS	Data reported under IFRS
in NIS millions						
Current Assets:						
Cash and cash equivalents	3,401	-	3,401	4,504	-	4,504
Short-term investments	493	-	493	2,559	-	2,559
Trade receivables for sales of electricity	4,392	-	4,392	4,546	-	4,546
Accounts receivable	329	1	330	537	-	537
Inventory fuels - current assets	a) 1,067	(5)	1,062	1,057	(4)	1,053
Inventory stores	b),c) 144	-	144	146	-	146
Regulatory assets, net.....	e) 2,972	(2,972)	-	-	-	-
	12,798	(2,976)	9,822	13,349	(4)	13,345
Non-current Assets:						
Inventory – fuel	a) 1,736	(40)	1,696	1,539	(30)	1,509
Long term receivables.....	1,178	-	1,178	1,833	-	1,833
Investment in an associate company	98	-	98	86	-	86
Regulatory assets	e) 696	(696)	-	-	-	-
Assets with respect to post-employment benefits:						
Surplus pension fund assets to pension liability	2,020	-	2,020	4,310	-	4,310
Funds in trust	1,728	-	1,728	1,909	-	1,909
	3,748	-	3,748	6,219	-	6,219
Fixed Assets, net:						
Operated fixed assets, net.....	b),c) 58,645	-	58,645	57,020	291	57,311
Fixed assets under construction.....	b),c) 6,075	-	6,075	6,497	(19)	6,478
Total fixed assets	64,720	-	64,720	63,517	272	63,789
Intangible assets	b),c) 948	-	948	974	2	976
	85,922	(3,712)	82,210	87,517	240	87,757
Regulatory deferred accounts, net, after taxes.....						
	e) -	2,696	2,696	-	2,114	2,114
	85,922	(1,016)	84,906	87,517	2,354	89,871

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NOTE 36:- EXPLANATION OF THE IMPACT OF THE TRANSITION TO IMPLEMENTATION OF FULL INTERNATIONAL STANDARDS (IFRS) (continued)

c. The impact of the transition to IFRS - quantitative disclosure (continued)

1) Following are details regarding the items in the Consolidated Statement of Financial Position and the impact of the transition to reporting under the IFRS standards on them: (continued)

		As of January 1, 2014			As of December 31, 2014		
	Notes	Reporting under the Government Companies Regulations in 1.1.2014 NIS	Impact of the adoption of IFRS	Reporting under the Government Companies Regulations in 1.1.2014 NIS	Impact of the adoption of IFRS	Reporting under the Government Companies Regulations in 1.1.2014 NIS	Impact of the adoption of IFRS
in NIS millions							
<u>Current Liabilities:</u>							
Credit from banks and other credit providers.....	a)	7,118	5	7,123	8,351	4	8,355
Suppliers and service providers.....		1,724	-	1,724	1,757	-	1,757
Accounts payable.....		1,742	-	1,742	1,799	-	1,799
Short term regulatory liabilities.....	e)	-	-	-	400	(400)	-
Advances from work orders less work in progress		398	-	398	453	-	453
Provisions.....		730	-	730	719	-	719
		11,712	5	11,717	13,479	(396)	13,083
<u>Non-Current Liabilities</u>							
Debentures	a)	32,770	10	32,780	35,695	8	35,703
Liabilities to banks	a)	8,572	11	8,583	4,737	5	4,742
Liabilities with respect to other post-employment benefits.....		2,924	-	2,924	2,930	-	2,930
Regulatory liabilities	e)	1,398	(1,398)	-	261	(261)	-
Provisions for returning sums to customers.....		2,565	-	2,565	2,675	-	2,675
Deferred taxes, net	f)	5,088	(614)	4,474	5,537	255	5,792
Debentures to the State of Israel.....		2,536	-	2,536	2,534	-	2,534
Liabilities to the State of Israel	a)	2,856	1	2,857	2,902	-	2,902
Other liabilities		691	-	691	683	-	683
		59,400	(1,990)	57,410	57,954	7	57,961
Equity	c)	14,810	(58)	14,752	16,084	272	16,356
		85,922	(2,043)	83,879	87,517	(117)	87,400
Regulatory deferred accounts, net, after taxes.....	e)	-	1,027	1,027	-	2,471	2,471
		85,922	(1,016)	84,906	87,517	2,354	89,871

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NOTE 36:- EXPLANATION OF THE IMPACT OF THE TRANSITION TO IMPLEMENTATION OF FULL INTERNATIONAL STANDARDS (IFRS) (continued)

c. The impact of the transition to IFRS - quantitative disclosure (continued)

2) The following is an estimate of the impact on the shareholders' equity of the Company:

	As of January 1, 2014	As of December 31, 2014 in 1.1.14 NIS
	(in NIS millions)	
Shareholders' equity according to financial statements prepared in accordance with the Government Companies Regulations.....	14,811	16,084
Impact as of January 1, 2014 due to cessation of adjustment of the statements to changes in the CPI.....	(58)	(30)
Impact on the other comprehensive income for the period	-	302
Shareholders' equity after implementation of the IFRS	14,752	16,356

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NOTE 36:- EXPLANATION OF THE IMPACT OF THE TRANSITION TO IMPLEMENTATION OF FULL INTERNATIONAL STANDARDS (IFRS) (continued)

c. The impact of the transition to IFRS - quantitative disclosure (continued)

3) Assessment of the impact in the consolidated statement of profit and other comprehensive income for the year ended on December 31, 2014, in the transition to reporting under IFRS:

	Notes (5)	Reporting under the Government Companies Regulations	Impact of implementing IFRS 14 due to classification of deferred account balances (e) in NIS millions	Additional impact of the adoption of IFRS (a)	Data reported under IFRS
Revenues		25,195	128	(18)	25,305
Cost of operating the electricity system		20,144	(2,858)	(331)	16,955
Profit from operating the electricity system		5,051	2,986	313	8,350
Sales and marketing expenses		902	-	(1)	901
Administrative and general expenses		1,136	21	-	1,157
Expenses (income) for liabilities to pensioners, net		2	-	(5)	(3)
		2,040	21	(6)	2,055
Profit from ordinary operations		3,011	2,965	319	6,295
Financing expenses, net		2,787	157	(109)	2,835
Profit before income tax		224	2,808	428	3,460
Income tax	f)	61	744	111	916
Profit after income tax		163	2,064	317	2,544
Company's share of the loss of included companies, net		(12)	-	-	(12)
Profit for the year		151	2,064	317	2,532
Net transactions in balances of deferred regulatory accounts, net after tax effect		-	(2,064)	-	(2,064)
Profit for the year		151	-	317	468
Other comprehensive income for the year, after tax effect		1,152	-	(15)	1,137
Comprehensive income for the year		1,303	-	302	1,605

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NOTE 36:- EXPLANATION OF THE IMPACT OF THE TRANSITION TO IMPLEMENTATION OF FULL INTERNATIONAL STANDARDS (IFRS) (continued)

c. The impact of the transition to IFRS - quantitative disclosure (continued)

4) Impact on comprehensive income for the period

	For the year ended December 31, 2014 (in NIS millions)
Comprehensive income for the period under the Government Companies Regulations.....	1,303
Depreciation differences including cancellation of amortization in accordance with the provisions of SFAS 90 after tax impact	147
Others after tax impact	170
Adjustment of remeasurements of a defined benefit plan after tax impact	(15)
Comprehensive income for the period after implementation of IFRS.....	<u>1,605</u>

5) Notes and explanations concerning the abovementioned information:

a) Impacts due to adoption of IFRS

- Adjusting the statements to the general purchasing power of the Israeli currency - see section b 4 above.
In 2014, as a result of cancellation of the adjustment to this purchasing power, the Company recorded profit of NIS 65 million, net, after tax.
- Cancelling the implementation of FAS 90 - as a result, the expense with respect to operating the electricity array has decreased in the amount of NIS 237 million, net, after tax.

b) Fixed assets and intangible assets, balance as of January 1, 2014 - as stated above, upon transition to the IFRS, the Company decided to use the relief of the IFRS 1 concerning regulated companies for determining the "deemed cost" of the fixed assets and other assets as the adjusted cost that was presented in the Financial Statements as of January 1, 2014.

Additionally, in light of the provisions of IFRS 1, on the date of transition, the Company positively examined impairment of all the fixed assets items for which this relief was used according to the provisions of IAS 36. In light of the stated examination, it was found that the recoverable amount of the fixed assets and other assets items is higher than their book value and therefore reduction for impairment was not required.

As a result of the aforesaid, the fixed assets balance as of January 1, 2014 did not change.

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NOTE 36:- EXPLANATION OF THE IMPACT OF THE TRANSITION TO IMPLEMENTATION OF FULL INTERNATIONAL STANDARDS (IFRS) (continued)

c. The impact of the transition to IFRS - quantitative disclosure (continued)

5) Notes and explanations concerning the abovementioned information: (continued)

c) Fixed assets and intangible assets, balance as of December 31, 2014 - upon transitioning to IFRS, the accounting treatment of fixed assets includes, inter alia, the following principles:

- Ceasing to adjust data in the financial statements to changes in inflation. As a result, the fixed assets balance as of December 31, 2014 increased by approximately NIS 127 million.
- Capitalization of financing costs under IAS 23, i.e., capitalizing all the exchange rate and interest differentials with respect to foreign currency loans as long as these costs do not exceed the alternative cost in local currency. As a result, the fixed assets balance as of December 31, 2014 decreased by approximately NIS 53 million. See section b 3 above. Regarding capitalization of financing costs and capital that were used for construction of fixed assets and other assets as were presented until now in the Company books, see Note 2 I above.
- Assets impairment: there is no parallel standard to FAS 90 in international standardization and examination of asset impairment is tested in accordance with IAS 36. As a result of cancellation of the implementation of FAS 90, the fixed assets balance as of December 31, 2014 has decreased by approximately NIS 122 million. See section b 1) above.
- Investments in operational power stations including investment renovations: under the existing standardization, costs that the Company does expect to be recovered within the rate were immediately charged to profit and loss. Under the existing standardization, costs as stated join the fixed assets cost, if they meet the rules of International Accounting Standard 16, fixed assets concerning capitalization of costs with respect to assets under construction. These costs will be examined for impairment as part of the examination of all the fixed assets under IAS 36. As a result, the fixed assets balance as of December 31, 2014 has increased by approximately NIS 322 million. See section b 2) above.
- According to a valuation executed in the Company as of December 31, 2014, reduction for impairment is not required for the IFRS data as well.

As a result of the aforesaid, the fixed assets balance as of December 31, 2014 increased in an amount of approximately NIS 274 million.

d) In 2014, as a result of the above mentioned, the Company recorded a decrease of the amortization expenses in the amount of approximately NIS 149 million, net, after tax (of this, the Company classified approximately NIS 90 million, after tax, to regulatory deferred accounts).

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NOTE 36:- EXPLANATION OF THE IMPACT OF THE TRANSITION TO IMPLEMENTATION OF FULL INTERNATIONAL STANDARDS (IFRS) (continued)

c. The impact of the transition to IFRS - quantitative disclosure (continued)

5) Notes and explanations concerning the abovementioned information: (continued)

- e) Regulatory Assets - according to the IFRS 14, the presentation of regulatory assets/liabilities, net and the change in them is different in the Financial Statements under the IFRS compared with the manner of their presentation at present. Regulatory assets will henceforth be defined as "regulatory deferred accounts". The total regulatory deferred accounts in credit and the total regulatory deferred accounts in debit will be presented as separate items in the statement of financial position and will be separated as a separate category; the change, net, in regulatory deferred accounts belongs to the statement of comprehensive income.

	<u>Notes</u>	<u>January 1 2014</u>	<u>December 31 2014</u>
		<u>(in NIS millions)</u>	
<u>Account classification following disclosure according to IFRS 14:</u>			
<u>Current assets:</u>			
Regulatory assets, net		2,972	-
<u>Non-current assets:</u>			
Regulatory assets		696	-
<u>Current liabilities:</u>			
Regulatory liabilities		-	(400)
<u>Non-current liabilities:</u>			
Regulatory liabilities		(1,398)	(261)
Total account classification		2,270	(661)
Tax effect		(601)	175
Total account classification, net		1,669	(486)
Deemed interest	(1)	-	53
Recognition of investments cancelled in the past due to FAS 90	(2)	-	123
Tax effect		-	(47)
		-	129
Total		1,669	(357)
<u>Presented:</u>			
Regulatory deferred accounts, net, after taxes - active		2,696	2,114
Regulatory deferred accounts, net, after taxes - passive		1,027	2,471
Total		1,669	(357)

- (1) If the Company recognizes the deemed interest component that includes sums recognized for financing construction and providing an entity with yield on equity, as well as yield on the foreign capital component.
- (2) The Company recognizes sums reduced in the past under FAS 90, and are currently recognized in the rate according to the asset lifespan.
- (3) In 2014, as a result of sections (1) and (2) above, the Company recorded income of approximately NIS 129 million, net, after tax (of this sum, the Company classified the deemed interest component in the amount of approximately NIS 39 million, net, after tax, to the financing expenses item).
- f) The deferred taxes item is presented without the component of deferred taxes with respect to regulatory deferred accounts. The deferred taxes component with respect to regulatory deferred accounts as of December 31, 2014 appears in setoff in the deferred regulatory accounts. See section 4 above.
- g) Regarding the transition to implementation of the IFRS and its impact on the operating results of the Company, see Note 3 d) above.

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NOTE 37:- SUBSEQUENT EVENTS AFTER THE STATEMENT OF FINANCIAL POSITION DATE, IN ADDITION TO THE DETAILS IN THE AFOREMENTIONED NOTES

Following are details of subsequent events after the statement of financial position date - in addition to the information included in the aforementioned Notes.

a. Appointment of directors and officeholders:

- 1) On January 1, 2015, Mr. Nissim Hilu was appointed acting General Counsel and Company Secretary.
- 2) On January 1, 2015, Mr. Yaakov Hain retired from his office as Deputy CEO and Senior Vice President Customers.
- 3) On January 1, 2015, Mr. Itzhak Balmas was appointed Senior Vice President Customers.
- 4) On January 1, 2015, Mr. Shimon Fisher was appointed acting Senior Vice President Generation and Energy.
- 5) On January 7, 2015, Mr. Tamir Polikar announced an advance notice of ending his term as Senior Vice President Finances and Economics of the Company at the end of March 2015.
- 6) On January 15, 2015, the Board of Directors of the Company approved the appointment of Adv. Yael Nevo as general counsel of the Company. The appointment will enter into effect during the month of April, 2015.
- 7) On February 22, 2015, Mr. Muki Ben Ami ended his term as director of the Company.
- 8) On February 28, 2015, Mr. Zvi Harpak retired from his office as Senior Vice President Organization, Logistics, Security and Emergency Economy of the Company.
- 9) The CEO, Mr. Eli Glickman, announced that he will retire during the coming months.
- 10) On March 15, 2015, the Board of Directors of the Company decided to appoint Mr. Ofer Bloch as CEO of the Company. The appointment requires the approval of the Minister of Finance and the Minister of National Infrastructures, Energy and Water after consultation with the Committee for examining appointments of the Government Companies Authority.
- 11) On March 19, 2015, Mr. Dov Cohen was appointed as acting Senior Vice President Organization, Logistics, Security and Emergency Management of the Company.

b. On January 4, 2015, the validity of the licenses of the Company was extended until January 1, 2016.
For additional details see Note 1 b and 1 e above.

c. Agreements with the employees

On February 21, 2015, a special collective agreement was signed between the Company and the New National Labor Federation and the employee union, in which there was agreement on early retirement of 400 to 440 employees in 2015, granting tenure and conditions for erasing permanent positions, extending employment of temporary employees employed in projects, deducting salary due to participation of employees in sanctions and strike, industrial peace and exhausting claims in issues arranged in the agreement. The Collective Agreement is subject to approval by the Commissioner of Wages and the Government Companies Authority.

For additional details regarding this agreement between the employee union and the Company see Note 12 f above.

d. The Electricity Authority

1. On January 26, 2015, the Company received the decision of the Electricity Authority, according to which the electricity prices are expected to fall as of February 1, 2015, at a rate of approximately 10% for household consumers and approximately 11.8% on average.
2. In January, 2015, the Company received the draft of the report by the Navigant consulting company, on behalf of the Electricity Authority, for the update of the rate bases for transmission and distribution. The Company delivered its reaction to this report to the Electricity Authority on January 29, 2015. On March 2, 2015, a letter was received from the Authority, including a response from the Navigant Company to the Company's reaction and the Company delivered its reaction on March 16, 2015.

For additional details see Note 3 c above.

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NOTE 37:- SUBSEQUENT EVENTS AFTER THE STATEMENT OF FINANCIAL POSITION DATE, IN ADDITION TO THE DETAILS IN THE AFOREMENTIONED NOTES (continued)

e. Repayments and raisings

1. On January 15, 2015, the Company signed an agreement for taking a loan from the Bank Hapoalim in the amount of NIS 1 billion.
2. On February 20, 2015, additional negotiable debentures of series 22 (final repayment) in the amount of NIS 600 million, were repaid.
3. On March 20, 2015, private (non-negotiable) debentures of series J in the amount of approximately NIS 1,664 million that were issued to institutional bodies in 2005 were repaid in full.

For additional details regarding capital raisings and material repayments see Note 20 c above.

- f. Regarding collection of NIS 300 million with respect to the debts of the Palestinian Authority to the Company see Note 6 d above.

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According to the provisions of the Companies Authority, whose principal points are published in the Circular of March 2, 2004, the Company is required by the Companies Authority, under its authority by the Government Companies Law, to include additional information (beyond the information included in the Financial Statements according to generally accepted accounting principles) regarding the attribution of the statement of profit and loss and statement of financial position to the generation, transmission and distribution activity segments.

a. Statement of operations for the year ended December 31, 2014:

	Total Company	Generation segment	Transmission segment	Distribution segment
	NIS in millions			
Required revenues.....	25,019	17,969	3,256	3,794
Adjustment for segment revenues	(359)	970	(420)	(909)
Revenues from electricity	24,660	18,939	2,836	2,885
Other revenues.....	535	324	21	190
Total revenues	25,195	19,263	2,857	3,075
Cost for operating the electricity system	20,144	15,969	2,488	1,687
Income from operating the electricity system	5,051	3,294	369	1,388
Sales and marketing expenses.....	902	-	-	902
Administrative and general expenses	1,136	594	153	389
Expenses from liabilities to pensioners, net	2	1	-	1
	2,040	595	153	1,292
Income from current operations	3,011	2,699	216	96
Financial expenses, net.....	2,787	1,261	610	916
Income (loss) before income taxes.....	224	1,438	(394)	(820)
Income taxes.....	61	33	9	19
Income (loss) after income tax	163	1,405	(403)	(839)
Company's share of the loss of associated companies, net.....	(12)	-	(1)	(11)
Income (loss) for the period	151	1,405	(404)	(850)

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b. Details of the generation sites statement of operations for the year ended December 31, 2014:

	Total generation segment	PEP and others	Rutenberg	Orot Rabin	Haifa	Reading	Eshkol	Gezer	Hagit	Alon Tavor	Ramat Hovav	Zafit	Other gas turbines
	NIS in millions												
Required revenues	17,969	502	4,175	4,230	1,401	507	1,408	1,556	1,715	722	854	715	184
Adjustment for segment revenues	970	-	232	235	78	28	78	87	95	40	47	40	10
Revenues from electricity	18,939	502	4,407	4,465	1,479	535	1,486	1,643	1,810	762	901	755	194
Other revenues	324	-	73	72	21	19	39	32	26	12	14	10	6
Total revenues	19,263	502	4,480	4,537	1,500	554	1,525	1,675	1,836	774	915	765	200
Cost for operating the electricity system	15,969	498	3,627	3,910	1,240	461	1,218	1,327	1,513	634	751	652	138
Income from operating the electricity system	3,294	4	853	627	260	93	307	348	323	140	164	113	62
Sales and marketing expenses	-	-	-	-	-	-	-	-	-	-	-	-	-
Administrative and general expenses	594	-	130	137	41	34	70	51	50	23	28	20	10
Expenses from liabilities to pensioners, net	1	-	1	-	-	-	-	-	-	-	-	-	-
	595	-	131	137	41	34	70	51	50	23	28	20	10
Income from current operations	2,699	4	722	490	219	59	237	297	273	117	136	93	52
Financial expenses, net	1,261	3	358	186	103	22	116	154	130	56	64	39	30
Income before income taxes	1,438	1	364	304	116	37	121	143	143	61	72	54	22
Income taxes	33	-	8	7	3	2	3	3	3	1	2	1	-
Net Income	1,405	1	356	297	113	35	118	140	140	60	70	53	22
Company's share of the loss of associated companies, net	-	-	-	-	-	-	-	-	-	-	-	-	-
Income for the period	1,405	1	356	297	113	35	118	140	140	60	70	53	22

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c. Details of the distribution sites statement of operations for the year ended December 31, 2014

	Total distribution segment	Northern District	Haifa District	Jerusalem District	Dan District	Southern District
	NIS in millions					
Required revenues.....	3,794	784	459	502	743	1,306
Adjustment for segment revenues ...	(909)	(188)	(110)	(120)	(178)	(313)
Revenues from electricity	2,885	596	349	382	565	993
Other revenues.....	190	41	22	21	34	72
Total revenues	3,075	637	371	403	599	1,065
Cost for operating the electricity system	1,687	340	215	237	329	566
Income from operating the electricity system.....	1,388	297	156	166	270	499
Sales and marketing expenses.....	902	193	104	106	181	318
Administrative and general expenses	389	80	51	52	73	133
Expenses from liabilities to pensioners, net	1	-	-	-	-	1
	1,292	273	155	158	254	452
Income from current operations	96	24	1	8	16	47
Financial expenses, net.....	916	193	101	116	177	329
Loss before income taxes	(820)	(169)	(100)	(108)	(161)	(282)
Income taxes	19	4	2	3	4	6
Net loss.....	(839)	(173)	(102)	(111)	(165)	(288)
Company's share of the loss of associated companies, net.....	(11)	(2)	(1)	(1)	(3)	(4)
Loss for the period	(850)	(175)	(103)	(112)	(168)	(292)

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d. Statement of Financial Position as of December 31, 2014:

	Total Company	Generation segment	Transmission segment	Distribution segment
	NIS in millions			
Current assets	13,349	8,132	2,096	3,121
Long-term receivables	9,677	5,920	641	3,116
Fixed assets, net	63,517	29,833	14,012	19,672
Intangible assets, net	974	440	205	329
	87,517	44,325	16,954	26,238
Current liabilities	13,479	6,908	2,425	4,146
Non-current liabilities, net	57,954	30,155	11,140	16,659
Shareholders' equity	16,084	7,262	3,389	5,433
	87,517	44,325	16,954	26,238

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e. Details of the generation segment Statement of Financial Position as of December 31, 2014:

	Total generation segment	PEP and others	Rutenberg	Orot Rabin	Haifa	Reading	Eshkol	Gezer	Hagit	Alon Tavor	Ramat Hovav	Zafit	Other gas turbines
	NIS in millions												
Current assets	8,132	248	1,935	1,593	737	195	723	766	806	292	410	327	100
Long-term receivables.....	5,920	723	1,177	1,364	417	267	588	356	392	184	216	169	67
Fixed assets, net	29,833	143	7,920	5,419	2,697	457	2,870	2,866	2,839	1,042	1,710	1,070	800
Intangible assets, net	440	2	113	56	45	8	48	49	48	18	28	18	7
	44,325	1,116	11,145	8,432	3,896	927	4,229	4,037	4,085	1,536	2,364	1,584	974
Current liabilities	6,908	182	1,823	1,625	530	158	594	553	546	209	321	213	154
Non-current liabilities, net	30,155	902	7,463	5,880	2,622	643	2,843	2,677	2,740	1,036	1,580	1,070	699
Shareholders' equity	7,262	32	1,859	927	744	126	792	807	799	291	463	301	121
	44,325	1,116	11,145	8,432	3,896	927	4,229	4,037	4,085	1,536	2,364	1,584	974

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f. Details of the distribution segment Statement of Financial Position as of December 31, 2014:

	Total distribution segment	Northern District	Haifa District	Jerusalem District	Dan District	Southern District
	NIS in millions					
Current assets	3,121	654	351	401	592	1,123
Long-term receivables	3,116	642	418	412	594	1,050
Fixed assets, net	19,672	4,140	2,189	2,499	3,690	7,154
Intangible assets, net.....	329	70	35	42	62	120
	26,238	5,506	2,993	3,354	4,938	9,447
Current liabilities	4,146	878	480	547	762	1,479
Non-current liabilities, net.....	16,659	3,480	1,923	2,116	3,154	5,986
Shareholders' equity.....	5,433	1,148	590	691	1,022	1,982
	26,238	5,506	2,993	3,354	4,938	9,447

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g. Statement of operations for the year ended December 31, 2013:

	Total Company	Generation segment	Transmission segment	Distribution segment
	NIS in millions			
Required revenues.....	29,766	22,641	3,177	3,948
Adjustment for segment revenues	(2,544)	(1,395)	(101)	(1,048)
Revenues from electricity	27,222	21,246	3,076	2,900
Other revenues.....	379	195	14	170
Total revenues	27,601	21,441	3,090	3,070
Cost for operating the electricity system	24,207	20,421	2,168	1,618
Income from operating the electricity system	3,394	1,020	922	1,452
Sales and marketing expenses.....	903	-	-	903
Administrative and general expenses	1,111	637	149	325
Expenses from liabilities to pensioners, net	20	10	2	8
	2,034	647	151	1,236
Income from current operations	1,360	373	771	216
Financial expenses, net.....	2,167	981	485	701
Income (loss) before income taxes	(807)	(608)	286	(485)
Income taxes.....	125	95	(45)	75
Income (loss) after income tax	(932)	(703)	331	(560)
Company's share of the loss of associated companies, net.....	(2)	-	-	(2)
Income (loss) for the period	(934)	(703)	331	(562)

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h. Details of the generation segment statement of income for the year ended December 31, 2013:

	Total generation segment	PEP and others	Rutenberg	Orot Rabin	Haifa	Reading	Eshkol	Gezer	Hagit	Alon Tavor	Ramat Hovav	Zafit	Other gas turbines
	NIS in millions												
Required revenues	22,641	466	4,446	5,171	1,578	666	2,524	2,420	2,061	993	1,158	966	192
Adjustment for segment revenues	(1,395)	-	(280)	(325)	(99)	(42)	(159)	(152)	(130)	(62)	(73)	(61)	(12)
Revenues from electricity	21,246	466	4,166	4,846	1,479	624	2,365	2,268	1,931	931	1,085	905	180
Other revenues	195	-	44	44	13	11	27	17	13	8	8	7	3
Total revenues	21,441	466	4,210	4,890	1,492	635	2,392	2,285	1,944	939	1,093	912	183
Cost for operating the electricity system	20,421	462	3,841	4,799	1,403	611	2,340	2,160	1,839	895	1,044	894	133
Income from operating the electricity system	1,020	4	369	91	89	24	52	125	105	44	49	18	50
Sales and marketing expenses	-	-	-	-	-	-	-	-	-	-	-	-	-
Administrative and general expenses	637	-	133	151	43	36	88	55	47	24	29	22	9
Expenses from liabilities to pensioners, net	10	-	2	2	1	1	2	1	1	-	-	-	-
	647	-	135	153	44	37	90	56	48	24	29	22	9
Income (loss) from current operations	373	4	234	(62)	45	(13)	(38)	69	57	20	20	(4)	41
Financial expenses, net	981	2	286	147	79	16	67	123	104	45	52	31	29
Income (loss) before income taxes	(608)	2	(52)	(209)	(34)	(29)	(105)	(54)	(47)	(25)	(32)	(35)	12
Income taxes	95	(1)	8	35	5	5	16	8	7	4	5	5	(2)
Net Income (loss)	(703)	3	(60)	(244)	(39)	(34)	(121)	(62)	(54)	(29)	(37)	(40)	14
Company's share of the loss of associated companies, net	-	-	-	-	-	-	-	-	-	-	-	-	-
Income (loss) for the period	(703)	3	(60)	(244)	(39)	(34)	(121)	(62)	(54)	(29)	(37)	(40)	14

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i. Details of the distribution segment statement of operations for the year ended December 31, 2013:

	Total distribution segment	Northern District	Haifa District	Jerusalem District	Dan District	Southern District
	NIS in millions					
Required revenues.....	3,948	812	465	537	776	1,358
Adjustment for segment revenues...	(1,048)	(216)	(123)	(143)	(206)	(360)
Revenues from electricity	2,900	596	342	394	570	998
Other revenues.....	170	38	21	16	27	68
Total revenues	3,070	634	363	410	597	1,066
Cost for operating the electricity system	1,618	316	200	248	321	533
Income from operating the electricity system.....	1,452	318	163	162	276	533
Sales and marketing expenses.....	903	198	104	100	175	326
Administrative and general expenses	325	66	41	46	60	112
Expenses from liabilities to pensioners, net	8	2	1	1	2	2
	1,236	266	146	147	237	440
Income from current operations	216	52	17	15	39	93
Financial expenses, net.....	701	149	77	88	136	251
Loss before income taxes	(485)	(97)	(60)	(73)	(97)	(158)
Income taxes	75	15	10	11	15	24
Net loss.....	(560)	(112)	(70)	(84)	(112)	(182)
Company's share of the loss of associated companies, net.....	(2)	-	-	-	(1)	(1)
Loss for the period	(562)	(112)	(70)	(84)	(113)	(183)

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j. Statement of operations for the year ended December 31, 2012:

	Total Company	Generation segment	Transmission segment	Distribution segment
	NIS in millions (Unaudited)			
Required revenues	30,184	22,889	2,799	4,496
Adjustment for segment revenues	(2,227)	(446)	(157)	(1,624)
Revenues from electricity	27,957	22,443	2,642	2,872
Other revenues.....	306	139	12	155
Total revenues	28,263	22,582	2,654	3,027
Cost for operating the electricity system	23,395	19,924	1,854	1,617
Income from operating the electricity system	4,868	2,658	800	1,410
Sales and marketing expenses	1,065	-	-	1,065
Administrative and general expenses	869	444	133	292
Expenses from liabilities to pensioners, net	1,544	809	121	614
	3,478	1,253	254	1,971
Income (loss) from current operations	1,390	1,405	546	(561)
Financial expenses, net.....	2,685	1,214	601	870
Income (Loss) before income taxes	(1,295)	191	(55)	(1,431)
Income taxes	(293)	43	(12)	(324)
Income (Loss) for the period.....	(1,002)	148	(43)	(1,107)

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k. Details of the generation segment statement of income for the year ended December 31, 2012:

	Total generation segment	PEP and others	Rutenberg	Orot Rabin	Haifa	Reading	Eshkol	Gezer	Hagit	Alon Tavor	Ramat Hovav	Zafit	Other gas turbines
	NIS in millions (Unaudited)												
Required revenues	22,889	232	4,261	4,396	1,197	440	3,693	2,206	2,742	1,120	1,601	744	257
Adjustment for segment revenues	(447)	-	(84)	(85)	(24)	(9)	(73)	(44)	(54)	(22)	(32)	(15)	(5)
Revenues from electricity	22,442	232	4,177	4,311	1,173	431	3,620	2,162	2,688	1,098	1,569	729	252
Other revenues	140	-	29	30	9	9	19	14	10	7	6	5	2
Total revenues	22,582	232	4,206	4,341	1,182	440	3,639	2,176	2,698	1,105	1,575	734	254
Cost for operating the electricity system	19,924	232	3,484	3,829	960	327	3,372	1,904	2,493	998	1,483	659	183
Income from operating the electricity system	2,658	-	722	512	222	113	267	272	205	107	92	75	71
Sales and marketing expenses	-	-	-	-	-	-	-	-	-	-	-	-	-
Administrative and general expenses	444	-	84	101	28	33	70	34	35	18	22	12	7
Expenses from liabilities to pensioners, net	809	-	162	204	62	59	136	43	56	24	36	16	11
	1,253	-	246	305	90	92	206	77	91	42	58	28	18
Income from current operations	1,405	-	476	207	132	21	61	195	114	65	34	47	53
Financial expenses, net	1,214	-	366	191	102	20	87	157	111	58	44	40	38
Income (Loss) before income taxes	191	-	110	16	30	1	(26)	38	3	7	(10)	7	15
Income taxes	43	-	25	3	7	-	(6)	9	1	2	(2)	1	3
Income (Loss) for the period	148	-	85	13	23	1	(20)	29	2	5	(8)	6	12

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I. Details of the distribution segment statement of operations for the year ended December 31, 2012:

	Total distribution segment	Northern District	Haifa District	Jerusalem District	Dan District	Southern District
	NIS in millions (Unaudited)					
Required revenues.....	4,496	956	552	559	910	1,519
Adjustment for segment revenues...	(1,624)	(346)	(199)	(202)	(328)	(549)
Revenues from electricity	2,872	610	353	357	582	970
Other revenues.....	155	31	19	15	30	60
Total revenues	3,027	641	372	372	612	1,030
Cost for operating the electricity system	1,617	326	215	229	332	515
Income from operating the electricity system.....	1,410	315	157	143	280	515
Sales and marketing expenses.....	1,065	249	119	98	222	377
Administrative and general expenses	292	61	38	37	56	100
Expenses from liabilities to pensioners, net	614	128	81	78	121	206
	1,971	438	238	213	399	683
Loss from current operations	(561)	(123)	(81)	(70)	(119)	(168)
Financial expenses, net.....	870	184	97	109	171	309
Loss before income taxes	(1,431)	(307)	(178)	(179)	(290)	(477)
Income taxes.....	(324)	(69)	(40)	(40)	(66)	(109)
Net loss for the period	(1,107)	(238)	(138)	(139)	(224)	(368)

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- m.** In accordance with the government decision from August 5 2004, the general accounting standards for Government companies are the same as for the private sector. The unique standards for Government companies aim to supplement the private sector's standards or to elaborate or highlight certain issues regarding Government companies, as detailed in the Companies Authority's circulars. The unique standards for Government companies will be executed in accordance with the law:

1) Separate Financial Statements

In January 2005, the Company decided to make the necessary preparations to enable preparation of separate Financial Statements of each activity, as required by the stipulation of the Government Companies Authority, ("Separate Financial Statements"), where the work plan includes, inter alia, preparation of methodology, work procedures, internal audit procedures and a computerized solution. Implementation of these preparations was postponed due to sanctions opened by the employees, who prevented the implementation of the decision.

On March 26, 2006, the Company received a letter from the manager of the Government Companies Authority, announcing that implementation of the first milestones, required to be completed by March 26, 2006, was postponed by one quarter at least. There has been no development in this issue up to the signing date of the Financial Statements.

Implementation of the Government Companies Authority stipulations on disclosure of Company activities is a condition in the Government Companies Regulations adopted by the Minister of Finance on the subject of preparing adjusted Financial Statements starting from January 1, 2004 and up to December 31, 2007, including an amendment to the Government Companies Regulations dated June 30, 2008, which are in force (after several extensions) up to December 31, 2014 (see Note 2 a(1) above). In addition, failure to include information required by law in the Financial Statements may impair the ability of the Company to publish Financial Statements.

The data presented in the Financial Statements and in the supplementary information' is the responsibility of the Company and do not obligate the State of Israel.

n. General

- 1) As previously stated, based on section 33.b. of the Government Companies Law, and in accordance with the provisions of the Companies Authority circular dated March 2, 2004 (see Note 1 b above), the Company is required to provide disclosure in the form of a note to the primary financial statements. It will include statements of operations, condensed balance sheets related to the various activities segments and details of assumptions and the principal details that were used in their preparation. Disclosure will also be provided of the financial targets, including targets to meet normative recognized costs in the various activities segments that were (or will be) determined by the Electricity Authority, and the differences between them and the effective costs, as stated in the Companies Authority's circular on financial statements (see Note 1 above).

- 2) The Company's activities are composed of three principal segments:

- a) Generation - activities of the power plants producing electricity.
- b) Transmission - the transmission and transformation system for high-voltage electricity over long distances.
- c) Distribution - the electricity grid and the transformer stations system that brings electricity to the end consumer (except for a small number of customers who purchase high-voltage electricity and are directly connected to the transmission system), as well as the customer service and collection system of the Company.

These segments are called the electricity chain ("the electricity chain").

- 3) The rate base that came into force in July 2002 initially included various rates for four segments in the electricity chain: generation, transmission, distribution and supply. The different rates were intended to enable the private producers and customers to trade in electricity through a partial usage of the Company's system.

- 4) The Company manages one accounting system that includes all of the activities of the electricity chain. The internal controls principles that exist for everything concerning the internal trade between the activities of the electricity chain are not compatible with those required for separate audited financial statements.

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o. The principles used in attributing the statements of income are as follows

1) General

- a) The principles that the Electricity Authority used for determining the rate for the aforesaid activities segments, were implemented in these statements of operations.
- b) Since the Company is one legal entity, complete separate entries are not actually recorded for the segments of the electricity chain. The attribution of the expenses and income of the statement of operations to the level of the segments is performed as applicable, as will be described below.

The statements of operations as they are presented in this note do not necessarily reflect the results of operations of the various segments if they had been managed as separate economic entities, as signified by generally accepted accounting principles.

2) Below are the principles for attributing the revenues between the various segments

a) Revenues from the sale of electricity

The gross revenues for the segment are calculated based on the rate model that was used by the Electricity Authority to determine the rates for the Company.

In this model, the rate for each segment is calculated separately for every consumer.

The final rate published by the Authority for every consumer is a scheme of rates that were calculated in every segment.

The revenues per segment are calculated by the product of the segment rate multiplied by the sales (kWh) for the end consumer.

(1) Amount sold per segment

The amount sold by each segment is calculated based on data of the amount of sales to the end customers according to the type of the customer and rates according to load and time ("LTR").

(2) Rate for the segment

The electricity rates that were determined by the Electricity Authority are divided into two categories:

- (a) Rates according to load and time ("LTR") - rate that varies according to the season of the year and the time of day, where it is split to each of the segments of the electricity chain (a total of nine rates at the segment level).
- (b) A uniform rate according to type of consumer that is supposed to reflect over an entire year, the LTR rate according to the expected level of demand by those paying that same rate during the various seasons and time of day (a total of five types of uniform rates at the segment level).

The uniform rate, in accordance with the various types of consumers, is calculated for the various segments, in accordance with the model that was used by the Electricity Authority in determining the rates for the Company.

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o. The principles used in preparing these statements of revenues are as follows (continued)

(3) Calculation of the revenues for the electricity chain segments

The calculation of the revenue for the segment is calculated by multiplying the amount of sales calculated for each segment by the various types of consumers at the appropriate rates. The difference, which derives from the Company's actual revenue and the calculated revenue obtained, is distributed among the segments according to the amount of their calculated revenue.

- (4) In addition, in view of the matter discussed in section n. 3 above, as of July 1, 2006, revenues from usage fees are calculated for substations and connections. These revenues are collected through the generation and distribution segment rates and transferred to the transmission segment for the usage fees for the segment's properties. Revenues from usage fees of substations and connections are calculated at a rate per kWh multiplied by the sales to the end consumer.

b) Other revenues - are attributed to the appropriate segment, according to its nature.

3) Below are the principles for attributing the expenses to the various segments

The specifically identifiable expenses are charged directly to the appropriate items. Certain indirect expenses are recorded for those items according to distribution bases that, in the Company's assessment, constitute a reasonable estimate for the attribution of those expenses.

- a) Cost for operating the electricity system** - reflects in the Company's financial statements the operating expenses for the generation, transmission and distribution segments. Fuels costs and provisions for non-recognition of fixed assets construction costs are fully attributed to the generation segment. Costs with respect to purchase of electricity from private electricity producers are charged to the generation sector. Costs with respect to purchase of electricity from owners of photo-voltaic installations are charged to the transmission segment in accordance with the decisions of the Electricity Authority that deal with rate regulation for renewable energy producers.
- b) Selling and marketing expenses** - include the expenses for services to consumers that are attributed to the distribution segment.

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o. The principles used in preparing these statements of income are as follows (continued)

3) Below are the principles for attributing the expenses to the various segments (continued)

c) General and administrative expenses (includes salary, depreciation and other expenses)

The basis for attributing the general and administrative expenses items to segments was determined in accordance with the nature of the activities of the Company's various units, whose costs are attributed to general and administrative expenses; see the following details:

- (1) The general administrative expenses, the accounting and economic division and asset maintenance expenses - are presented according to the distribution ratio of the operating expenses in the electricity chain during the reported year.
- (2) The expenses for the human resources department are presented according to the distribution ratio of the salary expenses in the electricity chain during the reported year.
- (3) Doubtful accounts and bad debts - are presented according to the ratio of the gross revenues from electricity sales in the electricity chain during the reported year.
- (4) Communications, electronics and quality control, planning and technological development expenses - are presented according to the activities of the relevant unit.

d) Expenses (income) from liabilities, to pensioners, net - These expenses (income) are presented according to the distribution ratio of the salary expenses in the electricity chain during the reported year.

e) Financial expenses (income), net - Primarily derive from the operated fixed assets and, therefore, they were attributed according to the average ratio of the operated fixed assets, net, as presented in the Company's books in the electricity chain during the reported year.

4) Income Taxes - deferred

The deferred taxes and income tax with respect to the change in the tax rate are presented according to the ratio between the income before tax for each of the various segments, divided by the total pre-tax income of all of the segments.

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p. The principles used in attributing the aforesaid statement of financial position items are as follows:

- 1)** The Company is one legal entity and, in effect, the statement of financial position balances are not separated according to the Company's activities segments in its accounts (except for direct fixed assets). Therefore, the Company is reallocating the balance sheet balances for the purpose of this note, in every reporting year, based on allocation keys, as described below.
- 2)** The statement of financial position as they are presented in this note do not necessarily reflect the financial position of the various segments, if they would have been managed as separate economic entities, as signified by generally accepted accounting principles.
- 3) Below are the principles for attributing the statement of financial position balances to the various segments:**

a) Working capital items:

The working capital items were attributed to the segments in accordance with those principles that the Electricity Authority used in determining the electricity rates (principally for the purpose of determining the coverage of the working capital's financial expenses) where the principal allocation keys are:

Fuels inventories and balance for fuels suppliers - were fully attributed to the generation segment. The trade receivables balance was allocated according to the distribution ratio for revenues.
Trade payables and other items were allocated primarily according to the ratio of the operating expenses and salary for the segments.
Fuel payables- allocated to the operating segment, divided between the units according to actual fuel costs.

b) Fixed assets:

Fixed assets that are specifically identifiable are included in the appropriate segment. Joint assets (about 3% of the entire assets) were distributed according to distribution keys that, in management's opinion, constitute a reasonable estimate for attributing these assets.

c) Shareholders' equity and deferred taxes:

Shareholders' equity was allocated according to the ratio of the active fixed assets, net.
Deferred taxes were allocated according to the ratio of the tax expenses.

d) Loans and debentures:

The loans and debentures were allocated to the segments in accordance with the other statement of financial position items, and principally according to the distribution ratio of fixed assets to segments, pursuant to the nature of the financing for the Company's assets under the rate principles.

- e)** The remaining statement of financial position items were distributed according to distribution keys that, in the Company's estimation, constitute a reasonable estimate for attributing these items.

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q. Information regarding the attribution of the income statement and statement of financial position according to 18 reporting units

1) General

In addition to the aforesaid in section n.1 above, the Company was required to provide disclosure in the form of a note that is to include condensed statements of operations and a statement of financial position, in reference to 18 activities that are included in the three electricity chain segments, as follows:

Generation segment	11 generation sites: Rutenberg, Orot Rabin, Haifa, Reading, Eshkol, Gezer, Hagit, Alon Tavor, Ramat Hovav, Zafit and the other gas turbines. In addition, it also reports on activities for acquiring electricity from private producers.
Transmission segment	The electricity transmission and transformation system.
Distribution segment	The Company's five districts: Northern, Haifa, Jerusalem, Dan, Southern.

Below, the 18 operations segments will be called: "reporting units".

2) Below are the primary principles for attributing the revenue

The revenue at the level of the reporting unit is calculated by stages since presently there is no electricity rate at the reporting unit level, and the Authority's current rates, at the level of the electricity chain's segments, do not allow for their attribution to a level that is lower than the segment level.

The revenue is calculated based on the following principles:

- a) Calculation of the revenue from electricity at the level of the electricity chain segments, which is based on the electricity rates and agrees with the total of all revenues from electricity at the total Company level.
- b) Determination of the required revenues at the reporting unit level for each reporting year. Required revenue - coverage of the actual costs during the reported year (operating costs including fuel and depreciation) neutralized by the various other revenue and expenses, and with the addition of normative financing costs of assets recorded in the books and the normative rate of return on capital.
The required revenues are structured based on the principal elements of the rules and principles that served the Electricity Authority for determining the electricity rate for the various segments.
- c) The difference between the total required revenues for the reporting unit in the segment and the revenues of the appropriate segment was distributed among the reporting units according to the ratio of required revenue of the segment.
- d) The revenues from electricity at the reporting unit level were not designated in order to estimate the revenues that will be obtained from the electricity if and when electricity rates are determined at the reporting unit level and, therefore, statements of operations according to the 18 reporting units do not necessarily reflect the results of their operations if they were managed as separate economic entities, as signified by generally accepted accounting principles.

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q. Information regarding the attribution of the income statement and statement of financial position according to 18 reporting units (continued)

3) The principles for the attribution of expenses are as follows:

The principles for attributing the expenses at the level of the reporting units agree with the principles that were applied in the reporting according to the three electricity chain segments (see section o. above).

Joint expenses for a segment (such as management of the segment) were attributed to the reporting units, generally on the basis of the direct operating costs for each reporting unit.

Other expenses that are not allocated in the Company's books of account (such as general and administrative and financial expenses) were attributed to the reporting units in accordance with the loading bases used in the reporting according to the electricity chain segments.

4) Principles that were used in attributing the statement of financial position items according to 18 reporting units

According to what is stated in section q. above, the Company is one legal entity and, in effect, the statement of financial position balances are not segregated in the Company's books according to the segments of the Company's activities. Therefore, the Company re-attributes the statement of financial position balances for the purpose of this note for each reported year based on allocation keys, as described above in section p., while providing additional details for the 18 reporting units.

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NOTE 39:- ADDITIONAL INFORMATION REQUIRED UNDER THE PROVISIONS OF THE GOVERNMENT COMPANIES AUTHORITY

- a. For information about attributing the statement of profit and loss and comprehensive income according to the generation transmission and distribution segments, see Note 38 above.

b. Disclosure about Reports on Internal Controls

- 1) According to Government Companies Regulations (additional report on actions taken and representations given to assure additional reports on the effectiveness of internal controls over the financial reporting) – 2007, all Government companies, including the Company, were obligated to attach to their annual and Interim Financial Statements an additional report of the actions taken in order to assure effectiveness of Internal controls over the Financial Reporting, including setting up an entire array of internal controls.

The Company established Administration, Control and Work, integrated a mechanized dedicated system and units and elected a consultant to assist in the implementation of the said regulations. The system allows documentation of risks and controls in any process, documentation of the performed tests and their results. The system also provides the ability to monitor faults corrections and to generate various control and administration reports, in order to enable the office holders signing the Financial Statements and the Report of the Board of Directors to declare in the additional report that the Financial Statements and the Report of the Board of Directors do not contain false representation of a material fact and that they properly reflect, in all material aspects, the financial position, results of operations, changes in equity and cash flows of the Company for the days and periods presented in the reports. . The Company established a procedure to verify: absence of weaknesses which may affect the correctness of the report, implementation of all disclosure controls enacted, including implementation of a methodical mechanism from managing and monitoring information gathering from position holders and statements of intermediate managers on the implementation of the disclosure controls in their spheres of responsibility and also applying suitable controls over amended work processes.

- 2) The Companies Authority required the Company to conduct audits according to the Government Companies Regulations (Additional Reports on the Effectiveness of Internal Control over Financial Statements) – 2007 and according to the Government Company Regulations (Additional Report on Actions Taken and Representations Given to Ensure the Correctness of the Financial Reports and the Board of Directors' Report) – 2005, and according to the circular of the Companies Authority on the subject of risk management in Government companies, of June 11, 2009, and present disclosure of them in the notes to the financial statements on the internal controls over the financial reporting related to assets/ liabilities/ activities/ trusts/ projects and services managed through service providers assets/ liabilities/ activities/ trusts/ projects and services, as these are defined in SAS 70 (Statements on Auditing Standards 70). In the framework of the controls tested as listed above, also tested were controls relating to service providers assets/ liabilities/ activities/ trusts/ projects and services, as these are defined in SAS 70.

The Companies Authority wished to ensure that within the framework of the chain of signings and backing the declarations carried out for the purpose of implementing the above stated regulations regarding SOX 302 and SOX 404 and the Government Companies Risk Management Circular, all the key advisors and other service providers relevant to the internal controls over the financial reporting in the Company in the stated spheres will provide a statement regarding the audits they executed and their findings with respect to the existence or non-existence of weaknesses or faults in accordance with the stated Regulations regarding SOX and the Risk Management Circular, SAS 70 including its amendments, including SSAE 16 ("Statements on Standards For Attestation Engagements 16"), as well as regarding the issue of conflict of interests, this in addition to the chain of signings and backing the declarations of those responsible for the processes, sub-processes and additional controls relevant to the internal controls over the financial reporting of the Company.

The position of the Company:

SAS 70 deals with an opinion of an auditor on the reliability of the controls that exist in service bureaus.

The key advisors and other service providers relevant to the internal controls over the financial reporting of the Company are experts and not service bureaus and therefore they are not comprised in SAS 70.

For the purpose of relying on the work of the expert, the Company examines his professional qualifications, his professional authorization by an appropriate professional entity, his experience and reputation, and also carries out tests in order to verify the use he makes of the data, assumptions and the methods he uses, and examines the outcome of his work.

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NOTE 39:- ADDITIONAL INFORMATION REQUIRED UNDER THE PROVISIONS OF THE GOVERNMENT COMPANIES AUTHORITY (continued)

b. Disclosure about Reports on the Internal Audit (continued)

The position of the Company: (continued)

The Authority is not accepting the Company's position and is of the opinion that in the absence of declarations as aforesaid, weaknesses or defects may exist according to the SOX Regulations and the Risk Management Circular or they will not be disclosed as required. So, for example, as stated in the non-implementation of the instructions of the Authority on execution of a risk survey in accordance with the Risk Management Circular. Moreover, under the SSAE 16 the interpretation included in the position of the Company is overly limited and the term "Service organization" is defined as: "An organization or segment of an organization that provides service to user entities, which are likely to be relevant to those user entities' internal controls over financial reporting".

A similar definition is also included in the ISAE 3402 (International Standard on Assurance Engagements 3402).

In January 2014, the Board of Directors of the Company approved the new triennial risk survey (also see section j below).

Moreover, the Company delivered data to the Companies Authority in accordance with an agreement of February 19, 2014.

- c. Government Companies are required to ensure that a misleading item will not be included in the Financial Statements and the accompanying information they submit, including information that might mislead a reasonable reader of the Financial Statements and their accompanying information.

- d. The Company will provide proper disclosure in the Financial Statements of significant assets for which it believes there is a material gap between their fair value and their carrying amount in the Financial Statements, which are not recorded at their full amounts in the Company's books, including on the basis of appraisals or evaluations performed, or insurance appraisals, if performed.

The Company does not have valuations of specific assets (except Rogozin land, where the book value is higher than the fair value of the land).

The Company annually reviews the need for provision for impairment of its assets according to IAS 36 and if needed performs a valuation of all its assets, which is attached as an annex to the financial statements.

See also Note 2 k) above and the position of the Companies Authority in section 14 j below.

- e. 1) The Finance Committee of the Board of Directors of the Company and the Government Companies Authority discussed the need to review all the assumptions at the basis of the liabilities arising from employee - employer relations. Consequently, the committee decided, to establish a sub-committee to implement the aforementioned ("The Actuary Committee"), which was established on October 21, 2007. This sub-committee reviewed, inter alia, the connection between the assumptions that serve as the basis for calculating the actuary liabilities of the pension funds, guidelines of the Capital Market Department and the actuarial calculation method, as presented in the records of the Company. The work of the sub-committee yielded a Company – Employees Rights document and work procedures to review the update of these assumptions.

- 2) On August 24, 2008, the Deputy Manager of the Companies Authority notified the Company that "pursuant to the audit conducted by the Committee of the Board of Directors of the Israel Electric Corporation Limited ("The Company") and to meetings we held with the Management of the Company on the subject of actuarial liabilities, in which we studied data and documents, submitted to us, related to the calculation method and the accounting presentation of the liability for pension in the financial statements of the Company, I wish to inform you that the Government Companies Authority ("The Authority") is reviewing all matters related to issues pertaining to liability for pension in the Financial Statements of the Company.

To this purpose the Companies Authority appointed, inter alia, the firm of Barlev & Co., Auditors, as an auditor on its behalf, according to Section 55 of the Government Companies Law and to Government Companies regulations (Rules on Authorization of an Auditor by the Authority) – 2005. The auditor will inform you of the issues to be examined at each point in time.

The Board of Directors of the Company instructed the CEO and all related parties in the Company to cooperate with the auditor, to the extent required to accomplish the task efficiently.

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NOTE 39:- ADDITIONAL INFORMATION REQUIRED UNDER THE PROVISIONS OF THE GOVERNMENT COMPANIES AUTHORITY (continued)

- 3) Pursuant to the appointment of an auditor on behalf of the Government Companies Authority, the Company addressed the Managing Director of the Government Companies Authority on September 16, 2008 and clarified that the Company will cooperate with the auditor and whoever acts on his behalf. The Company appealed concurrently to the Electricity Authority to appoint an auditor on its behalf (or rely on the findings of the auditor appointed by the Government Companies Authority), in view of the announcement of the Electricity Authority that it intends to conduct its own audit of the pension liability of the Company. No response was received, as yet, to this appeal. The Company believes that a comprehensive audit, performed jointly by the Board of Directors of the Company (with participation of the Company's Management, Actuary and external auditor) together with the Government Companies Authority and the Electricity Authority will finally clarify all the various issues in question in this subject.

As of the signing date of the financial statements, the Company did not receive any response regarding the said audit report.

- 4) On December 10, 2009, following previous requests on the subject, the Chairman of the Board of Directors addressed the Managing Director of the Government Companies Authority, requesting information on the findings of the audit conducted by the auditor, acting on behalf of the Government Companies Authority. The Chairman noted that despite previous requests of the Company to receive a draft report of the auditor and although many months elapsed since the auditor commenced his audit, the Company has not received a draft report and the main findings of the auditor. The Chairman of the Board of Directors claims that in preparation for publishing updated Financial Statements of the Company, including material changes in the actuarial liabilities and in light of the long time that elapsed, it seems that the time has come to receive the findings related to these liabilities in an orderly and urgent manner. The fact that no audit report was published on the subject and not even a non-binding draft, leads to the conclusion that the report submitted by the auditor does not contain any new information in addition to results of audits conducted by the Company, which the Company delivered to the representatives of the Government Companies Authority. If the aforementioned conclusion is not well-grounded, the actual facts should be presented without any further delay.

On June 29, 2008, the Government Companies Authority Director addressed the Securities Authority Chairman for consultation, under Section 33a of the Government Companies Law, on the matter of regulating the attribution of employees' pension liabilities to their service periods. In this address, the Authority Director explained, inter alia, that as long as there is a need to change the manner of attributing pension liabilities, the matter will be evaluated concurrently with other actuary issues requiring clarification by the publishing date of the financial statements as of June 2008.

The Government Companies Authority proposed that the Government Companies Regulations be amended to include reference to the said matter as above. As stated, the amendment was included in the regulations signed by the Finance Minister on June 29, 2008.

On November 23, 2008, the Government Companies Authority requested to disclose its position as follows: "The policy of maintaining real wages for pensioners is the current correct accepted policy and should be implemented by the Company. The pensioners' promotion in rank mechanism in the Company is intended, in theory, to maintain the real wages of the pensioners, but actually creates an increase in the real wages, due, inter alia to the fact that the inflation environment in Israel changed materially to a low inflation environment. Considerations should include the fact that a low inflation environment and accelerated promotion in rank of pensioners cannot co-exist for prolonged periods of time and are not in the best interest of the Company, since these generate high costs and deficits to the Company" (regarding the change of the pensions update mechanism, see Note 12 d 1 above).

Regarding the findings of the report of the State Comptroller that relates to the period of December 2008 to January 2012 see Note 12 j above.

As of the statement of financial position date, several subjects are still being reviewed and the subject of actuary liabilities is examined.

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NOTE 39:- ADDITIONAL INFORMATION REQUIRED UNDER THE PROVISIONS OF THE GOVERNMENT COMPANIES AUTHORITY (continued)

- f. The Government Companies Authority has required a clarification, on whether the Company's Board of Directors discussed the reports of the State Comptroller that were published on October 2012 regarding the pension arrangements of the Electric Company's employees, capital raising by the Electric Company and replacement of the partner in the accounting firm who is responsible for auditing the Financial Statements of the Electric Company, according to the required in the circulars of the Government Companies Authority and whether, in view of the stated in the reports, the Board of Directors believes that changes should be included in the financial statements regarding liabilities of employee-employer relations.

As mentioned in Note 12 j above, the Company's Board of Directors discussed the State Comptroller's reports that were sent to the Company by the Prime Minister's Office during July 2012, as detailed above, for the purpose of providing the Company's response to the Prime Minister's Office according to the law. On October 2012, the State Comptroller published the final report.

During the discussion, the Board of Directors received an in-depth, detailed and comprehensive review and afterwards conducted a discussion of the Company's response to the final reports of the Comptroller following the Prime Minister Office's request from Management. The Board of Directors, having heard the review and conducted the discussion, adopted the Company's response and approved its submission to the Prime Minister's Office. The Board of Directors has instructed Management to maintain a continued process of implementing the State Comptroller's lessons in accordance with the Board of Directors' policy.

The Management of the Company and the Board of Directors estimate, based on the opinion of its legal advisers, that the contents of the report of the State Comptroller does not affect the financial statements of the Company.

- g. The Government Companies Authority required the Company to ascertain and provide disclosure, that the rights recorded in the financial statements related to liabilities with respect to employee-employer relations did not deviate from the current binding rights from aspects of Labor laws and that these liabilities were recorded accurately.

The Company's position is:

The Company tightened the controls over the salary and pension payments and established a procedure, approved by the Company's Board of Directors, on the subject of the manner of updating changes in employee rights and benefits. The Company estimates that these steps strengthened the internal controls over the financial reports for subjects related to handling the employees' wages rights section from now onwards. Regarding rights of wages deriving from the past, the Company received an opinion of its legal advisers, and in 2011 applied to the Commissioner of Wages to receive his approval for validity of wage rights that had not yet received approval. The Commissioner of Wages stated that he cannot provide an approval as requested, and that he intends to conduct an examination of the salary components of the Company. A decision by the Commissioner of Wages regarding salary exceptions in the Company of October 10, 2013 is pending at the Haifa Regional Court of Labor, and at present it is not in effect until a decision is reached in the proceeding. See Note 12 g above.

- h. Regarding reporting and control rules for land and attached assets in Government companies see Note 14 j above.
- i. See Note 14 above for the composition of the fixed assets.

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NOTE 39:- ADDITIONAL INFORMATION REQUIRED UNDER THE PROVISIONS OF THE GOVERNMENT COMPANIES AUTHORITY (continued)

- j. On the subject of risk management in the Company, the Government Companies Authority has drawn the attention of the Board of Directors in 2012 to what is stated in the circular of the Government Companies Authority on the subject of risk management in Government Companies, of June 11, 2009, which is available on the website of the Government Companies Authority, and mainly on the responsibility of the Board of Directors to outline and approve the risk policy of the Management of the Company and supervise its implementation, including prevention or minimizing the occurrence of financial risks, obedience risks, operational risks and strategic risks.

The position of the Company:

During the months of November 2012 to July 2013, the Company carried out a risk survey through an external advisor. During the survey, the key risks that affect the Company and the achievement of its objectives were identified, and the actions taken by the Company to handle the risks were described.

The report was presented and approved by the management and the Board of Directors of the Company, and a copy was sent to the Companies Authority. No comments were received regarding this risk survey.

- k. As part of the Company's risk management and according to an agreement with the Companies Authority, the Company has completed an embezzlement and fraud survey focused on identifying risk areas during 2014. In January, 2015, its findings were presented to the Company's CEO, and are designed to be presented to the Committee of the Board of Directors.
- l. The Government Companies Authority announced that the substance of calculating fixed assets impairment is based, in a company of a similar type to that of the Company, on the rates of the Company, which are determined by regulation and thus determines the economic value of the Company's assets. The Government Companies Authority believes that it is appropriate to require the Company to examine the need for fixed assets impairment in accordance with FAS 144 (ASC 360 and ASC 980). Therefore, following discussions conducted between the Government Companies Authority and the Securities Authority, the Government Companies Authority is studying, inter alia, with related State parties, possibilities for applying its professional position in the framework of the amended Government Companies Regulations.
- m. The Government Companies Authority requested to disclose the position of the Company on questions and issues it presented, regarding accounting treatment according to SFAS 90, in the provision for impairment of new stations, operated from January 1, 2003 (and presented in the approved financial statements from 2010).
With regard to the Companies Authority's position, see also section l above.

The Position of the Company is:

Pursuant to the publication of the rate base for the generation segment in 2010 and in view of non-recognition of part of the fixed assets costs, the Company applies the directives of SFAS 90 and recorded a provision for assets impairment accordingly. Regarding assets which were defined as assets where construction was recently completed ("Assets built after determining the previous rate base which therefore were not included in that rate. Namely, assets for which no first rate was determined after their commissioning"). Also see Note 2 a. 2) above.

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NOTE 39:- ADDITIONAL INFORMATION REQUIRED UNDER THE PROVISIONS OF THE GOVERNMENT COMPANIES AUTHORITY (continued)

- n. The Government Companies Authority requested to disclose the implications of the Law to Promote Competition and Reduce Centralization - 2013 (hereinafter: the "Centralization Law"), as was published in the Official Gazette on December 11, 2013, insofar as they are relevant to the operation of the Company within the electricity sector and the communications sector.

Chapter B of the Centralization Law deals with weighing pan-economy centralization considerations and sectorial competition considerations when allocating rights. As part of the law, a "Committee for Reducing Centralization" has been established, and its members are the General Director of the Antitrust Authority (as Chairman of the committee), the director General of the Ministry of Finance or head of a division in the Ministry of Finance and the Head of the National Economic Council or one of his deputies.

The Centralization law has significant impact on the Company since the Committee determined in light of the law that the Company is a "Centralized Entity" as is defined in the Centralization law, due to it being a real significant corporation, under the definition appearing in section 4 of the law, and because its accumulated extent of control in the field of essential infrastructure (as this term is defined in the law) exceeds half of all the activity in that field.

Defining the Company as a Centralized Entity may impact the Company as detailed below:

- a) Allocating rights and renewing or extending rights given to the Company - according to the provisions of the Centralization Law, every entity that is authorized to allocate a right, renew or extend it (a right means license, contract or significant holding as they are defined in the law) in the field of essential infrastructure should weigh pan-economic centralization considerations and conduct consultation with the Committee for Reducing Centralization when allocating a right as stated to a Centralized Entity. In addition, the authorized entity will consider considerations of promoting sectorial competition when allocating that right.
- b) Allocating a right in essential infrastructure by the Company - according to the provisions of the Centralization Law, insofar as a government company will wish to enter a contractual engagement with a third party, in which the government company will allocate a right (including a contractual engagement to execute the activity that is one of the fields of essential infrastructures) in a field belonging to one or more of the essential infrastructure fields, the tender committee of the government company will have to weigh pan-economy centralization considerations and consult with the Committee for Reducing Centralization as part of approving such a contractual engagement. Additionally, the tender committee of the company may be required to consider considerations of promoting sectorial competition when allocating such rights.
- c) **Privatization of a government company - in case of a decision to privatize a government company (as defined in section 1 of the Government Companies Law), the Government Companies Authority will consult with the Committee for Reducing Centralization before formulating an opinion or a memorandum on its behalf, under section 59(b) of the Government Companies Law, regarding the possibility of allocating rights in a government company to a Centralized Entity and the terms for this. Additionally, as part of reaching such a decision, the Government Companies Authority will consider considerations of promoting sectorial competition.**

The Companies Authority requested that the Company will note that according to the Centralization Law, competition and industry centralization consideration should also be considered in relation to the operations of the Company in the electricity sector and the communications sector.

In general, the provisions of the Centralization Law that deal with pan-economic centralization considerations and sectorial competition considerations in allocating rights entered into force on December 11, 2014. However, the provisions pertaining to extension of validity or renewing a license (including the licenses of the Electric Company) are expected to enter into force on December 11, 2018.

At this stage, the Company is still studying the expected implications of the law and the manner of its application to the Company, and is preparing to act on the matter.

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NOTE 39:- ADDITIONAL INFORMATION REQUIRED UNDER THE PROVISIONS OF THE GOVERNMENT COMPANIES AUTHORITY (continued)

- o. It will be expressly noted in the Financial Statements that the presentations included in the Financial Statements and in the enclosed information are at the sole responsibility of the Company and do not bind the State of Israel.

The Company notes that, to the best of its knowledge, the Company's presentations, except for positions expressed by various governmental bodies which are included in the Financial Statements and the accompanying information, are at the sole responsibility of the Company's Management and Board of Directors and do not bind the State of Israel, subject to law.

- p. The Companies Authority requested to provide disclosure with respect to all the engagements, existing and expected, with the private producers including production licenses granted to private producers and with respect to which agreements with the Company have not yet been signed. So far, approximately 180 big customers that purchase electricity from approximately 1,800 consumption locations transferred to private suppliers. The total generation that the Company has lost after transfer of all the customers as detailed above is approximately 8 billion kWh a year. In addition, the Company estimates that this process is expected to continue in 2015, although the Company has no certainty at this stage as to the number of customers, kWh and revenues it will lose. For additional details see Note 34 a 4) above.
- q. The Companies Authority requested to provide disclosure regarding the effectiveness of the procedures included in the declaration given by the Vice President for Human Resources of the Company, which, based on his knowledge, the reports delivered to the fund do not include misrepresentation of material or misleading facts regarding the period of the account.

The position of the Company:

As noted in the declaration given by the Deputy CEO Human Resources of the Company to this report to the CEO of Infinity Ltd., the controls in the processes included in the declaration are effective.

- r. The Companies Authority requested to provide disclosure in the Financial Statements for the estimate of the Company and the actions it intends to take regarding the date of transition to full international standards. The required disclosure appears in Notes 2 a 4) and 3 d above.
- s. The Companies Authority requested the Company to attach audited financial statements of the Jordan Assets Incorporated Company.

Financial statements of the company have not been prepared or signed since 2005 until the present due to issues from the past of classification of a number of assets between the Jordan Assets Company and the Company. Additionally, directors have not yet been appointed to the Jordan Assets Company.

The Company is working with the various regulation authorities to regulate the approval of these financial statements.



The Israel Electric Corporation Ltd.

Chapter D

Additional Particulars
about the Corporation

For the Year 2014

Prominent Disclaimer

This English translation of the **“Additional Particulars about the Corporation”** for the year ended December 31, 2014 ("English Translation") is provided for information purposes only.

In the event of any conflict or inconsistency between the terms of this English Translation and the original version prepared in Hebrew, the Hebrew version shall prevail and holders of the Notes should refer to the Hebrew version for any and all financial or other information relating to the Company.

The Company and its Directors make no representations as to the accuracy and reliability of the financial information in this English Translation, save that the Company and its Directors represent that reasonable care has been taken to correctly translate and reproduce such information, yet notwithstanding the above, the translation of any technical terms are, in the absence of generally agreed equivalent terms in English, approximations to convey the general sense intended in the Hebrew version.

The Company reserves the right to effect such amendments to this English Translation as may be necessary to remove such conflict or inconsistency.

Name of the Company: The Israel Electric Corporation Ltd.
Company Number with the Companies Registrar: 520000472
Statement of Financial Position Date: December 31, 2014
Date of the Report: March 24, 2015

This Chapter is prepared in accordance with the Securities Regulations (Periodic and Immediate Reports), 1970 (the "Regulations").

Regulation 9d: Report of the Liabilities Schedule According to Payment Dates

For the report on the liabilities schedule of the Company, see immediate report concurrently published by the Company (Regulation 126) with this periodic report.

Regulation 10a: Summary of reports on the quarterly comprehensive income

For a summary of reports on the comprehensive income of the Company for each of the Quarters in 2014 (in NIS million) see section a'5 in the Board of Directors' Report.

Regulation 11: A list of investments in subsidiaries and related companies, as of the statement of financial position date (31.12.2014)

Subsidiaries and related companies held by the Company¹ on December 31, 2014, are listed below with an indication of the number of shares, type, nominal value, proportion of the Company's holding in them out of the total issued shares of this type and the rate of the securities, of the issued shares capital, the voting rights and the authority to appoint managers held by the Company:

¹ All the subsidiaries and related companies detailed in this regulation are not traded in the stock exchange.

Name of Subsidiary	Share Type	Number of Held Shares and Nominal Value	Proportion of the Company's Holding (%)				Millions of NIS
			In Securities	In Capital	In Voting Rights	In Appointment of Directors	Adjusted Balance Sheet Value
Jordan Investment Company Ltd.	Ordinary	300,000 of NIS 0.0005 each	100.00	12.00	73.17	73.17	
	Ordinary A	(*)110,000 of NIS 0.0001 each	99.98	87.99	26.82	26.82	
Migrashei Hakablanim Ltd.	Preferred Deferred	2,000,630(**) of NIS 0.0001 each	100.00 <u>100.00</u> 100.00	76.05 <u>23.95</u> 100.00	100.00 <u>0.00</u> 100.00	100.00 <u>0.00</u> 100.00	
National Coal Supply Company Ltd.	Ordinary A	909,000 of NIS 1 each	100.00	100.00	100.00	100.00	55
Advanced Training Fund of Israel Electric Corporation Ltd.(***)	Management A	6 of NIS 1 each	50.00 of the Management shares		50.00	50.00	
PAMA Energy Resources Development Company Ltd.	Ordinary	3,467,790 of NIS 0.10 each	49.99	49.99	49.99	30.77	
I.B.C. Israel Broadband Company (2013) Ltd.	Ordinary	400 of NIS 1each	40.00	40.00	40.00	40.00	86

(*) Including 66 shares held by officeholders in trusteeship for the company

(**) Held by officeholders in trusteeship for the company

(***) A casting share, granting its holder the right to determine the outcome in any case of equality of votes of the general assembly or the Board of Directors, was personally allocated to Mr. David Hagoel, the former Chairman of the Board of Directors of the Electric Company.

Balance of loans to held companies: None.

For additional details see Notes 1h, 2f and 11 to the Financial Statements of the Company of December 31, 2014 ("Financial Statements").

Regulation 12: Changes in investments in subsidiaries and related companies during 2014

There were no changes in investments in subsidiaries and related companies during 2014.

Regulation 13: Comprehensive income of every subsidiary or related company of the corporation, during the last reporting year that ended on the date of the statement of financial position of the corporation or before it, adjusted to the statement of financial position date (December 31, 2014), while distinguishing between profit or loss and other comprehensive profit, as their meaning in the accepted accounting principles.

The following table details the comprehensive income (loss) of the subsidiaries and related companies as of December 31, 2014:

Name of Company	Net Profit (loss)	Comprehensive Profit (loss)	Proposed Dividend	Management Fees	Interest
National Coal Supply Company Ltd.	11	8	5	-	
Issuance of series NIS Electric 2013I.B.C. Israel Broadband Company (2013) Ltd.	(29)	-	-	-	-

Regulation 20 Trading on the Stock Exchange - Securities that were Listed for Trading - Trading Halt Dates and Reasons

During 2014, Company debentures from the issue of the “2029 Electric Linked” series and from the issue overseas of the “2024 Dollar Electric” were listed in the Institutional Continuous Trading System.

Name of Series	Security no.	Nominal value	Listed at
2029 Electric Linked	6000186	766,378,000	Institutional Continuous Trading Floor
2024 Dollar Electric	6000194	1,250,000,000	Institutional Continuous Trading Floor

Regulation 21(a)(1): Rewards to Officers

Compensation paid by the Company and commitments to pay it assumed (including employers' costs) for each of the five officeholders in the Company or in a company it controls, who received the highest compensation from the Company itself or from a corporation it holds, as the case may be, paid with respect to 2014 as recognized in the financial statements for 2014 (adjusted to the CPI for the month of December 2014) is detailed below:

2014														
Details of Rewards Recipient				Rewards* for Services							Other Rewards			
Name	Position	Position Scope	Equity holding rate	Salary**	Bonus	Shares Based Payment	Management Fees	Consulting Fees	Commission	Other	Interest	Rent	Other	Total
Yiftah Ron-Tal (1)	Chairman of the Board of Directors	100%	-	1,208,329	-	-	-	-	-	-	-	-	-	1,208,329
Eli Glickman (2)	Company CEO	100%	One share (negligible)	1,138,625	-	-	-	-	-	-	-	-	-	1,138,625
Adrian Bianu (3)	Senior VP Corporate Sustainability and Risk Manager	100%	-	1,122,532	-	-	-	-	-	-	-	-	-	1,122,532
Tamir Polikar (4)	Senior VP of Finances and Economics	100%	-	1,106,890	-	-	-	-	-	-	-	-	-	1,106,890
David Elmakias (5)	Deputy CEO planning, development and Technology	100%	-	1,097,661	-	-	-	-	-	-	-	-	-	1,097,661

(*) Reward amounts are presented in terms of annual cost to the company (in NIS) for a period of twelve (12) months ended on December 31, 2014 (adjusted to the CPI for December 2014).

(**) The amounts specified above include salary in terms of cost incurred by the Company expenses refund with respect to subsistence allowance, telephone, vehicle and payments to professional societies ("Expenses Refund") and charging tax with respect to vehicle, insurance, electricity, advanced studies, fixed and mobile phone, gift and meals ("Charged to Tax")

Notes to the Table:

Terms of employment for employees employed by personal contract:

The employment agreement of an officeholder is a personal employment agreement, in a uniform version, dictated and required by the Companies Authority, in accordance with the Government Companies Authority's Circular no. 2001/1 of November 7, 2001 ("**The Authority's Circular Regarding Senior Employees**"). The salary of an officeholder is determined in accordance with the classification of the Company, which is determined by the Committee for Classifying Government Companies that was established by virtue of the Government resolution (the "**Committee for Classifying Government Companies**"), and is updated once a year in accordance with the increase of the CPI and subject to the approval of the Board of Directors of the Company. As part of the employment of an officeholder and in accordance with his employment agreement, and after receiving approval for it from the Board of Directors of the Company and from the Government Companies Authority, the officeholder is entitled to for purpose of his function, to a vehicle supplied by the employer and the Company bears the costs of its use. Within the framework of his work, he is also entitled to expenses of maintaining a landline and cellular telephone, board and lodging expenses, clothing allowance, advance study fund, annual leave and convalescence pay. The officeholder shall cease to serve in office and his term in office shall expire in accordance with the causes which are set forth in the Government Companies Law and on the dates set forth therein. According to the Authority's Circular Regarding Senior Employees, an advance notice of three months must be issued to a senior employee who is dismissed from employment or by senior employee who resigns voluntarily. The terms of office and employment of the officeholders are compatible with the compensation policy of the Company.

On February 9, 2015, after receiving prior approval from the Compensation Committee and Board of Directors of the Company, the general meeting of the Company approved an amendment to the compensation policy of the Company. Accordingly, the Company executed provision of NIS 1.5 million for a bonus for seven senior officers with a personal contract. This sum is not included in the above table. See Note 33 d (4) to the Financial Statements.

Yiftah Ron-Tal - started his term as chairman of the Board of Directors of the Company on September 16, 2010 and his tenure as Chairman of the Board of Directors was renewed on October 2, 2013. The amount presented in the "Salary" column for 2014 includes an annual salary of NIS 793,852 (which includes, *inter alia*, a combined salary in the amount of NIS 747,769, annual payments of NIS 8,976 and Expenses Refund in the amount of NIS 37,106), plus employer's costs in the amount of NIS 258,585 plus Charges to Tax in the amount of NIS 155,893.

Eli Glickman - started work as Company CEO on April 14, 2011. The salary is paid according to an agreement from April 2011 which shall be in force until the expiry of his term in office. The amount presented in the "Salary" column for 2014 includes an annual salary of NIS 804,025 (which includes, *inter alia*, combined salary in the amount of NIS 747,077, annual payments of NIS 8,976 and Expenses Refund in the amount of NIS 47,972), plus employer's costs in the amount of NIS 259,662 plus Charges to Tax in the amount of NIS 74,938. **The aforementioned has announced his intention to end his term of office at the Company in the coming months.**

Tamir Polikar - started work in the Company as Deputy CEO Finances and Economics on April 28, 2013. The salary is paid according to the contractual engagement of April 2013, which shall be in effect until the expiry of his term. The amount presented in the "Salary" column for 2014 includes an annual salary of NIS 730,318 (which includes, *inter alia*, combined salary in the amount of NIS 672,769, annual payments of NIS 14,912 and Expenses Refund in the amount of NIS 42,638), plus employer's costs in the amount of NIS 259,803 plus Charges to Tax in the amount of NIS 116,768.

The aforementioned has announced his intention to end his term of office at the Company at the end of March 2015.

Terms of employment for employees subject to a collective agreement:

The salary is paid according to collective agreements and arrangements applied to the majority of Company employees. The salary is updated according to collective agreements entered for all employees. Employment termination by the Company is according to the collective agreements and arrangements of the Company. Employment termination by the employee is according to the law and Company procedures, or upon reaching retirement age. The terms of office and employment of the officeholders are compatible with the compensation policy of the Company. For details of the collective agreements and arrangements that apply to the employees of the Company see section 14 to the Report of Description of the Business Affairs of the Corporation.

David Elmakias - started work in the Company on October 20, 1974. The amount presented in the "Salary" column for 2014 includes an annual salary of NIS 734,346 (which includes, *inter alia*, combined salary in the amount of NIS 385,224, salary increments of NIS 206,976, annual payments of NIS 75,974 and Expenses Refund in the amount of NIS 66,172), plus employer's costs in the amount of NIS 263,285 plus Charges to Tax in the amount of NIS 100,129. Employment termination by the employee is subject to the law and Company procedures, or upon reaching retirement age. Employment termination by the Company is subject to the collective agreements and arrangements

of the Company. The terms of office and employment of Mr. Elmakias are compatible with the compensation policy of the Company.

Adrian Bianu - started work in 1978. The amount presented in the "Salary" column for 2014 includes an annual salary of NIS 754,934 (which includes, inter alia, combined salary in the amount of NIS 408,659, salary increments of NIS 209,275, annual payments of 79,350 and Expenses Refund in the amount of NIS 57,649), plus employer's costs in the amount of NIS 254,823 plus Charges to Tax in the amount of NIS 101,775.

Regulation 21(a)(2): There are no three senior officeholders in the Company itself who receive the highest compensation that are not included in the list under Regulation 21(a)(1).

Regulation 21(a)(3): There are no stakeholders in the Company who receive rewards that are not directors and are not included in the list of regulation 21(a)(1) above, who receive a reward in connection with services they provided as office holders in the Company or a company it controls.

Regulation 21(b): No rewards were paid to senior office holders with respect to the reported year that were not recognized in the statement of financial position for the reported year.

Details regarding compensation given to directors in accordance with the circular of the Government Companies Authority²

The compensation given to directors (except the Chairman of the Board of Directors) in 2014, which does not deviate from that which is customary³, amounted to NIS 1,113,258 adjusted to the CPI of December 2014, (the amount does not include VAT). The Compensation of the external directors was determined according to the classification of the Company, at the amounts specified in the Government Companies Regulations (Rules for Compensation and Expenses to an External Director in Government Companies) – 1994. As on the date of the report, the Company is classified in Class 10(1). The compensation of the external directors is determined according to the decisions of the general meeting of the Company, according to minimum amounts specified for a Company in the Company's class in the Companies Regulations (Rules for Compensation and Expenses to an External Director) – 2000, although these regulations allow a higher salary.

Regulation 21 a: The holding in the Company

The State of Israel is the holder of the Company as on the date of the report.

Regulation 22: Transactions with a Stakeholder

The State holds about 99.85% of the shares of the Company and is the controlling stakeholder in it. For details, to the best of the knowledge of the Company, concerning any transaction with the controlling shareholder or in whose approval the controlling shareholder has a personal interest, which the Company has executed during the reporting year or at a later date than the end of the reporting year, or which is still valid on the date of the report, including with respect to letters of guarantee that were provided by the State of Israel to secure the liabilities of the Company and loans provided by the State of Israel to the Company, see Note 33 to the financial statements

The Company received several loans directly from the State of Israel. In addition, the Company has received the State of Israel's guarantee for certain of its borrowings and debentures issued by the Company, as follows (supplement to Note 20 e to the Financial Statements):

a. Loans Guaranteed by the State of Israel

The State has provided guarantees to the benefit of third parties for the obligations of the Company to banking corporations in Israel and abroad. The total balance of these obligations as on December 31, 2014, amounted to approximately NIS 6,158.6 million, as detailed below:

1. A State guarantee to the benefit of Bank Hapoalim Ltd., in September 1996 with respect to an amount of up to NIS 600 million, according to the loan agreement entered in September 1996 between the Company and Bank Hapoalim Ltd., the Company received a credit line in six payments, during September through November 1996. The guarantee was approved on May 9, 1996, by the Board of Directors of the Company. The balance of the loan as on December 31, 2014, is approximately NIS 95.6 million. The guarantee is with respect to the unpaid balance. The Company is paying a commission at an annual rate of 0.2%, paid according to an amortization table.
2. A State guarantee to the benefit of CITIBANK in December 2005 with respect to an amount of up to USD 250 million, according to the loan agreement entered in December 2005 between the Company and CITIBANK in the U.S.A., insured by OPIC (an agency of the U.S.A. Government) for receiving credit of up to USD 250 million. The Company utilized approximately USD 222.8 million out of this amount during 2006 through 2007. The balance of the loan as on December 31, 2014, is approximately NIS 606.5 million. The guarantee is with respect to the unpaid balance. The Company paid, in advance, a guarantee commission of approximately USD 4.5 million.
3. A State guarantee for the debentures (series 24) and (series 25) that were issued under the Company prospectus of June 26, 2012, as amended on July 2, 2012. The nominal value of

² Circular 2013-5-1 of the Government Companies Authority "Accounting and Finances - Financial Statements"/

³ Namely, does not exceed the maximum sum under regulations 4 and 5 to the Companies Regulations (Rules for Compensation and Expenses to an External Director) – 2000, and does not exceed the amount stated according to regulation 7 of those regulations.

the debentures (series 24) and (series 25), revalued under the linkage terms as of December 31, 2014, is approximately NIS 2,036.5 million and NIS 1,020.0 million, respectively. For details see section 22.3 in the Report of the Business Affairs of the Corporation.

4. On June 18, 2013, the Audit Committee of the Board of Directors approved a State guarantee provided in June 2013 to the benefit of several banks in Israel, according to loan agreements that were signed in July 2013 between the Company and the banks, for providing credit to the Company in a total amount of NIS 2.4 billion. The loans balance as of December 31, 2014 is NIS 2.4 billion. According to the agreement that provides the guarantee that was signed between the Company and the State on this subject, the Company is paying the State a commission at an annual rate of 0.5% with regard to the provision of the guarantee.

b. **Loans borrowed directly from the State of Israel**

Bank	Loan	Loan Currency	Repayment Period		Outstanding Balance of Principal and Interest payable as of December 31, 2014	
			First repayment	Last repayment	Source currency, USD	NIS
State of Israel ⁴	\$800 mil.	USD	05/28/2002	05/25/2023	459,075,962.14	1,785,346,416.77
	\$ 250 mil.	USD	09/10/2000	09/10/2020	114,365,368.57	444,766,918.37
	\$ 180 mil.	USD	09/10/2003	09/10/2024	118,665,805.03	461,491,315.76
	\$ 270 mil.	USD	08/10/2005	08/10/2025	149,064,219.61	579,710,750.06
Total					841,171,355.35	3,271,315,400.96

The Company fulfills the payment terms of the aforementioned loans.

c. **Perpetual debentures issued to the State of Israel**

Pursuant to an arrangement with the Ministry of Finance, during the period from 1983 through 1985, the Company issued 9 series of perpetual debentures to the State of Israel for an aggregate consideration of NIS 15.5 million, which as on December 31, 2014 (nominal value plus interest payable and linkage to the CPI differences up to December 31, 2014), amounts to approximately NIS 2,534.0 million, as detailed in the following table ("Perpetual Debentures"). The perpetual debentures bear interest at a rate of 5% and 5.75% per annum, fully linked to the CPI. The principal amount of the perpetual debentures is not linked to the CPI. The perpetual debentures are secured by fixed charges on certain deposits of the Company, at a total nominal value of NIS 92 (Old Shekel 92,000), payable to the State of Israel. The perpetual debentures have priority only over non-guaranteed loans or loans guaranteed by a floating lien only in the amounts deposited in those charged deposits of the Company. As a result of their terms, the perpetual debentures were treated until December 31, 2005 as equity. Following the implementation of the IAS 22, commencing January 1, 2006, the classification of the perpetual debentures was changed to extended-term liability and the interest with respect to these perpetual debentures is charged as financing expenses in the statement of operations. For details, see Note 23 in the financial statements.

⁴ These loans were granted to the Company through the Israel Industrial Bank Ltd. In the 1990th the loans were endorsed to the benefit of the State through a signature on the check between the bank and the State in October 2009.

	Issued amount (in NIS)	Coupon	Outstanding Balance as of December 31, 2014
Series 1.....	342,940.69	5 %	222,361,621.71
Series 2.....	2,348,640.00	5.75 %	149,634,762.83
Series 3.....	702,538.71	5 %	348,964,487.19
Series 4.....	558,981.66	5 %	234,989,855.35
Series 5.....	834,185.81	5 %	352,199,967.91
Series 6.....	710,312.09	5 %	198,794,185.13
Series 7.....	759,335.64	5 %	210,765,258.21
Series 8.....	1,146,203.97	5 %	318,146,498.77
Series 9.....	8,064,000.00	5.75 %	526,076,437.28
Total	15,467,138.57		2,561,933,074.38

Regulation 24: Convertible shares and securities held by parties at interest in the corporation, in a subsidiary, and a related company, as close as possible to the date of the report

Name of Company	"Party at Interest" / Senior office holder	Type of Share	Nominal Value in NIS	No. of Shares	Proportion of Holding (%)		
					In Capital	In Voting Rights	In Appointment of Directors
<u>In the corporation</u>							
Israel Electric Corporation Ltd.	State of Israel	Ordinary	0.1	79,980,010	99.77	99.77	100.00
		Ordinary B	0.1	40,053,252	100.00	100.00	100.00
	Adv. David Yahav*	Ordinary	0.1	1	0	0	0
	Yiftah Ron-Tal	Ordinary	0.1	1	0	0	0
	Yitzhak "Ika" Yakhin**	Ordinary	0.1	1	0	0	0
	Adv. Nissim Hilu***	Ordinary	0.1	1	0	0	0
National Coal Supply Company Ltd.	Israel Electric Corporation	Ordinary A		909,999	100	100	100****
I.B.C. Israel Broadband Company (2013) Ltd.	Electric Corporation	Ordinary	-	400	40	40	40

* On December 31, 2014, Adv. David Yahav ended his term as legal advisor and secretary of the Company.

** On June 30, 2014, Mr. Yakhin ended his term as Deputy CEO Human Resources of the Company.

*** On January 1, 2015, Advocate Hilu was appointed substitute General Counsel and secretary of the Company, until the appointment of a permanent General Counsel.

**** According to the articles of the national Coal Supply Company, 3 directors are appointed from the public and 6 are appointed from among the employees of the Electric Company.

The Company has several other subsidiaries and second-tier subsidiaries in which office holders in the Company hold shares, in trust for the Electric Company, however, since the activities of these companies are immaterial to the operation of the corporation, no information about these holdings are presented.

Regulation 24A: Registered Capital, issued capital and convertible securities on the report date, see Note 24 to the Financial Statements.

Additionally, the company has no convertible securities.

Regulation 24B: Register of Shareholders of the Company

The list of shareholders of the Company, updated to the date of the report is presented below:

Shareholders - Israel

Name of Shareholder	Address	Ordinary Shares of NIS 0.1 each
Barlev Yehuda	3a Tolkovski St., Tel Aviv 69358	95
Birkenheim Alexander	Unknown address	8
Braker Yair	14 Rachel St., Haifa 34401	8
Goldstein Ben-Zion	20 Modiin St., Apt. 20, Qiryat Ono, 5502208	112
Goldstein Zvi Ran	22 Schwartz St., Entrance B, Apt. 3, Raanana	1
Gorodish Baruch	P.O.B 29, Sha'arei Tikva, Efraim 44810	1
Dr. Munny Eliyahu	3 Ha'Rimon St., Tel Aviv	95
DR. Yakov Razon	34 Shneur Zalman St., Herzliya 46364	1
Dr. Sharam Menachem	6 Freud St., Haifa 34753 (outdated address, deceased per returned post date)	116
Dvir Yosef	8 Giborei Gehtto Varsha St., Haifa	1
Davidzon - Gotter Sarah	Ahuzat Poleg, Building 621, Kibbutz Tel Itzhak 45805.	1
Giorah Dekel	63 Ha'Botnim St., Pardes Hanah - Karkur, 37013	15
Hershter Yakov Itzhak	57 Jabotinski St., #4 Tel Aviv 62748	572
Zelinger Dov	2 Ori St., Tel Aviv	95
Bank Leumi Listing Company Ltd.	2-4 Lilinblum St., Tel Aviv	68,569
Hazan Dov	4a Narkis St., Kiryat Yam A, 29500	95
Shapirah Hanah	16 Bat Yiftah, Zahalah, Tel Aviv 69932 (outdated address)	4
Adv. David Yahav	7/30 Alexander Creek St., Zur Itzhak	1
Yifrah Ziporah	Moshav Eitan 79580	954
Cohen Elza	5 Gotlib St., Tel Aviv (outdated address)	79
Gideon Katz	13 Shoham St., Tel Aviv, 69359	668
Leon Lahav	1 Hahsharat Ha'yishuv St., Haifa 34985	8
Eli Landau	63 Wingate St., Hezliyah Pituah 46752	1
Lazovski Gila (senior) Horev Ziporah	Palmah Zova, Yehuda Mountains 90870 (Lazovski) 6 Golomb St., Hod Ha'Sharon 45303 (Horev)	31
Meir David A.	Lonz St., Jerusalem (outdated address)	40
Holder of shares derived from bearer 6% preferred stock	Unknown address	801
Miara Pinhas	P.O.B 6967, Haifa 31068	8
Noiman David	14 David Shimoni St., Jerusalem	95
The Estate of the late Avraham Rutenberg	c/o Alexander Rutenberg, 13 Yeffe Nof St., Haifa, 34372	801
The Estate of the late Yakov Hushi	c/o Ruth Lynn, 1 Keller St., Haifa	8
The Estate of the late Yakov Spivakovski	c/o Tali Sharon, 2 Andersen St., Tel Aviv, 69107	477
The Estate of the late Yakov Peled	4 Maabarot St., Haifa 34461	8
The Estate of the late Lipshits Shmuel	c/o Marit Taub, 7 Neve Sh'anah St., Jerusalem (outdated address)	8
The Estate of the late Narkis Zuckerman	c/o Niza Shelef, 5 Rachel St., Haifa 34401	4
The Estate of the late Adv. Moritz Yithak	c/o Yael Moritz, 10 Berkovich St., Tel Aviv	887

The Estate of the late Rogover Arie	c/o Naomi Hernik, 69 Shderot Ben Gurion, Tel Aviv	8
The Estate of the late Figenbaum Rivka	18 Pevzner St., Haifa (outdated address)	601
Pnini Israel	53 Eshel St., Herzliyah	3,810
Panzer Natan	P.O.B 4241, Haifa 31042	92
Aminoff Perjulah and Latfula, by Ajajan Palti	4 Havazelet street, Jerusalem 94224 (outdated address)	1,650
Friedman Mordechai	26 Oscar Schiendler St, Tel Aviv	1
Rozenbaum M.	P.O.B 51 Rehovot (outdated address)	8
Shasha Avraham	8/7 Ha'tishim Veshalosh St., Petah Tikva	21,421
Shasha Amnon	32 Yahalom St., Neve Savion, Or Yehuda, 60405	4,768
Shasha Efraim Shai	8/7 Ha'tishim Veshalosh street, Petah Tikva	4,007
Shor Natan	1 Barak, Zahalah, Tel Aviv, 69933	64
Shamai Haim	11 Borochoy St., Givataim	1
Zarfati Shlomi	9 Ha'oren St., Moshav Magshimin	1
Goldstein Nir	8 Peretz St., Givat Shmuel	1
Zarfati David	7a Nurit St., Nes Ziona	1
Lasker Amos	13 Shechterman St., Ramat Efal	1
Ron-Tal Yiftah	22/3 Asher St., Modein, 71724	1
Shasha Elad	8/7 Ha'tishim Veshalosh street, Petah Tikva	4,005
Zeibert Efrat	11 Borochoy St., Givataim	4,006
Yitzhak "Ika" Yakhin	17 Levona St., Givat Zeev 90917	1
Nissim Hilu	7 Beiliss St., Haifa 3481407	1
Michal Yaakov	20 George Weiz St., Apt. 301, Tel-Aviv 6997712	4,768
Erez Seri	3 Harav Emanuel Davidashvili St., Qiryat-Ata	1
Dr. Yitzhak Laks	75A Macabim, St., Shoham 6083054	1
Yoram Hessel	17 Nissim Aloni St., Apt. 2401, Tel Aviv 62919	1
Total ordinary shares in Israel (private shareholders)		123,888
The State of Israel	Ministry of Finance, Jerusalem 91000	79,980,010
Total ordinary shares in Israel		80,103,898
The State of Israel Ordinary shares B		40,053,252
Total shares in Israel		120,157,150

Shareholders – Abroad (excluding GB)

Name of Shareholder	Address	Ordinary Shares of NIS 0.10 each
Estate of Simon and Matilda Budenstein	c/o Mr. Richard Budenstein, 1925 Welsh Road Box 3, Philadelphia, Pennsylvania 19115, U.S.A.	200
C&R Fund Inc.	45 East End Ave, N.Y., N.Y 10028 Apt 14G (Invalid address)	5340
Estate of Samuel Fireman dec'd	c/o Mrs. Ruth Fireman, 59 Kittredge Terrace, San Francisco, California 94118, U.S.A.	801
Mrs. Shari Friedman	c/o Stanley J. Friedman of Shereff Friedman, Hoffman & Goodman, 919 Third Avenue, New York 10022, U.S.A. (Invalid address)	384
Mr. Harry and Mrs. Fajga Gejerman	16461 40th St. Flushing, Long Island, New York 11365, U.S.A.	3204
Mrs. Morris and Mrs. Jenny Gejerman	16461 40th St. Flushing, Long Island, New York 11365, U.S.A.	1602
Mr. Harvey Goldberg	1041 Chestnut St. Valley Stream, N.Y., U.S.A (Invalid address)	801
Jacob Nachum Gutwirth	580 Fifth Avenue New York, N.Y., U.S.A. (Invalid address)	921
Mr. Martin and Mrs. Kay Harrison	2725 Malcolm Ave., Los Angeles, CA. 90064, U.S.A. (Invalid address)	1907
Mrs. Kay Harrison	2725 Malcolm Ave., Los Angeles, CA. 90064, U.S.A.	1907
Mr. Jeffrey K., Israel	3357 NW 101 Ave. Sunrise, Florida 33351, U.S.A.	858
Mr. Fred and Mrs. Sara Levi	639 East Moore Blvd. Columbus 9, Ohio, U.S.A.	401
Mr. Elliot H. Lipschultz	816 Cedar Lane, Northbrook, Illinois 60062, U.S.A.	601
Mr. Benjamin Feld	P.O. Box 272124, Houston, Texas, TX 77277-2124, U.S.A. (Invalid address)	801
Mr. I. Meltzer	4682 408th Street, W. Quartz, Hill Calif. 93536-2120, U.S.A.	954
Namen Namenson	1674 Mac Combs Road, Bronx N.Y.C., U.S.A. (Invalid address)	801
Mrs. Anne Oksenberg Fridman	993 Park Ave., Apt. 10S, New York, NY 10028, U.S.A.	921
Shimon Piaskowsky and Ruth Piaskowsky	42 Verde Vistra Drive, Thousand Oaks, Calif. 91360, U.S.A.	401
Prudential – Bache Securities Inc.	c/o Prudential Securities Inc - One New York Plaza, 9th Floor, New York, N.Y. 10292, U.S.A., Attn: Dan Monaco FVP	5722
Chaim Schitlowsky	c/o Amalgamated Bank of New York, 11-15 Union Square, N.Y., U.S.A.	8
Miss Liza Tausig	46 Arleigh Road, Great Neck, N.Y. 11021, U.S.A. (Invalid address)	401
Mr. Nachim Torczyner	c/o Harry Torczyner, 146 W 57, St. New York, N.Y. 10019-3301, U.S.A.	1065
Jacques Buchenhultz	634 Esmeralda, Buenos Aires, ARGENTINE	88
Simon Dattner	60 Vestingstraat, Antwerp, BELGIUM (Invalid address)	344
Gregoire Karlin	86 Rue Due Pelican, Antwerp, BELGIUM (Invalid address)	512
Michel Karlin	86 Rue Due Pelican, Antwerp, BELGIUM (Invalid address)	512
Stanislas Van Mierlo	44 Stefanie St. Antwerp, BELGIUM (Invalid address)	144
Max Rosshandler	20 Rue Van Lerious, Antwerp, BELGIUM	88
Miss Judith Stern	22 Avenue Helene, Antwerp, BELGIUM	88
Mrs. Maryze Juster	72 Blvd. Exelmans, Paris 75016, FRANCE	115
Isaac Naiditch	30 Avenue Marceau, Paris, FRANCE	432
Total abroad (Excluding GB)		32,324

Shareholders – Abroad (GB)

Name of Shareholder	Address	Ordinary Shares of NIS 0.10 each
Ohad Egoz, Adv.	1a Pinhas Rosen St., Tel Aviv 69512 (Amnon Egoz) For dividends: Flat 82, Maida Vale 33, London W9 1AJ, UK	14,477
Barclays Nominees (Branches) Ltd.	1 Churchill palace, London E14 5HP	1162
John William Watkinson Buckley, Esq.	4A Upper Park Road, Hampstead, London NW3 2UD	402
Arturo Dolcetta	c/o National Westminster Bank Ltd., 64 Knightsbridge, London SW1	801
Carlo Dolcetta	c/o General Manager Aircosse Ltd., Park Road, Waterford, Ireland	801
Roger Goodison. Esq.	36 Deer Park place, Sheffield S6 5ND	50
Thomas Hale, Esq.	37 Thrupps Lane Hersham Walton on Thames KT12 4LX	50
Mr. Jeremy Philip Hayes, and Mr. John Allan Hayes	19 Goodwyn Avenue, London NW7 3RJ	95
Robert Lebozer, Esq.	23 Park View, Winchmore Hill, London N.21.1QS, England	296
Dr. Israel Lifshitz	Barclays Bank International Ltd., P.O.ox 115, 168 Fenchurch Street, London EC3P 3HP	256
Rev. R. Nevin Lyons and William G. Wilson. Esq.	1. 813 Lisburn Road, Balmoral, Belfast. 2. 29 Wellington Place, Belfast	1,049
Midland Bank (Overseas) Nominees Limited	60 Gracechurch Street, London E.C.3	2,099
Vera Elizabeth Mire	116 Walm Lane, London NW2 4RT	344
Namen Namenson, Esq.	c/o White Weld & Co. Winchester, House, London Wall, London EC2	401
Natwest Nominees Ltd	For Dividends – C/o National Westminster Bank Crawley The Boulevard, 16 The Boulevard Crawley, West Sussex RH10. For letters – National Westminster Bank PLC, 41 Lothbury, London EC2P 2BP	128
Kenneth Martin Nicol, Esq.	1 Shepparn Way, Minchinhampton, Stroud, Gloucestershire	801
Mr. Shirleyh Horacio Phillips	1 Fayland Avenue Streatham Park, London SW16 1TB	128
Rensburg Client Nominees Ltd.	100 Old Hall St., Liverpool L3 9AB	250
Antea Deryn Ennion	Four Walls, Dunstan Lane, Burton, South Wirral Cheshire L64 8TG	2,098
George Rex Shaw-Twilley, Esq.	4 Buckland Walk, Newport, Shropshire TF10 7NQ	50
Sale and District Hebrew Congregation	Hesketh Road, Sale, Cheshire	401
Gordon Taylor, Esq.	17 Colney Lane, Cringleford, Norwich Norfolk NR4 7RF	521
Shelagh M. Thomlinson	27 Drayson Mews, London W8 4LY, UK	144
Mrs. Sybil Treig	22 Denbigh Road, London W13	601
James Wilson, L.R.A.M.	25 Bourenmouth Korn, Blackpool South, Lancs.	801
Estate of Miss Rosemary Patricia Wingfield dec'd	102 Tachbrook Street, London SW1V 2 ND	300
Miss Susan Linda Holingsworth	142 Wilkinson Street, Whitemoor, Nottingham	10
Dr. Thomas Trefor Jones	Dolydd, Ruthin, North Wales (Invalid address)	80
Thomas Andrew Maguire	Munville House, Lisnaskea, Co., Fermanagh, North Ireland (Invalid address)	40

Name of Shareholder	Address	Ordinary Shares of NIS 0.10 each
Mrs. M.I. Maton, Executrix for Lady M.B. Onslow, dec'd	Grovely, Northampton, Nr. Reading, Berks (Invalid address)	48
Miss Marie Diana Rogers	35 Anhalt Road, Battensea London S.W.11 (Invalid address)	80
Total GB		28,764
Total Shares		120,218,238

Regulation 25 A: Registered Address

Address: : 1 Netiv Ha'Or Street, P.O. Box 10, Haifa 3100001

Telephone : 04-8184700

Fax : 04-8184710

Company's website : www.israel-electric.co.il

e-mail : UBZ1D@IEC.CO.IL

Regulation 26: Board members of corporation

The following are particulars of the board members:

1. Major General (Reserve Duty) Yiftah Ron-Tal

Name: Yiftah Ron-Tal

Identity card no.: 054067939

Date of birth: April 15, 1956

Address: 22/3 Asher St., Modiin

Citizenship: Israel

Membership on board committees: Chairman of the Board of Directors, Chairman of the Strategy, Structural Change and Image Committee, Sub-committee for Regional Cooperation and Business Development, Marketing and Service Committee, Human Resources and Organization Committee, Budget, Financial and Risks Management Committee, Agreements and Assets Committee, Corporate Liability and Regulation Committee.

External director: No.

Has accounting or financial expertise and/or professional competence: Has professional competence..

Independent Director: No.

Is he an employee of the company, of a subsidiary, of an Affiliated Company, of a stakeholder? No

Date of appointment: Appointed as a director on September 15, 2010 and appointed as the Chairman of the Board of Directors on October 7, 2010. The term of office of Mr. Ron-Tal as director was renewed on September 30, 2013, and his term of office as Chairman of the Board of Directors of the Company was renewed on October 2, 2013.

Education: L.L.B in Law from the Hebrew University, E.M.B.A. (certified) from Bar Ilan University.

Other Education and Professional Certificates: Graduate of an Advanced Systems Course in the National Security College.

Is he a relative of another stakeholder in the company? No

Does the company regard him as an accounting and financial expert for purposes of meeting the minimum number determined by the board of directors: No.

His employment over the past five (5) years: CEO and Chairman, R-Ticam Ltd that was owned by him (2006-2010), Chairman of the Board of Israel Ports Development and Assets Company (2007-2010), acts as a member of the Friends of Meir Medical Center in Kfar Saba, a member of the Board of trustees of the non-profit organization of the University of Ariel, Chairman of the Board of Trustees of the pre-army preparatory programs, chairman of the Committee of Friends of the "AleI Siach" non-profit organization, a member of the Committee for Appointing Legal Advisors to the Companies Authority, a member of the Referees Organization of the Football Association, Chairman of the Steering Committee of the Forum of Leading Companies of the Economy in the field of infrastructure, with emphasis on energy and water - Academic College, Netanya, Chairman of the presidium of the "Special in Uniform" project of the "Lend a Hand to a Special Child" non-profit organization, member of the Board of Trustees of the Museum of the Righteous Among the Nations and the Educational Heritage Center to commemorate their actions. Waiting for approval as member of the presidium of the CEO forum. **List of corporations in which he serves as a director:** None.

2. **Rochelle Don-Yechiya (Gurevich)**

Name: Rochelle Don-Yechiya (Gurevich)

Identity card no.: 012603403

Date of birth: February 4, 1952

Address: 24 Yoni Netanyahu Street, Givat Shmuel

Citizenship: Israel, U.S.A.

Membership on board committees: Chairperson of Agreements and Assets Committee, Strategy Organizational Restructuring and Image Committee; Human Resources and Organization Committee, Corporate Liability and Regulation Committee; Sub-committee for Regional Cooperation and Business Development.

External director: No.

Independent Director: No.

Has accounting or financial expertise and/or professional competence: Has professional competence.

Is she an employee of the company, of a subsidiary, of an Affiliated Company, of a stakeholder? No.

Date of appointment: February 20, 2013, (also served as a director from October 1998 to October 2001, from January 2002 to January 2005, from January 2005 to January 2008, and from January 2010 to January 2013).

Education: B.A. Linguistics, B.A. Economics, L.L.B Law, L.L.M Law, Tel Aviv University. Holds a Mediator's certificate from the National Mediation Institute of the Israel Bar Association; graduate of the Reorganization of a Failing Company Course, Bar Ilan University.

Is she a relative of another party at interest in the company? No.

Does the company regard her as an accounting and financial expert for purposes of meeting the minimum number determined by the board of directors: No.

Her employment over the past five (5) years: Owns a law and mediation office; in Israel, member of management of the late Yaakov and Ida Limar Foundation.

List of corporations in which she serves as a director: Channel 2 News Company of the Israeli Television.

3. **Yaffa Vigodsky**

Name: Yaffa Vigodsky

Identity card no.: 007428253

Year of birth: June 17, 1946

Address: 3 Sinai St., Ramat Hasharon

Citizenship: Israel

Membership on board committees: Chairperson Human Resources and Organization committee; Agreements and Assets committee; Strategy, Structural Change and Image Committee, Compensation Committee.

External director: No.

Independent director: No.

Has accounting and financial expertise and/or professional competence: Has professional competence.

Is she an employee of the company, of a subsidiary, of an Affiliated Company, of a stakeholder? No.

Date of appointment: February 18, 2007, (reappointed on February 21, 2010, on September 15, 2011 and on October 29, 2014).

Education: BA General and Educational Administration, MA Educational Administration, Tel Aviv University.

Is she a relative of another party at interest in the company? No.

Does the company regard her as an accounting and financial expert for purposes of meeting the minimum number determined by the board of directors: No.

Her employment over the past five years: General Manager of Educational Television, member of the National Technological Committee, and Chairperson of the Fund for Persons with Eroding Professions, Chairperson of the "Ma'agalim" Fund.

List of corporations in which she serves as a director: AMAL network.

4. **Professor Yehuda Adler**

Name: Yehuda Adler

Identity card no.: 057962011

Date of birth: November 21, 1962

Address: 17 Hashehafim St., Ra'anana.

Citizenship: Israel

Membership on board committees: Chairman of Subcommittee for Regional Cooperation and Business Development, Marketing and Service; Strategy, Restructuring and Image Committee; Committee of Human Resources and Organization.

External director: No.

Independent director: No.

Has accounting and financial expertise and/or professional competence: Has professional competence.

Is he an employee of the company, of a subsidiary, of an Affiliated Company, of a stakeholder? No.

Date of appointment: October 28, 2013.

Education: M.D., The Hebrew University – Jerusalem, Professor of Cardiology - Tel Aviv University, Master's Degree in Health Systems Administration from the University of Tel Aviv.

Is he a relative of another party at interest in the company? No.

Does the company regard him as an accounting and financial expert for purposes of meeting the minimum number determined by the board of directors: No.

His employment over the past five (5) years: Chairman of Practice Committee - Sheba Tel Hashomer, Head of Sheba Tel-Hashomer Talpiot; Head of Misgav Ledech Hospital, Jerusalem; Chairman of the Administration for Promoting Academy and Research in the Galilee Hospitals..

List of corporations in which he serves as a director: Aposense Ltd.

5. **Gideon Frank**

Name: Gideon Frank

Identity card no.: 07570237

Date of birth: November 13, 1943

Address: Beit Itzhak Sha'ar Hefer 42920 PO Box 8109

Citizenship: Israel

Membership on board committees: Corporate Responsibility and Regulation Committee; Audit Committee; Strategy Organizational Restructuring and Image Committee; Subcommittee for Regional Cooperation and Business Development, Marketing and Service.

External director: No.

Independent director: No.

Has accounting and financial expertise and/or professional competence: Has professional competence.

Is he an employee of the company, of a subsidiary, of an Affiliated Company, of a stakeholder? No.

Date of appointment: Served as director of the Company from January 6, 2010 until November 30, 2012. The appointment was renewed on December 26, 2012.

Education: B.Sc. Mechanical Engineering, M.Sc. Nuclear Sciences from the Technion, Israel Institute of Technology.

Is he a relative of another party at interest in the company? No

Does the company regard him as an accounting and financial expert for purposes of meeting the minimum number determined by the board of directors: No.

His employment over the past five (5) years: Advisor to the Atomic Energy Commission; lecturer, Tel Aviv University, Master's Degree, Security Studies; Lecturer in the course for outstanding students in the School of Governance, Strategy and Diplomacy of the Interdisciplinary Center Herzliya; Member of the Board of Trustees of Afeka, the Tel-Aviv College of Academic Engineering.

List of corporations in which he serves as a director: Van Leer Group Foundation, Netherlands; The Managing Committee of the Board of Directors of the Technion; CRECOR BV Netherlands; (Subsidiary of Van-Leer Foundation), FundNuclear Threat Initiative (USA).

6. **Dr. Ziv Reich**

Name: Dr. Ziv Reich

Identity card no.: 25078544

Date of birth: December 4, 1972

Address: 1 Eliyahu Berlin, Tel Aviv

Citizenship: Israel

Membership on board committees: Chairman of Committee for Reviewing the Financial Statements; Audit Committee; Agreements and Assets Committee; Rewards Committee.

External director: Yes.

Independent director: No.

Has accounting and financial expertise and/or professional Competence: Has accounting and financial expertise.

Is he an employee of the company, of a subsidiary, of an Affiliated Company, of a stakeholder? No

Date of appointment: December 2, 2009, and reappointed on December 2, 2012.

Education: B.A. in Business Management specializing in Accounting and Financing from the College of Management, Tel Aviv; M.A in Political Science and Internal Auditing, Bar Ilan University; Ph.D. in Business Management, Warnborough University, London.

Is he a relative of another party at interest in the corporation? No.

Does the company regard him as an accounting and financial expert for purposes of meeting the minimum number determined by the board of directors: Yes.

His employment over the past five (5) years: Dean of School of Insurance in Netanya Academic College; Academic lecturer, staff member and leader of the Accounting Program in Netanya Academic College; Chairman of the Committee of the Israel Postal Rates and Bank Hadoar Rates.

List of corporations in which he serves as a director: Chairman of the Investments Committee of Shlomo Insurance Company; Chairman of Investments Committee in the Advance Study Fund for Pharmacists.

7. Arie Yehuda Rapoport

Name: Arie Rapoport

Identity card no.: 052603081

Date of birth: June 29, 1954

Address: 17 Yitzhak Sade St., Tel Aviv

Citizenship: Israel

Membership on board committees: Chairman of the Rewards Committee; Chairman of the Audit Committee; Strategy, Organizational Restructuring and Image Committee; Budget, Financial Management and Risk Management Committee; Committee for Reviewing the Financial Statements.

External director: Yes.

Independent director: No.

Has accounting and financial expertise and/or professional competence: Has accounting and financial expertise.

Is he an employee of the company, of a subsidiary, of an Affiliated Company, of a stakeholder? No.

Date of appointment: August 2, 2011, and reappointed on August 14, 2014.

Education: B.A. in Economics and Accounting, Tel Aviv University.

Is he a relative of another party at interest in the company? No.

Does the company regard him as an accounting and financial expert for purposes of meeting the minimum number determined by the board of directors: Yes.

His employment over the past five (5) years: Accountant at Rapoport & Co., Accountants

List of corporations in which he serves as a director: Rapoport & Co., Auditors, Arie Rapoport Investments and Management Ltd., Arie Rapoport Trust Company Ltd., First Global Finance (2008) Ltd., TMG Trade Finance (2008) Ltd., Plasma Ltd., ATP Trade Finance Ltd., Raja Finance Ltd., Ragua VeYafe Ltd., Allium Medical Inc., Newgrand Properties Ltd., , Patrice Services Ltd., KSR Properties Ltd., Variety Jerusalem Club Fund Ltd., Variety Israel (registered society), Chairman of Moadon Yaakov Society (registered society), Arthur Rubinstein society.

8. Dr. Ofir Bashan

Name: Ofir Bashan

Identity card no.: 25342156

Date of birth: June 20, 1973

Address: 2/12 professor Israel Uman St., Rehovot

Citizenship: Israel

Membership on board committees: Chairman of Budget, Financial Management and Risk Management Committee; Committee for Reviewing Financial Statements; Corporate Responsibility and Regulation Committee; Agreements and Assets Committee.

External director: No.

Independent director: No.

Has accounting and financial expertise and/or professional competence: Has accounting and financial expertise and professional competence.

Is he an employee of the company, of a subsidiary, of an Affiliated Company, of a stakeholder? No.

Date of appointment: October 14, 2012.

Education: B.Sc. in Industrial Engineering and Management (specialization in production) from the University of Coventry, England; MBA in Business Administration, specializing in financing, from the Herriot Watt University, Ireland; Ph.D. Economics from the IUBL University of California.

Is he a relative of another party at interest in the company? No.

Does the company regard him as an accounting and financial expert for purposes of meeting the minimum number determined by the board of directors: Yes.

His employment over the past five (5) years: Lecturer in Economics, Ben-Gurion University; Lecturer in Economics at the Jerusalem Hadassah College; Court arbitrator and expert; expert on behalf of ICC (international institute for arbitration).

List of corporations in which he serves as a director: director in the "Adopt a Child's Heart" non-profit organization at the Wolfson Hospital; director in the Association of Publicly Traded Companies.

9. **Raik Abu-Reish**

Name: Raik Abu-Reish

Identity card no.: 024784225.

Date of birth: February 23, 1970.

Address: P.O.B. 804, Yarka 24967.

Citizenship: Israel.

Membership on board committees: Human Resources and Organization Committee; Budget, Financial Management and Risk Management Committee; Agreements and Assets Committee; Committee for Regional Cooperation and Business Development, Marketing and Service.

External director: No.

Independent director: No.

Has accounting and financial expertise: and/or professional competence: Has accounting and financial expertise and professional competence.

Is he an employee of the company, of a subsidiary, of an Affiliated Company, of a stakeholder? No.

Date of appointment: May 3, 2010 until May 2, 2013. Reappointed on March 13, 2014.

Education: B.A. (graduate) Economics Accounting from the Hebrew University; L.L.B. (graduate) Law, Sha'arei Mishpat College.

Is he a relative of another party at interest in the company? No.

Does the company regard him as an accounting and financial expert for purposes of meeting the minimum number determined by the board of directors: Yes.

His employment over the past five (5) years: Owner of an accounting firm.

List of corporations in which he serves as a director: Zim.

Regulation 26A: Senior position holders in the corporation

The following are particulars of the current senior officeholders:

1. **Eliyahu Glickman**

Name: Eliyahu Glickman

Identity card no. : 057154478.

Date of birth: August 7, 1961.

Date on which he began his term: April 14, 2011.

Position in the company: CEO.

Is he a relative of another senior officeholder or a party at interest? No.

Education: Graduate of a course in International Management, Georgetown University, M.Sc., Financial Management, Graduate School of the American Navy, California, USA.

Business experience over the past five (5) years: VP Customers and Vice CEO "Partner Communication Ltd.".

Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company: None.

Pursuant to the definition of a stakeholder as stated in section 1 of the Securities Law, the CEO is a stakeholder in the Company, by force of his position as the CEO.

2. **Adrian Bianu**

Name: Adrian Bianu

Identity card no. 016830648

Date of birth: August 29, 1948.

Date on which he began his term: December 1, 2003.

Position in the company: VP Corporate Sustainability and Risk Administration.

Is he a relative of another senior officeholder or a party at interest? No.

Education: BA in electrical engineering from Bucharest Polytechnic (Romania), M.Sc. and DSc. in electrical engineering, Technion - Israel Institute of Technology.

Business experience over the past five (5) years: Deputy CEO, Strategic Resources.

Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company: Director in enterprises of the Company as part of the Technological Hothouse (see details in section 12 in the Description of the Company's Business Affairs).

Pursuant to the definition of a "stakeholder" as stated in section 1 of the Securities Law, the officer is not a stakeholder in the Company.

3. **Nissim Hilu**

Name: Nissim Hilu

Identity card no. 005868237

Date of birth: September 17, 1949.

Date on which he began his term: January 1, 2015.

Position in the corporation: Substitute legal advisor and secretary of the company and its subsidiaries.

Is he a relative of another senior officeholder or a party at interest? No.

Education: L.L.B in Law, the Hebrew University.

Business experience over the past five (5) years: Deputy legal advisor of the Company since 2000 and substitute legal advisor from January 1, 2015.

Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company: None

4. **Oren Helman**

Name: Oren Helman

Identity card no. 024163875

Date of birth: November 3, 1968.

Date on which he began his term: December 15, 2011.

Position in the corporation: VP Regulation, Government Relations and Communications.

Is he a relative of another senior officeholder or a party at interest? No.

Education: BA in Political Science, and MA in Public Policy, Tel Aviv University.

Business experience over the past five (5) years: Manager of the Government Press Office in the Prime Minister's Office; Strategy Consultant, "Goren Amir".

Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company: Director of the Coal Company.

Pursuant to the definition of a "stakeholder" as stated in section 1 of the Securities Law, the officer is not a stakeholder in the Company.

5. **Amir Livne**

Name: Amir Livne

Identity card no.: 23725740

Date of birth: April 19, 1968

Date on which he began his term: April 14, 2011

Position in the corporation: Head of the Organizational Restructuring Administration of the Company and Senior Aide to the CEO (in the status of a division manager).

Is he a relative of another senior officeholder or a party at interest? No.

Education: L.L.B Law, L.L.M Law, Haifa University.

Business experience over the past five (5) years: Assistant to the CEO of the Company.

Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company: None.

Pursuant to the definition of a stakeholder as stated in section 1 of the Securities Law, the officer is not a "stakeholder" in the Company.

6. **Mr. Yitzhak Balmas**

Name: Yitzhak Balmas

Identity card no.: 058874496

Date of birth: July 25, 1964

Date on which he began his term: February 1, 2013

Position in the corporation: Appointed on January 1, 2015 as Deputy CEO Customers instead of his position as VP Generation and Transmission.

Is he a relative of another senior officeholder or a party at interest? No.

Education: B.Sc. Electrical Engineering and Computers Ben Gurion University, M.E Mechanical Engineering and Business Management, Technion, Haifa.

Business experience over the past five (5) years: Engineering Planning Division Manager (from June 2007 to May 2012), Acting VP Engineering projects (from May 2012 to February 2013), VP Generation and Transmission (March 2013 to December 2014).

Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company: None.

Pursuant to the definition of a stakeholder as stated in section 1 of the Securities Law, the officer is not a "stakeholder" in the Company.

7. **Ron Weiss**

Name: Ron Weiss

Identity card no.: 059611756.

Date of birth: April 3, 1965.

Date on which he began his term: February 1, 2013.

Position in the corporation: VP Engineering projects.

Is he a relative of another senior officeholder or a party at interest? No.

Education: B.Sc. Electrical Engineering, Ben-Gurion University, the Negev; M.Sc. Electrical Engineering, the Technion, Haifa.

Business experience over the past five (5) years: VP technical issues in the Transmission and Transformer Division (from July 2001 to November 2010); Head of Transmission and Transformer Division (from November 2010 to February 2013).

Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company: None.

Pursuant to the definition of a stakeholder as stated in section 1 of the Securities Law, the officer is not a "stakeholder" in the Company.

8. **David Elmakias**

Name: David Elmakias

Identity card no.: 63565139

Date of birth: August 1, 1950

Date on which he began his term: December 16, 2013

Position in the company: Senior VP Planning, Development and Technology Division

Is he a relative of another senior officeholder or a party at interest? No.

Education: bachelors and Master's Degree in Electrical Engineering, the Technion Institute of Technology, and PhD in Electrical Engineering, Tel Aviv University.

Business experience over the past five years: Head of Division for Planning, Development and Technology (from April 2003 to December 2013).

Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company: None.

Pursuant to the definition of a stakeholder as stated in section 1 of the Securities Law, the officer is not a "stakeholder" in the Company.

9. Tamir Polikar

Name: Tamir Polikar

Identity card no.: 59749408

Date of birth: August 14, 1965

Date on which he began his term: April 28, 2013

Position in the company: VP Finances and Economics

Is he a relative of another senior officeholder or a party at interest? No.

Education: accountant, Bachelor's Degree in Accounting and Business Administration and M.B.A.

Business experience over the past five years: Business Manager at Better Place Israel Company between the years 2012-2013, Consultation and Investments between 2011-2012, CEO Sonol 2007-2010.

Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company: None.

Pursuant to the definition of a stakeholder as stated in section 1 of the Securities Law, the officer is not a "stakeholder" in the Company.

10. Yossi Shenk

Name: Yossi Shenk

Identity card no.: 69363208

Date of birth: October 24, 1951.

Date on which he began his term: August 1, 2013

Position in the company: VP Teleprocessing.

Is he a relative of another senior officeholder or a party at interest? No.

Education: Bachelor of practical Computer Engineering at the Technion and Bachelor of Computer Sciences at the Israeli branch of the American Champlain College and M.B.A. at the Derby College.

Business experience over the past five years: Head of Information Systems and Teleprocessing Division (from April 2009 to August 2013).

Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company: None.

Pursuant to the definition of a stakeholder as stated in section 1 of the Securities Law, the officer is not a "stakeholder" in the Company.

11. Amit Oberkowitz

Name: Amit Oberkowitz

Identity card no.: 059030015

Date of birth: August 19, 1964.

Date on which he began his term: July 10, 2014

Position in the company: Head of Human Resources Division.

Is he a relative of another senior officeholder or a party at interest? No.

Education: Certified, Business Administration, University of Derby; Certified, Political Science, Tel Aviv University.

Business experience over the past five years: Deputy Head of Human Resources Division for 3 years; Head of Department of Administration of the Gas Turbine Power Stations in the Generation Division of the Company for 9 years.

Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company: None.

12. Shimon Fischer

Name: Shimon Fischer

Identity card no.: 056412463

Date of birth: March 27, 1960.

Date on which he began his term: January 1, 2015

Position in the company: Substitute VP Generation and Energy.

Is he a relative of another senior officeholder or a party at interest? No.

Education: Graduate of Electrical Engineering at the Technion, M.B.A. in Business Administration at the Netanya College.

Business experience over the past five years: Head of Generation Division; Head of the Haifa Power Station; Electrical Engineer and Deputy Head of the Haifa Power Station.

Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company: None.

13. Nitza Rogozinski

Name: Nitza Rogozinski

Identity card no. : 025487950.

Date of birth: June 10, 1973.

Date on which she began her term: April 27, 2014.

Position in the company: Internal Auditor.

Is she a relative of another senior officeholder or a party at interest? No.

Education: L.L.M. (certified) Law from the Bar-Ilan University; Graduate of Business Administration - the College of Management Academic Studies; Accountant; Certified Internal Auditor (CIA).

Business experience over the past five years: Chief Internal Auditor - Amitim Senior Pension Funds; Head of Internal Auditing Division - Amitim Senior Pension Funds.

Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company: None.

Regulations 26(b): Independent Authorized Signatories as Appointed by the Company:

Pursuant to the decision of the Board of Directors on the subject of signature authorities and in accordance with the Company's procedure on the subject, the Company does not have independent approved signatories, as this term is defined in the Securities Law - 1968.

Regulation 27: Accountant of the corporation

Brightman Almagor Zohar and Co., CPAs - 5 Maalei HaShichrur St., Haifa.

Regulation 28: Changes in memorandum or articles of association

No changes were made to the memorandum or articles of association of the Company during the reporting period.

Regulation 29(C): Decisions of a special shareholders meeting

For decisions made by the special general shareholders meeting on August 14, 2014, see immediate report of August 14, 2014 (reference No. 2014-01-133998).

Regulation 29A (4): Exemption, insurance, or liability for indemnity in respect of officeholders in effect on the date of this report

a. Insurance for Directors and Office Holders

According to the compensation policy approved by the compensation committee on December 19, 2013, by the Board of Directors of the Company on December 26, 2013, and by the general meeting on January 9, 2014, the Company purchased the following insurance policies:

1. Liability insurance for directors and office holders for a period of three years starting from January 16, 2015 and until January 15, 2018, inclusive.
2. Third party liability insurance - (the directors and office holders are part of the insured under this policy) as customary in the Company.
3. Personal accident insurance - the insurer's liability limit is up to NIS 400,000 without deductible. The Company pays a premium in the amount of NIS 144 a year for each director.

For details of the terms of the policies mentioned above see the immediate report of the Company of January 9, 2014 (reference no.: 2014-01-011125).

b. Indemnification of Members of the Board of Directors and Officers

For details on issuing indemnification letters to officers who served in the Company on the publication date of the financial statements as on June 30, 2009, regarding a liability or expense related to the restatement of these financial statements, and for details on indemnification letters to directors, CEO of the Company, CFO and the legal advisor and Company secretary, whose issue was approved by the general meeting of shareholders on November 22, 2012, see Note 33 f to the financial statements.

Eliyahu Glickman
Chief Executive Officer

Dr. Ziv Reich
Chairman of the Committee for
Reviewing the Financial Statements

Yiftah Ron-Tal
Chairman of the Board of Directors

Date of approval of the report: March 24, 2015.

CORPORATE GOVERNANCE QUESTIONNAIRE¹

INDEPENDENCE OF THE BOARD OF DIRECTORS				
			Correct	Not Correct
1.		Throughout the reporting year two or more external directors served in the corporation. <i>A response of "correct" may be given on this question if the period of time during which two external directors did not serve does not exceed 90 days, as provided in Section 363A.(b)(10) of the Companies Law. However, whatever the response (correct/not correct), the period (in days) during which two or more external directors did not serve in the reporting year (including also a period of service that was approved retroactively) must be indicated, separating between the different external directors:</i> Director A: <u>Mr. Ziv Reich</u> Director B: <u>Mr. Arie Rapoport (except for 1-14.8.14)</u> Number of external directors serving in the corporation as of the date of publication of this questionnaire: <u>2</u>	✓	
2.		- The proportion² of independent directors³ serving in the corporation as of the date of publication of this questionnaire: <u>2/9</u> The proportion of independent directors set in the articles⁴ of the corporation⁵: <u>0</u> ☐ Not relevant (there is no article set in the articles)	—	—

¹ Published as part of proposed legislation to improve the statements on March 16, 2014.

² “Proportion” in this questionnaire - a certain number out of the total., 3/8 .

³ Including “external directors” as defined in the Companies Law.

⁴ Regarding this question - “Articles” including under a specific provision of law that applies to the corporation (for example, in a banking corporation - the directives of the supervisor of banks).

⁵ A debenture company is not required to answer this section.

INDEPENDENCE OF THE BOARD OF DIRECTORS

			Correct	Not Correct
3.		During the reporting year an examination was conducted with the external directors (and the independent directors) and it was found that they had complied in the reporting year with the provision of Section 240(b) and (f) of the Companies Law regarding the absence of a relation of the external (and independent) directors serving in the corporation and that they satisfy the conditions for service as an external (or independent) director.	✓	
4.		All the directors who served in the corporation in the course of the reporting year are <u>not</u> subordinate ⁶ to the CEO, directly or indirectly (other than a director representative of employees, if the corporation has an employees' representative body). If your response is "not correct" (i.e. any director is subordinate to the CEO, as stated) – indicate the proportion of directors who did <u>not</u> satisfy this restriction: _____	✓	
5.		All the directors that announced the existence of a personal interest they have in an approval of a transaction on the agenda of the meeting, were not present at the meeting and did not vote as stated (other than a discussion and/or vote in circumstances as provided in Section 278(b) of the Companies Law): If your answer is "Not correct"- Was it for the purpose of presenting a certain subject by him pursuant to the provisions of the end of section 278 (a): ☐ Yes. ☐ No. (Mark an X in the appropriate box). The proportion of meetings in which directors as stated participated in the discussion and/or participated in the vote except under circumstances as stated in subsection :a _____.	✓	

⁶ Regarding this question - the service of a director in a held corporation that is controlled by the corporation will not be considered "subordination", however, the service of a director in a corporation who is serving as an office holder (except as director) and/or is working in a corporation controlled by the corporation will be considered as "subordination" for purposes of this question.

INDEPENDENCE OF THE BOARD OF DIRECTORS

			Correct	Not Correct
6.		A controlling shareholder (including his relative and/or anyone acting on his behalf), who is <u>not</u> a director or other senior officer in the corporation, <u>was not present</u> at meetings of the board of directors that were held in the reporting year. If your response is "not correct" (i.e. the controlling shareholder and/or his relative and/or anyone acting on his behalf who is not a board member and/or senior officer in the corporation, was present at meetings of the board of directors as stated) – indicate the following details regarding the presence of each additional person at such meetings of the board of directors: Identity: _____. Position in the corporation (if exists): _____. Details of the relation to the controlling shareholder (if the person present was not the controlling shareholder himself): _____. Was it for the purpose of presenting a particular subject by him: ☒ Yes ☒ No <i>(Mark an X in the appropriate box).</i> Rate of his presence⁷ at meetings of the board of directors held in the reporting year for presenting a certain subject by him: ____, Other presence: _____. ☐ Not relevant (the corporation has no controlling shareholder).	✓	

⁷ While separating between the controlling shareholder and his relative and/or anyone on his behalf.

DIRECTORS' COMPETENCE AND QUALIFICATIONS

			Correct	Not Correct
7.		The corporation's articles do <u>not</u> include a provision that restricts the possibility of immediate termination of the service of all the directors in the corporation who are not external directors (<i>in this regard – a determination by a simple majority is not considered a restriction</i>) ⁸ . If your response is "not correct" (i.e. such a restriction exists), indicate –	✓	
	a.	The period of time set in the articles for the service of a director: _____.		
	b.	The required majority set in the articles for the termination of service of the directors: _____.		
	c.	The quorum set in the articles for a general meeting for terminating the service of the directors: _____.		
	d.	The required majority for changing these provisions in the articles: _____.		

⁸ A debenture company is not required to answer this section.

DIRECTORS' COMPETENCE AND QUALIFICATIONS

			Correct	Not Correct
8.		The corporation conducted a training program for new directors in the area of the corporation's business and in the area of the law applying to the corporation and the directors, and also conducted a continuation program for training serving directors, that is adapted, <i>inter alia</i>, to the position held by the director in the corporation. If your response is "correct" – indicate whether the program was operated in the reporting year: Yes	✓	
9.	a.	The corporation has set a minimum number of board members who are required to have accounting and financial expertise. If your response is "correct," indicate the minimum number that was set: <u>5</u>	_____	_____
	b.	The number of directors who served in the corporation in the course of the reporting year: 11. Having accounting and professional expertise⁹: 5 Having professional competence¹⁰: 6 <i>In the event of changes in the number of such directors in the reporting year, the lowest number of directors of each type who served in the reporting year (except during a period of 60 days immediately after the change) will be provided: _____</i>		
10.	a.	Throughout the reporting year the board of directors was composed of members of both genders. If your response is "not correct" – indicate the period of time (in days) during which the above was not fulfilled: _____ <i>A response of "correct" may be given on this question if the period of time during which directors of both genders did not serve does not exceed 60 days. However, whatever the response (correct/not correct), the period</i>	✓	

⁹ After appraisal by the Board of Directors, according to the provisions of the Companies Regulations (Conditions and Criteria for a Director Who Possesses Accounting and Financial Expertise and a Director Who Possesses Professional Competence), 2005.

¹⁰ See footnote 9.

DIRECTORS' COMPETENCE AND QUALIFICATIONS

				Correct	Not Correct
			<i>of time (in days) during which directors of both genders did not serve in the corporation must be indicated: 0 (Directors of both genders served throughout the period).</i>		
		b.	The number of directors of each gender serving on the corporation's board of directors as of the date of publication of this questionnaire: Men: <u>8</u> Women: <u>3</u>	_____	_____

MEETINGS OF THE BOARD OF DIRECTORS (CONVENING A GENERAL MEETING)

							Correct	Not Correct
11.		a.	Number of meetings of the board of directors held in each quarter of the reporting year:					
			First quarter (2014 year): <u>41</u>					
			Second quarter: <u>25</u>					
			Third quarter: <u>25</u>					
			Fourth quarter: <u>30</u>					
		b.	Indicate next to the name of each of the directors who served in the corporation during the reporting year the rate ¹¹ of his attendance at meetings of the board of directors (in this subsection – including meetings of committees of the board of directors of which he is a member of, and as noted hereinafter) that were held in the course of the reporting year (referring to his period of service):					A table is attached in a separate file
			<i>(Add lines according to the number of directors)</i>					
			Director's name	Rate of his attendance at meetings of the board of directors	Rate of his attendance at meetings of the audit committee ¹²	Rate of his attendance at meetings of the committee for examining the financial statements ¹³	Rate of his attendance at meetings of the compensation committee ¹⁴	Rate of his attendance at meetings of additional committees of the board of directors in which he is a member (naming the committee's name)
			Rochelle Don-Yechiya	96%				Corporate Responsibility and Regulation - 100% Strategy, Structural Change

¹¹ See footnote 2.

¹² For a director who is a member of this committee.

¹³ For a director who is a member of this committee.

¹⁴ For a director who is a member of this committee.

MEETINGS OF THE BOARD OF DIRECTORS (CONVENING A GENERAL MEETING)

									Correct	Not Correct
								and Image - 100% Engagements and Assets - 100% Locating CEO - 75% Human Resources and Organization - 100%		
			Yaffa Vigodsky	84%	78%			Human Resources and Organization - 100% Engagements and Assets - 91% Locating Internal Auditor - 100% Locating CEO - 100% Business Development, Marketing and Service-50%		
			Ziv Reich	100 %	92%	100%	100%	Corporate Responsibility and Regulation - 100% Engagements and Assets - 85% Locating Internal Auditor - 100% Human Resources and Organization - 71% Budget, Financial Management and Risk		

MEETINGS OF THE BOARD OF DIRECTORS (CONVENING A GENERAL MEETING)

									Correct	Not Correct
								management - 93%		
			Gideon Frank	86%	92%			Corporate Responsibility and Regulation - 100% Strategy, Structural Change and Image - 23% Drawing Conclusions from the 2013 Storm - 100% Locating Internal Auditor - 100% Locating CEO - 75% Regional Cooperation - 100% Business Development, Marketing and Service - 75%		
			Raik Abu Reish	100%		67%		Engagements and Assets - 75% Human Resources and Organization - 100% Budget, Financial Management and Risk Management - 100%		
			Yiftah Ron-Tal	100%				Corporate Responsibility and Regulation - 100% Strategy, Structural Change		

MEETINGS OF THE BOARD OF DIRECTORS (CONVENING A GENERAL MEETING)

								Correct	Not Correct
							and Image - 100% Engagements and Assets - 23% Locating CEO - 100% Regional Cooperation - 100% Human Resources and Organization - 100% Budget, Financial Management and Risk Management - 79% Business Development, Marketing and Service - 100%		
			Arie Rapoport	93%	92%	90%	100%	Strategy, Structural Change and Image - 67% Engagements and Assets - 92% Locating Internal Auditor - 75% Locating CEO - 100% Regional Cooperation - 100% Budget, Financial Management and Risk Management - 100%	

MEETINGS OF THE BOARD OF DIRECTORS (CONVENING A GENERAL MEETING)

								Correct	Not Correct
			Mordechai Ben Ami	93%				Corporate Responsibility and Regulation - 67% Strategy, Structural Change and Image - 67% Human Resources and Organization - 71% Budget, Financial Management and Risk Management - 79% Business Development, Marketing and Service - 100%	
			Varda Samet	82%			75%	Corporate Responsibility - 100% Regulation - 67% Strategy, Structural Change and Image - 100% Human Resources and Organization - 71%	
			Ofir Bashan	93%		100%		Corporate Responsibility and Regulation - 100% Strategy, Structural Change and Image - 67% Drawing Conclusions from the 2013 Storm - 100% Budget, Financial Management and Risk	

MEETINGS OF THE BOARD OF DIRECTORS (CONVENING A GENERAL MEETING)

								Correct	Not Correct
							Management - 79% Business Development, Marketing and Service - 33%		
			Yehuda Adler	89%			Strategy, Structural Change and Image -100% Locating CEO - 100% Regional Cooperation - 100% Human Resources and Organization - 86% Business Development, Marketing and Service - 50%		
12.		In the reporting year, the board of directors held at least one meeting regarding the management of the corporation's business by the CEO and the officers subordinate to him, without their presence, and they were given the opportunity to state their position.							✓

SEPARATION BETWEEN THE FUNCTIONS OF CEO AND CHAIRMAN OF THE BOARD OF DIRECTORS

			Correct	Not Correct
13.		Throughout the reporting year a chairman of the board of directors served in the corporation. <i>A response of "correct" may be given on this question if the period of time during which a chairman of the board of directors did not serve in the corporation does not exceed 60 days, as provided in Section 363A.(2) of the Companies Law. However, whatever the response (correct/not correct), the period of time (in days) during which a chairman of the board of directors did not serve in the corporation must be indicated: 0.</i>	✓	
14.		Throughout the reporting year a CEO served in the corporation. <i>A response of "correct" may be given on this question if the period of time during which a CEO did not serve in the corporation does not exceed 90 days, as provided in Section 363A.(6) of the Companies Law. However, whatever the response (correct/not correct), the period of time (in days) during which a CEO did not serve in the corporation must be indicated: 0.</i>	✓	
15.		In a corporation in which the chairman of the board of directors also serves as and/or exercises the powers of a CEO, the dual office was approved in accordance with Section 121(c) of the Companies Law ¹⁵ . ☒ Not applicable (if no such dual office exists in the corporation).		
16.		The CEO is <u>not</u> a relative of the chairman of the board of directors. If your response is "not correct" (i.e. the CEO is a relative of the chairman of the board of directors) –	✓	
	a.	Indicate the family relationship between the parties: _____	_____	_____
	b.	The service of the CEO was approved in accordance with Section 121(c) of the Companies Law ¹⁶ .	_____	_____

¹⁵ For a debenture company - approval in accordance with section 121(d) of the Companies Law.

¹⁶ For a debenture company - approval in accordance with section 121(d) of the Companies Law.

SEPARATION BETWEEN THE FUNCTIONS OF CEO AND CHAIRMAN OF THE BOARD OF DIRECTORS

				Correct	Not Correct
			☐ Yes ☐ No <i>(Mark an X in the appropriate box)</i>		
17.		The controlling shareholder or his relative does <u>not</u> serve as CEO or as a senior officer in the corporation other than a director. ☐ <i>Not applicable (there is no controlling shareholder in the corporation).</i>		✓	

AUDIT COMMITTEE

			Correct	Not Correct
18		The following <u>did not serve</u> on the audit committee in the reporting year:	_____	_____
	a.	The controlling shareholder or his relative. ☐ Not applicable (there is no controlling shareholder in the corporation).	✓	
	b.	The chairman of the board of directors.	✓	
	c.	A director who is employed by the corporation or by the controlling shareholder in the corporation or by a corporation under his control.	✓	
	d.	A director who provides services to the corporation or to the controlling shareholder in the corporation or to a corporation under his control on a regular basis.	✓	
	e.	A director whose main livelihood derives from the controlling shareholder. ☐ Not applicable (there is no controlling shareholder in the corporation).	✓	
19.		A person not permitted to be a member of the audit committee, including a controlling shareholder or his relative, was not present in the reporting year at meetings of the audit committee, other than in accordance with Section 115(e) of the Companies Law.	✓	
20.		A quorum for transacting business and passing resolutions at all meetings of the audit committee that were held in the reporting year was a majority of the members of the committee, a majority of those present being independent directors and at least one being an external director. If your response is "not correct" – indicate the rate of meetings at which this requirement was not fulfilled: _____	✓	
21.		The audit committee held in the reporting year at least one meeting attended by the internal auditor and the independent auditor and without the presence of officers in the corporation who are not members of the committee, regarding defects in the business management of the corporation.		✓

AUDIT COMMITTEE

			Correct	Not Correct
22.		At all meetings of the audit committee at which a person who is not permitted to be a member of the committee was present, this was with the approval of the chairman of the committee and/or at the request of the committee (regarding the general counsel and secretary of the corporation who is not a controlling shareholder or his relative).	✓	
23.		Arrangements set by the audit committee regarding the manner of handling complaints by the corporation's employees concerning defects in its business management and the protection provided for employees that complained as stated were in force during the reporting year.	✓	
24.		The audit committee (and/or the committee for reviewing the financial statements) was satisfied that the volume of work of the independent auditor and his fees with respect to the financial statements in the reporting year were adequate for executing appropriate control and review.		✓

FUNCTIONS OF THE COMMITTEE FOR EXAMINING THE FINANCIAL STATEMENTS (HEREINAFTER – THE COMMITTEE) IN ITS WORK PRIOR TO APPROVAL OF THE FINANCIAL STATEMENTS

			Correct	Not Correct
25.				
	a.	Indicate the period of time (in days) set by the board of directors as a reasonable time for submitting the recommendations of the committee ahead of the discussion by the board of directors for approval of the financial statements: <u>2</u>	_____	_____
	b.	The number of days that actually elapsed between the date of submission of the recommendations to the board of directors and the date of the discussion by the board of directors for approval of the financial statements: First quarter report (2014 year): <u>2</u> Second quarter report: <u>2</u> Third quarter report: <u>2</u> Annual report: <u>3</u>	_____	_____
	c.	The number of days that elapsed between the date of transfer of the draft of the financial statements to the directors and the date of the discussion by the board of directors for approval of the financial statements: First quarter report (2014 year): <u>14</u> Second quarter report: <u>14</u> Third quarter report: <u>14</u> Annual report: <u>16</u>		
26.		The corporation's independent auditor participated in all the meetings of the committee and the board of directors at which the corporation's financial statements for the periods included in the reporting year were discussed. (if your answer is "not correct", the proportion of its participation will be noted)	✓	

FUNCTIONS OF THE COMMITTEE FOR EXAMINING THE FINANCIAL STATEMENTS (HEREINAFTER – THE COMMITTEE) IN ITS WORK PRIOR TO APPROVAL OF THE FINANCIAL STATEMENTS

			Correct	Not Correct
27.	Throughout the reporting year and until publication of the annual report, the committee complied with all the conditions set out below:		_____	_____
	a.	The number of its members was no less than three (at the time of the meeting of the committee and the approval of the financial statements as stated).	✓	
	b.	It complied with all the conditions prescribed in Section 115(b) and (c) of the Companies Law (regarding the service of members of the audit committee).	✓	
	c.	The chairman of the committee is an external director.	✓	
	d.	All its members are directors and a majority of its members are independent directors.	✓	
	e.	All its members are able to read and understand financial statements, and at least one of the independent directors possesses accounting and financial expertise.	✓	
	f.	The members of the committee submitted a declaration prior to their appointment.	✓	
	g.	The quorum of the committee for meeting and for passing resolutions was a majority of its members, provided that a majority of those present were independent directors including at least one external director.	✓	
	If your response is "not correct" on one or more of the subparagraphs of this question, specify with respect to which report (periodic/quarterly) the stated condition was not complied with and the condition that was not complied with: _____		_____	_____

COMPENSATION COMMITTEE

		Correct	Not Correct
28.	The number of members of the committee in the reporting year was at least three, and its external directors constituted the majority (at the time of discussion by the committee). ☐ Not relevant (a discussion was not held).	✓	
29.	The terms of office and employment of all the members of the compensation committee in the reporting year are in accordance with the Companies Regulations (Rules regarding compensation and expense reimbursement of external directors), 2000.	✓	
30..	The following did not serve on the compensation committee during the reporting year:	_____	_____
	a. The controlling shareholder or his relative. ☐ Not relevant (there is no controlling shareholder in the corporation).	✓	
	b. The chairman of the board of directors.	✓	
	c. A director who is employed by the corporation or by the controlling shareholder in the corporation or by a corporation under his control.	✓	
	d. A director who provides services to the corporation or to the controlling shareholder in the corporation or to a corporation under his control on a regular basis.	✓	
	e. A director whose main livelihood derives from the controlling shareholder. ☐ Not relevant (there is no controlling shareholder in the corporation).	✓	
31.	A controlling shareholder or his relative were not present at the meetings of the compensation committee during the reporting year, except if the chairman of the committee determined that any of them is required for the presentation of a certain matter.	✓	

COMPENSATION COMMITTEE

		Correct	Not Correct
32.	The compensation committee and the board of directors did not use their authority under sections 267a(c), 272(c)(3) and 272(c1)(1)(c) to approve a transaction or a compensation policy, despite the objection of the general meeting. If your answer is “not correct”, indicate - The type of transaction approves as stated: _____ The number of times their authority was used in the reporting year: _____	✓	

INTERNAL AUDITOR

		Correct	Not Correct																								
33.	The chairman of the board of directors or CEO of the corporation is the person in charge of the internal auditor of the corporation.	✓																									
34.	The chairman of the board of directors or the audit committee approved the work plan in the reporting year. In addition, the audit issues dealt with by the internal auditor in the reporting year will be detailed: (Mark an X in the appropriate box). <table><tr><th>No.</th><th>Audit Issue</th></tr><tr><td>1.</td><td>Operation of the “Orot Rabin” power station generation units.</td></tr><tr><td>2.</td><td>Operation and maintenance of the gas system at the Haifa power station site.</td></tr><tr><td>3.</td><td>Controlling the handling of and placing meters with private electricity producers and photo-voltaic installation owners.</td></tr><tr><td>4.</td><td>Maintenance and operation of infrastructure and fuel tanks at the gas turbines power station.</td></tr><tr><td>5.</td><td>Receiving and connecting private electricity producers to the electricity system.</td></tr><tr><td>6.</td><td>Handling cases of electricity theft.</td></tr><tr><td>7.</td><td>Forecasted cash flow.</td></tr><tr><td>8.</td><td>Implementing the decisions of the committee for reviewing the financial statements for the first half of 2013.</td></tr><tr><td>9.</td><td>Controlling payments to suppliers in the supply and storage division.</td></tr><tr><td>10.</td><td>Handling authorizations during internal mobility of employees.</td></tr><tr><td>11.</td><td>The wireless communication array.</td></tr></table>	No.	Audit Issue	1.	Operation of the “Orot Rabin” power station generation units.	2.	Operation and maintenance of the gas system at the Haifa power station site.	3.	Controlling the handling of and placing meters with private electricity producers and photo-voltaic installation owners.	4.	Maintenance and operation of infrastructure and fuel tanks at the gas turbines power station.	5.	Receiving and connecting private electricity producers to the electricity system.	6.	Handling cases of electricity theft.	7.	Forecasted cash flow.	8.	Implementing the decisions of the committee for reviewing the financial statements for the first half of 2013.	9.	Controlling payments to suppliers in the supply and storage division.	10.	Handling authorizations during internal mobility of employees.	11.	The wireless communication array.	✓	
No.	Audit Issue																										
1.	Operation of the “Orot Rabin” power station generation units.																										
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10.	Handling authorizations during internal mobility of employees.																										
11.	The wireless communication array.																										

INTERNAL AUDITOR

			Correct	Not Correct
	12.	Developing a system for managing the generation control and electricity consumption (ENERSIP).		
	13.	Business continuity management (BCM).		
	14.	Preparing specifications for the national grid.		
	15.	Activating engagements and supervising service providers of the information systems and teleprocessing division.		
	16.	Provisioning, cataloguing and managing equipment and materials inventory.		
	17.	Fleet management.		
	18.	Emergency/duress preparedness.		
	19.	Printing and dissemination of information in the engineering design division.		
	20.	Operation of fire extinguishing systems in the Jerusalem district office building.		
	21.	Guarding and security.		
	22.	Quality control.		
	23.	Directors' remuneration for 2013.		
	24.	Jordan Assets Company.		
	25.	Company engagements in irregular transactions and with interested parties (January - December 2013).		
	26.	Follow-up of State Comptroller's report on: the project for the construction of a comprehensive computer system (ERP).		
	27.	Preparation and implementation of administrative enforcement program.		

INTERNAL AUDITOR

		Correct	Not Correct
	28.	Follow-up - inventory purchases.	
	29.	Follow-up - fire extinguishing.	
	30.	Follow-up - purchase and control of the use of fuels.	
	31.	Follow-up - taxes and fees.	
	32.	Follow-up - regions in the southern district	
	33.	Follow-up - rotation in sensitive positions.	
	34.	Follow-up - urgent acquisition of the projects execution division.	
	35.	Follow-up - preparing specifications.	
	36.	Follow-up - maintenance of connections to homes.	
	37.	Follow-up - establishment and development of low voltage and high voltage grid in the Jerusalem District	
	38.	Follow-up - participation in travel fees and vehicle maintenance.	
	39.	Follow-up - guarding and security.	
	40.	Follow-up - maintenance of the distribution grid.	
	41.	Follow-up - handling illegal use of electricity (illegal aliens).	
	42.	Follow-up - operating and monitoring substations and switching stations.	
	43.	Follow-up - concern of information leak to an external factor during preparation of a prospectus.	

INTERNAL AUDITOR

			Correct	Not Correct
	44.	Follow-up - maintenance of high voltage and ultra high voltage lines.		
	45.	Follow-up - operation of 103 call centers.		
	46.	Follow-up - district supervision and operating grid in the Haifa district.		
	47.	Follow-up - administering and providing laboratory services.		
	48.	Follow-up - managing demand in the Dan district.		
	49.	Follow-up - Company archives.		
	50.	Follow-up - IEC landline array.		
	51.	Follow-up - organization and methods.		
	52.	Follow-up - treatment of chemical processes at the power stations.		
	53.	Follow-up - establishment and development of low/high voltage grid and transformation stations in the Southern district.		
	54.	Follow-up - purchase and sale of land.		
	55.	Follow-up - implementation of virtualization technology at end stations.		
	56.	Follow-up - preparation of requirements and specifications for working clothes - administration and housekeeping.		
	57.	Follow-up - safety and hygiene.		
	58.	Follow-up - equipment protection at power stations.		
	59.	Follow-up - management of engagements and supervising contractor works of the project execution division.		

INTERNAL AUDITOR

		Correct	Not Correct
	60.	Follow-up - controlling payments to suppliers in Israel.	
	61.	Follow-up - work of the substation planning sector at the engineering planning division.	
	62.	Follow-up - management of engagements and supervision of district pruning works.	
	63.	Follow-up - preparation and assimilation of procedures.	
	64.	Follow-up environmental monitoring.	
	65.	Follow-up - applications to the Hipertronics Company.	
	66.	Follow-up - management and control of cellular devices at the communications and electronics unit.	
	67.	Follow-up - employee's conduct at the Orot Rabin site - anonymous complaint.	
	68.	Follow-up - employee conduct Netanya area.	
35.	Scope of employment of the internal auditor in the reporting year (in hours ¹⁷): full-time position (180 hours).		_____
	A discussion was held (by the audit committee or the board of directors) in the reporting year regarding the findings of the internal auditor.		✓
36.	The internal auditor is not an interested party, a relative, an independent auditor of the corporation or anyone on its behalf, and does not have material business relations with the corporation, its controlling party, relative or corporations under their control.		✓

¹⁷ Includes work hours invested in held companies and in audit outside of Israel, as relevant.

INTERESTED-PARTY TRANSACTIONS

		Correct	Not Correct
37.	The controlling shareholder or his relative (including companies controlled by him) is not employed by the corporation and does not provide management services to it. If your response is "not correct" (i.e. the controlling shareholder or his relative is employed by or provides management services to the corporation), indicate – - The number of relatives (including the controlling shareholder) employed by the corporation (including companies controlled by them and/or through management companies): _____ - Were such employment agreements and/or management services approved by the organs stipulated by law: ☐ Yes ☐ No <i>(Mark an X in the appropriate box)</i> ☐ Not applicable (the corporation has no controlling shareholder).	✓	
38.	To the best of the corporation's knowledge, the controlling shareholder does not have any additional business in the corporation's area of operations (in one area or more). If your response is "not correct" – indicate whether an arrangement was established between the corporation and its controlling shareholder that delimits their activities: ☐ Yes ☒ No <i>(Mark an X in the appropriate box)</i> ☐ Not applicable (the corporation has no controlling shareholder).		✓

End Notes:

Note to question number 1: The period (in days) in which two external directors did not hold a position in the corporation in the reporting year is 14 days.

Note to question number 2: Since the authority to appoint directors of the Company is in the hands of the Minister of Finance and the Minister of National Infrastructures, Energy and Water, and following consultation with the Appointment Review Committee, the Company on February 8, 2009 approached the Government Companies Authority to obtain their position and guidelines regarding the adoption of provisions and regulations of the Company regarding the Independent Director, the rate of Directors and their terms in office. The Government Companies Authority's position as of February 24, 2009 is that the binding stipulating regulation is that a public government company requires the appointment of a certain number of independent directors, as defined in Amendment No. 8 to the Companies Law may impose significant limitations on the appointment of directors of that company, due to the strict requirements which meet the "independent director" regarding his relationship with the state and the entities it controls. On the other hand, the position of the Government Companies Authority does not deem that such a provision will significantly improve the activity of the Company's directors and reinforce independent status, beyond current measures of protection in accordance with the provisions of the Government Companies Law and the principles of administrative law. Therefore, the company adopted the provisions regarding the number of independent directors.

Note to question number 6: By virtue of section 27(b) of the Government Companies Law - 1975, invitation to meetings of the board of directors will also be delivered to the Government Companies Authority, and it may send a representative to every meeting who will be allowed to participate in the meeting, and his standing will be as a director, but he will not be counted as part of the quorum and he will not have a right to vote. Beyond that, a representative of a controlling shareholder was not present in meetings of the board of directors.

Note to question number 7: The appointment of certain directors and termination according to the guidelines of the Government Companies law 1975. Furthermore, although the company regulations contain instructions according to which the company is entitled to relieve a member of the board of directors of his duties at the end of his term in an extracurricular decision considering that the State of Israel holds 99.85% of the Company's share capital, effectively there is nothing in the guidelines that limits the possibilities of immediate removal of directors from their position.

Note to question number 12: The subject was on the agenda of the board of directors on 25.12.14. Due to time constraints, the board of directors had to postpone the discussion and conduct it at the next meeting on 1.1.2015.

Note to question 19: Based on sections 27(b) and 29(b) of the Companies Law 1975, invitation to a meeting of the Audit Committee will be issued to the Authority of Government Companies and the latter is entitled to send a representative to each of the meetings at Director status; however he will not be considered of the legal quorum and will not have voting rights.

Note to question 24: The Electric Company as a government company has no influence over the appointment and the remuneration of the external Auditor and these are decided upon by the Authority for Government Companies, in accordance with Government Company regulations (appointing Accountants and their remuneration), 1994. Notwithstanding, the Committee for Reviewing the Financial Statements held a discussion on March 16, 2015 that focused on the scope of engagement of the External Auditor.

Note to question 31: See note to question 19 above.

Note to question 38: The Controlling shareholder established and owns two government companies, which are predicted to work in the electricity sector: The System Management Company Ltd. and new Power Generation Stations Ltd. The Company was informed that it has been decided to liquidate the Power Generation Stations Ltd. company.

Chairman of the Board of Directors	Chairman of the Audit Committee	Chairman of the Committee for Reviewing the Financial Statements
Date: March 24, 2015		

ANNEX 1

Actuarial Liabilities of the Israel Electric Corporation

**At
December 31, 2014**

March 24, 2015

To
Mr Tamir Polikar, CFO, Finance and Economics
Israel Electric Corporation Ltd.
P.O. Box 10
Haifa 31000, Israel

Dear Sir,

Re: **Actuarial liability as of December 31, 2014 in respect of employee benefits pursuant to IAS 19**

1. **General**

1.1 This report consists of the following chapters and appendices:

1. General
2. The benefits included in the valuation
3. Methodology and actuarial and accounting principles underlying the valuation
4. The data based on which the report has been prepared
5. The assumptions based on which the report has been prepared
6. Valuation changes in the current reporting year
7. Results of valued liabilities
8. Uncertainties and risks
- Appendix A – Additional reports for disclosure in the financial statements
- Appendix B – Presentation of expected benefit cashflows
- Appendix C – Additional details of financial assumptions
- Appendix D – Additional details of data
- Appendix E – Valuation changes made prior to the current year
- Appendix F – Details of benefits

1.2 We have been requested by the Israel Electric Corporation Ltd. ("the Company" or "IEC") to prepare this actuarial valuation relating to the value of the Company's employee benefit liabilities for the purpose of reporting in the financial statements pursuant to International Financial Reporting Standard 19, "Employee Benefits" ("IAS 19"). The valuation was requested by Mr Tamir Polikar, the Company's CFO, Finance and Economics. The starting date of the engagement was 1.4.2010, and the date of signing the engagement agreement was 30.5.2010. We agree to publish this report with the Company's financial statements. The Company agreed to grant us indemnity for this work to an amount of up to \$ 30 million (US Dollar).

1.3 The valuation was performed solely for the purpose mentioned above and this report is not to be used, or to reach conclusions, for any other purpose such as determining the provisions required for funding the benefits, valuations of the Company etc. The actuarial results appropriate for any other purpose may materially differ from the results reported in this document.

- 1.4 This report is intended to present results and provide explanations relating to the valuation. This report is prepared for the purpose of its inclusion in the Company's financial statements.
- 1.5 The amounts reported herein were calculated according to the Company's interpretations of IAS 19 and its accounting policies regarding its implementation (see section 3 below). The Company is fully and exclusively responsible for these interpretations and policies.
- 1.6 According to this valuation, there is a surplus of assets over liabilities in the pension plan. Based on the Company's instructions, this surplus is presented as an asset of the Company in whole. According to legal regulations of the Fund, in specific situations where there is a surplus, it is returned to the Company, where the surplus is determined according to the actuarial valuation of the Fund. The actuarial valuation of the Fund is different from the Company's valuation contained in this report, primarily due to a different discount rate and different assumptions regarding future salary increases. According to the most recent actuarial valuation of the Fund (as of December 31, 2014), the liabilities were higher than those calculated in this valuation, and there were no surplus assets over liabilities.
- 1.7 In order to calculate the amounts included in this report, we relied on information concerning the employee benefit terms and conditions (including constructive obligations) and on historical and current employee data, as provided to us by the Company, that were not verified by us. The full responsibility for the completeness and reliability of the information and data as provided to us lies with the Company.
- 1.8 The valuation results are highly sensitive to the actuarial assumptions. The actual demographic and economic experiences are likely to differ from the assumptions, and assumptions are likely to change in future, which will impact on the valuation of the accrued benefits liability. Section 8 below provides additional information.
- 1.9 The valuation was performed by Mr Emanuel Berzack, a qualified actuary, and his actuarial team at Ernst & Young (Israel) Ltd. Mr Berzack has a B.Econ.Sc (Statistics and Actuarial Science) from the University of the Witwatersrand in South Africa and is a Fellow of the Israel Association of Actuaries (FILAA) and a Fellow of the Institute of Actuaries (FIA) in the UK. Our professional experience of the last 12 years includes actuarial valuations of employee benefits of a similar kind to those of the Company, of pension liabilities of pension funds and insurance liabilities of insurance companies, in the role of a valuation actuary or reviewing or audit actuary.
- 1.10 This report has been prepared in accordance¹ with the relevant standards in "Technical Actuarial Standard R – Reporting Actuarial Information" published in November 2009 and in the "Pensions Technical Actuarial Standard" published in November 2012 by the Board for Actuarial Standards of the Financial Reporting Council in the UK. We did not refer to "Technical Actuarial Standard D - Data" of said Board since in view of the agreement entered into between Ernst & Young and the Company, the responsibility for validating the completeness, reliability and suitability of the data lies with the Company.

¹ excluding section C.5.20 which requires providing forecasted results for the next report date (we did not calculate the next quarter's expected liabilities).

1.11 Definitions:

- "salary" – Pensionable Salary
- "the Fund" – the Central Pension Fund of the employees of the Israel Electric Corporation Ltd.
- "pension plan" – the set of benefits paid by the Fund
- "date of valuation" – December 31, 2014
- "linked pensions agreement" – the collective agreement between the company and the Histadrut and the committee of Company employees, which inter alia changes the method of the pensions update (linking pensions to the CPI (the "Index") instead of updates by promotions and wage agreements)

2. **The benefits included in the valuation**

2.1 Our calculations are based on the details of the benefits and their terms, as obtained in a document from the Company, dated December 31, 2014, attached to this report as Appendix F. The information in this document, upon which we relied for the purpose of preparing this report, was not verified by us.

2.2 The valuation relates to the benefits in respect of permanent employees, pensioners (including disability retirement) and survivors (for convenience purposes, the pensioners and survivors shall hereinafter be referred to as "pensioners"), who are divided into those in the defined benefit pension plan (for whom the benefits are identical) and generation C. Employees in the defined benefit pension plan commenced their employment at the Company up to and including June 10, 1996, and generation C employees are permanent employees who commenced their employment at the Company after this date. In addition, the valuation relates to the supplemental severance pay benefit in respect of employees employed under a special agreement.

2.3 The benefits to which the valuation refers are as follows (see details in Appendix F):

2.3.1 In respect of employees and pensioners of the defined benefit pension plan, the benefits consist of the following:

- post-retirement pension in respect of pensionable salary, comprised of the following components, subject to each employee/pensioner's individual entitlement to each one: regular salary², shift work, home service, Arava additions, convalescence pay (one 12th of salary), 13th salary (one 12th of salary) 14th salary (one 12th of salary) and "CPI increment";
- disability pension;
- survivors' pension in respect of employees who die during service³ or following retirement (including employees who died after retirement on account of disability);
- retirement grant for service above 35 years' service and to survivors on the death of the spouse as above ("additional years grant");
- "up to 35 years" grant paid upon retirement and to survivors in the event of the employee's death;

² includes combined salary, management increment, seniority, personal addition, continual education addition and physical effort addition.

³ a lump sum which is paid upon the employee's death as a result of a work-related accident (see section 7.2 of Appendix F, in section "Rights of Employees Entitled to Pension from the Pension Fund of Company Employees and Rights of Pensioners") was not taken into consideration in the valuation.

- disability retirement grant;
- grant for unutilized days of sick leave;
- severance pay at 8.33% of salary received when leaving employment without entitlement to pension;
- discounted electricity for pensioners (including VAT and tax grossing up);
- holiday gifts for pensioners (including tax grossing up);
- grant at 20 years of service;
- social welfare activities (worth 0.49% of grants and pension excluding convalescence pay, home service, Arava additions, discounted electricity and holiday gifts);
- social welfare fund for the defined benefit pension plan pensioners only; and
- life insurance benefits for pensioners.

2.3.2 In respect of generation C employees, the benefits consist of:

- supplementation of severance pay at 2.33% of regular salary (including 13th salary) for each year of service. In addition, in respect of 14th salary for employees who started work at the Company before January 1, 2004, supplementation of severance pay for years of work above 35 years will be calculated;
- "up to 35 years" grant paid upon retirement and to survivors in the event of the employee's death;
- grant for unutilized sick leave;
- discounted electricity for pensioners (including VAT and tax grossing up);
- holiday gifts for pensioners (including tax grossing up);
- grant at 20 years of service;
- social welfare activities (valued at 0.49% of the other benefits); and
- life insurance benefits for pensioners.

2.3.3 In respect of non-permanent employees employed by a special agreement: supplementation of severance pay upon leaving or retiring or upon the termination of the maximum work period for this type of employee (5 or 10 years), whichever is soonest.

2.4 An update for pension amounts takes place in the month of January each year, in accordance with the rate of annual change in consumer price index (the ratio of the index for the most recent month of December to the index for the December previous to that).

2.5 Our valuation does not take into consideration the payment of other possible benefits or increase to existing benefits at the Company's discretion, other than the allowance for early retirements, which require Company approval, based on the assumed early retirement rates (see 5.4 below).

2.6 We were informed by the Company that, according to the position of the Commissioner of the Ministry of Finance, there are salary irregularities with a potential total impact on the actuarial liability of about NIS 450 million. Legal proceedings in the labor court regarding this issue are yet to be decided. The actuarial liability in this report does not include a reduction with respect to this issue.

3. **The valuation methodology and actuarial and accounting principles underlying the report**

- 3.1 In accordance with IAS 19, the liabilities were calculated using the projected unit credit method. Under this method the liability is calculated as the present value of projected payments to employees and pensioners in respect of the relevant benefits based on the accrued rights of employees and pensioners as of the valuation date (the "past obligation"). The calculation projects each employee and pensioner's expected benefit payment amounts and dates, while taking into account the projected salary growth rate, mortality, termination and disability rates of employees and pensioners, as well as the labor agreements and the Company's benefit payment policy.
- 3.2 The liabilities and additional disclosures in this report were calculated and presented in accordance with the Company's accounting policy as detailed in sections 3.3-3.10 below.
- 3.3 Accrued rights are calculated for each benefit in the following way⁴:

The benefit	Method of calculating the past liability
Post-employment pension (including disability pension) and social welfare activities	Based on the benefit formula in the pension plan, namely, at the rate of accruing the plan's pension percentages.
Grant of post employment discounted electricity rates and holiday gifts, including tax grossing up (and VAT on the electricity benefit)	The liability is fully recognized for anyone who has at least 10 years of service and has reached the age of 40 (60 for generation C employees). If those criteria are not met, the past liability is based on the ratio of accrued service to accumulated service until said service and age, multiplied by the full liability.
Death in service survivors' pension	The liability is recognized in full.
Severance pay upon leaving without entitlement to pension, and grant of "up to 35 years"	Based on eligibility on the valuation date. Eligibility is accrued based on accrued service. For the "up to 35 years of employment" grant, there is a 35-year accumulation maximum.
Grant for additional years	This liability is not recognized prior to 35 years of service. As for employees with over 35 years of service, the past liability is calculated according to the actual benefit terms, namely the number of additional years' (over 35 years) service as at the valuation date.
Grant for unutilized sick leave	According to the number of unutilized sick leave days as of the valuation date
Grant for disability retirement	According to eligibility on the valuation date. Eligibility is accrued according to service, subject to a maximum of 30 years (up to 15 times salary).
20-year grant	Based on the ratio of accrued service to 20 years. There is no liability in respect of employees with over 20 years of service (as they already received the grant).
Increased severance pay for non-permanent employees employed under special agreement	Using the straight-line method from commencement of work through the end of the maximum work period or retirement age (67), whichever is sooner.
Social welfare fund	Using the straight-line method from commencement of work until the date the employee reaches age 50/55 (male/female), or 30 years of service, whichever is later.

⁴ Namely, the manner of attributing the benefits to the period of employment

Life insurance benefits	The calculation of the liability in respect of the life insurance benefits was done on the basis of two-thirds of the sums insured in the event of death, after consideration of pensioner participation of one third of the cost of the benefit. It was assumed that the sums insured in the future will be linked monthly to the CPI. In regards to life insurance benefits, in respect of which there exists an insurance arrangement, a margin was added for the cost of the benefit. The calculation of the accrued obligation was done using the straight-line method from commencement of work until the average retirement age (66).

- 3.4 Actuarial losses and gains attributable to post-employment benefits are attributed to capital. Actuarial gains and losses attributable to benefits that are not post-employment benefits are attributed to profit and loss.
- 3.5 The results presented in Appendix A are on a real (index-linked) basis. Thus the opening balances have been linked to the CPI of the valuation month, and the calculation of the expected return on assets, the interest cost and all other results displayed in Appendix A are on a real (index-linked) basis.
- 3.6 The service cost was calculated in respect of rights accrued during the reporting period using the method described in section 3.3. For example, for the main pension benefits, until 35 years of service the cost reflects the added percentage to the pension rate. After 35 years of service the cost reflects the added grant for additional years. After full recognition of the liability, the service cost does not include any cost in respect of this benefit. The annual service cost is calculated once a year, based on the assumptions that applied at the end of the previous year, and in each quarter the proportion that relates to that quarter is presented. Differences between this service cost and the actual service cost are represented in actuarial gains and losses.
- 3.7 The interest cost and expected asset return are calculated at a real annual interest rate of 2.29% (the uniform discount rate inherent in the liability as of December 31, 2013).
- 3.8 The service cost presented in this report includes a reduction in respect of employee participation in the cost of pension, and is presented after the reduction as net service cost (that is, the employees' pension contributions were taken into consideration in the service cost).
- 3.9 The value of the assets presented in Appendix A was provided to us by the Company and was not checked by us.
- 3.10 The "termination benefits" displayed in Appendix A are defined as payments to existing pensioners until the forecasted average retirement age on the basis of this valuation (including consideration of early retirement). The actuarial gain / loss because of "termination benefits" is not included in the actuarial gain / loss displayed in Appendix A. These amounts are recognized directly in the Company's profit and loss statement.

4. **The data based on which the report has been prepared**

The valuation is based on data we received from the Company, correct to December 20, 2014. We have relied on this data and did not check it in a detailed manner or validate it in relation to the data source. We have only checked the general reasonability of the data in relation to the data from the prior quarter. The main data we received was as follows (see Appendix D for more detail):

- 4.1 Employee and pensioner⁵ data – we received files on January 6, 2015 containing data for each employee and pensioner entitled to their relevant benefits. The data includes details of age, gender, pension or salary components, rank, service etc. as of the valuation date. In addition, these files include data for the average monthly value of the holiday gift including grossing up for tax.
- 4.2 We made the following adjustments to said data based on the Company's instructions⁶:
 - 4.2.1 Increase of salary and pension for cost of social welfare activities by 0.49%. This increase was done for all salary / pension components except convalescence pay, Arava addition, home service, holiday gifts and discounted electricity rates.
 - 4.2.2 Increase of salary to active employees only (excluding convalescence pay, holiday gifts and discounted electricity rates) by 0.9456% to reflect the effect of the salary agreement that was signed during July 2013 (the actual salary increase takes place in January 2015).
 - 4.2.3 Increase of salary to active employees only (excluding convalescence pay, holiday gifts and discounted electricity rates) by 1.6% to reflect the anticipated effect of the future salary agreement (see section 5.2.2.1 below) which relates to the period up to the valuation date (from January 2013 until the valuation date).
 - 4.2.4 Indexing of the pensioners' annuities (including survivors and disabled pensioners) according to the change in the CPI from December 2013 to December 2014 (which is the last index by which the actual pensions were updated), at a rate of 0.2%.
 - 4.2.5 We received a file containing a list of employees who, according to the Company, retired near the date of the valuation and whose status needed to be changed from "employee" to "pensioner" along with the calculation of their liability accordingly.

⁵ The possibility that pensioners died without the Company's knowledge was not taken into consideration in the valuation.

⁶ To remove all doubt, the rates and manner of adjustment represent part of the Company's instructions and were not determined or examined by us.

4.3 Below is a summary of the aforementioned data, before and after the adjustments mentioned in section 4.2:

Before the adjustments in section 4.2 above				
Group	Number	Monthly salary/pension in NIS – regular salary, taken from data	Average age	Average service (years)
Defined benefit pension plan *				
Employees	7,772	114,966,659	54.2	27.7
Pensioners – former employees	3,559	45,960,141	73.6	
Pensioners – survivors (including children)	1,928	14,059,453	73.4	
Generation C**				
Employees	1,992	16,335,448	42.8	13.1
Pensioners – former employees	-	-	-	
Pensioners – survivors (including children)	24	3,506	59.7	
Employees under special agreements (non-permanent employees) ***				
Employees	689	3,689,953	38	3.3

After the adjustments in section 4.2 above				
Group	Number	Monthly salary/pension in NIS – regular salary, calculated by formula based on salary components	Average age	Average service (years)
Defined benefit pension plan *				
Employees	7,751	118,254,658	54.1	27.7
Pensioners – former employees	3,580	46,441,578	73.5	
Pensioners – survivors (including children)	1,928	14,191,352	73.4	
Generation C**				
Employees	1,991	16,876,392	42.8	13.1
Pensioners – former employees	15	2,191	68.0	
Pensioners – survivors (including children)	10	1,461	48.0	
Employees under special agreements (non-permanent employees) ***				
Employees	689	3,817,959	38	3.3

* The salary and pension for those in the defined benefit pension plan include all the components to which the employee/pensioner is entitled, including regular salary⁷, shift work, home service, Arava additions, convalescence pay (the 12th portion), 13th salary (the 12th portion), 14th salary (the 12th portion) and value of holiday gifts (grossed up for tax). The amounts of the 13th and 14th salaries were calculated by dividing the regular salary by 12 in respect of all those qualifying based on service data.

⁷ includes combined salary, management increment, service addition, personal addition, continual education addition and physical effort addition.

****** The generation C salary (for the purpose of calculating the benefits and severance payments) and holiday gifts include all the components to which the employee/pensioner is entitled, including regular salary, 13th salary (the 12th portion) and grossed up value of holiday gifts. The amount of the 13th salary was calculated by dividing the regular salary by 12.

******* The displayed salary for non-permanent employees under special agreements is the salary eligible for severance pay only. (In the data file there are two salary fields – regular salary and severance pay. The field that is used for calculations is severance pay.)

4.4 Data obtained for assets, payments and contributions consisted of the following (at nominal value):

Data item		NIS '000
	Assets as at the valuation date	
4.4.1	Balance of plan assets for post-employment benefits	27,739,098
4.4.2	Balance of assets according to Section 116A (of IAS 19) benefits	1,908,949
	Payments during the reporting period	
4.4.3	Increased severance pay to employees under special agreements	22,095
4.4.4	Supplemented severance pay (2.33%) to generation C employees	–
4.4.5	"20-year grant"	4,447
4.4.6	Termination benefits – for paid benefits by the fund, and for benefits not paid by the fund (electricity, holiday gifts)	49,425
	Termination benefits – for paid benefits by the fund	47,584
4.4.7	Unutilized sick leave grant	22,410
4.4.8	Post-employment benefits (excluding termination benefits)	784,286
4.4.9	"up to 35 years" grant	8,010
4.4.10	Discounted electricity benefit and holiday gifts	40,553
4.4.11	Withdrawals from plan assets for payment of benefits	705,401
	Contributions during the reporting period	
4.4.12	Company's contributions to plan assets or assets according to Section 116A (of IAS 19)	600,000
4.4.13	Employees' contributions to plan assets or assets according to Section 116A (of IAS 19)	–

5. Actuarial assumptions

The assumptions detailed below represent the Company's assumptions – the Company being the entity that is responsible, according to IAS 19, for determining the assumptions. The financial assumptions (see section 5.1 below) are based on generally accepted market data as published by an external party. The Company set the rest of the assumptions, most of which were set in consultation with us, and in our opinion they are reasonable.

In principle, changes may be expected to assumptions as a result of investigations relating to employees and pensioners demographic experience or other relevant information, that are carried out from time to time, and/or after publications of new mortality and disability tables by the Israeli Ministry of Finance or other parties, to the extent that it is decided that these tables apply to the Company.

5.1 Financial assumptions

- 5.1.1 Inflation rate – the difference between the nominal spot interest rate (on non-indexed corporate bonds) and the real spot interest rate (on indexed corporate bonds) at a duration of 16.8 years. For the actuarial valuation there is essentially no requirement for an explicit assumption for inflation, since, according to the Company's accounting policy, the interest rate for discounting is based on the Government bond rate tied to inflation, and since the assumptions for salary and pension increases are set in real terms. The rate of inflation is relevant for calculating the erosion of real value of the discounted electricity, convalescence and holiday gift components of salary, since they are linked to CPI on a yearly basis (and not monthly). With effect from the valuation for the first quarter of 2012, after applying the linked pensions agreement, the inflation rate is also relevant to the calculation of the erosion of pension payments (due to linking once a year rather than each month). The resulting inflation rate as at the valuation date is 2.15%.

With regard to the past, an adjustment to pension amounts, discounted electricity, convalescence and holiday gift components was made, in respect of the actual index from their last update until the valuation date.

Furthermore, from a technical perspective, the cash flows that we calculated for the valuation are future pension and other benefit payments, projected without the influence of future inflation. Therefore, the real discount rates mentioned below (based on the Government bond rate tied to inflation) are appropriate for discounting these cash flows. The use of nominal discount rates (based on market data for non-indexed Government bonds) and adding inflation (the difference between the nominal and real interest rates) to the projected cash flows, leads to the same result.

- 5.1.2 Discount rates – on November 25, 2014, the Israel Securities Authority published its position that in Israel there exists a deep market in high quality corporate bonds. According to the accounting policy of the Company, the discount rates used in the valuation are taken from a yield curve based on market data for high quality corporate bonds tied to inflation as of December 31, 2014, as established by Mervach Hogen Ltd (in the previous quarter, the discount rate was based on Government bond yields). The use of these interest rates is required by IAS 19, given the Company's opinion (which coincides with

that of other Israeli corporations) regarding the existence of a deep market in high quality corporate bonds in Israel.

If the plan assets yield lower real returns than the discount rates, based on their fair value, the net liabilities (total liabilities net of plan assets) will increase and vice versa.

See Appendix B for details of the projected cash flows of benefits.

See Appendix C for information on the values of the interest rates.

- 5.1.3 The interest cost rate and expected return on assets for the reporting period were determined by the Company at 2.29% pa, as described in section 3.7 above.

5.2 Salary and pension increases

- 5.2.1 For employees in the defined benefit pension plan and generation C, it is assumed that the salary components will increase according to the framework of salary increases and rank progression included in the Company's existing labor agreements and policies (as specified in Appendix F), and the supplementary assumptions applied to this framework are as follows:

- 5.2.1.1 The annual increase in respect of general salary and cost-of-living allowance agreements (the general update in the salary scale) is 0.8% per year (nominal) in respect of the period from 2013 until 2016 (inclusive), and at the rate of the actual increase in the CPI less 0.75% per year (a 0.75% erosion each year in real terms) from 2017 onwards. As stated in section 4.2.2, the salary on which the valuation is based is the actual salary in December 2014 with the addition of 0.9456% to reflect the effect of the last salary agreement from July 2013 that has not yet been reflected in the actual salary. This assumption affects all of the salary components, but does not affect the discounted electricity, holiday gifts and convalescence (it is assumed that the Arava and home service components will be included in future salary agreements).

- 5.2.1.2 It is assumed that the average annual salary increase which results from promotions (including a promotion to senior rank) and from changes in eligibility to new or increased salary components related to the job classification increment, master's degree, "shift work", "home service", "Arava addition" and additional grade at Eilat, will be at the following annual rates:

Age	Non-senior employees	Senior employees
0 – 32	1.43%	1.27%
32 – 37	0.77%	1.27%
37 – 42	0.43%	1.27%
42 – 47	0.37%	1.27%
47 – 52	0.34%	1.27%
52 – 57	0.26%	1.65%
57 – 62	0.20%	0.91%
Over 62	0.17%	0.76%

5.2.1.3 For employees who at the valuation date are not entitled to continuing education payment A and/or B, the annual rate of eligibility is as follows:

Age	Eligible for payment A	Eligible for payment B
Until 40	7.8%	3.5%
40 – 50	3.5%	1.5%
50 – 60	1.1%	0.8%
Over 60	0.0%	0.4%

5.2.1.4 It is assumed that the ceiling for continuing education payment B for employees at professional grade 44 (nominal) and up will be linked to salary and cost-of-living allowance agreements. The amount of the ceiling, correct to the valuation date, was NIS 922 (before the effect of the last salary agreement in July 2013).

5.2.1.5 According to labor agreements, the value of holiday gifts (including tax grossing up) and convalescence pay will increase by the actual rate of increase in the CPI, and that the update (for CPI) of convalescence takes effect in June each year, and of holiday gifts takes effect at in January each year. The cost of the gifts for pensioners is increased for grossed up tax at a rate of 13.86% (at all ages), and for pensioners who retired before retirement age the cost is increased for an additional grossed up tax at a rate of 18.31%.

5.2.1.6 The cost of discounted electricity is calculated according to the average electricity tariff at the valuation date (the fixed monthly fee before VAT is NIS 13.69 and the variable rate per kilowatt-hour before VAT is NIS 0.5403), and according to the following assumptions:

- The change in the discounted electricity tariff (including VAT and tax grossing up) is in accordance with the forecast that we received from the Company.
- The cost of discounted electricity for pensioners is increased for VAT and grossed up tax at a rate of 13.86% (at all ages), and for pensioners who retired before retirement age the cost is increased for an additional grossed up tax at a rate of 18.31%.
- The assumed electricity consumption in kWh is according to the age of the pensioner, and according to the classification of the pensioner into the following groups: a) recipients of old-age pension and disability pension, b) recipients of survivors' pension. It is assumed that the average power consumption per pensioner at any given age will remain constant.
- The reduction in the cost of electricity in respect of pensioners who do not utilize the benefit is according to the age of the pensioner, and according to the classification of the pensioner

into the following groups: a) recipients of old-age pension and disability pension, b) recipients of survivors' pension.

5.2.1.7 For the purpose of the actuarial valuation prepared according to IAS 19, it is assumed that the Company will not create new ranks or execute other changes to employment terms and the existing system for rank promotion and salary increases (apart from the general upgrading of the salary scale from time to time due to future salary agreements).

5.2.1.8 It is assumed that there were no changes, and will not be any changes, to employees' rate of part-time employment, and that the current rate of part-time employment reflects the average rate of part-time employment from the past and that will be in future.

5.2.1.9 There is a group of employees who were previously entitled to shift work additions, and who are classified as entitled to this addition in pension; for them it is assumed that they will be entitled to this addition to pension.

5.2.2 In respect of non-permanent employees under special agreements, a real annual salary growth of 2.0% is assumed, including the general salary updates and individual employee salary increases.

5.3 Mortality and disability rates

5.3.1 See Appendix E below regarding changes made to the mortality assumptions.

5.3.2 Life expectancy improvement (decline in mortality rates)

The value of the actuarial liability is highly sensitive to the mortality assumption. It is known that medical developments and lifestyle improvements have helped to increase life expectancy in general. The actuarial assumptions take into account the continued increase in life expectancy.

The mortality rates detailed below are in effect as of December 31, 2008. We assumed a decline in mortality rates (leading to prolonged lifespan) from December 31, 2008 and on, based on the Circular no. 2013-3-1 on the subject of "Calculation Method for Actuarial Balance Sheets and Annuitisation Factors for Pension Funds" issued by the Capital Markets, Insurance and Savings Division of the Israeli Ministry of Finance on January 30, 2013 ("Pension Circular 2013")⁸.

It should be emphasized that there is a great deal of uncertainty regarding this assumption, and an alternative assumption may be just as reasonable (see section 8.4 below).

⁸ According to this model, the average annual decline in mortality rates from 2008 to 2031 for ages 70, 80 and 90, for example, is 1.5%, 1.5% and 0.6% for men (born after 1945), respectively and 2.9%, 2.0% and 0.7% for women, respectively.

5.3.3 Pensioner mortality tables

In July 2012, we carried out an analysis of the mortality records of the Company's employees and pensioners (of different types) from 1996 through 2009, in relation to the mortality tables in the "Position Paper", published by the Capital Markets, Insurance and Savings Division of the Israeli Ministry of Finance regarding an updated basis of demographic assumptions of pension funds ("the study"). In Pension Circular 2013-3-1, which was released after the publication of the Position Paper, the same mortality tables as in the Position Paper were published.

Based on the study, we recommended to the Company to adopt the tables in the "Pension Circular 2013" with adjustments that take into account the experience of the Company, while, inasmuch as the experience was more reliable (the statistical significance of the data is greater), we gave more weight to the experience and less to the "standard" table. The Company accepted our recommendation and established the assumptions accordingly.

For pensioners the assumption is:

- for males –table P3 of the "Pension Circular 2013", without adjustment
- for females –table P3 of the "Pension Circular 2013", increased by 18% until age 67, and from age 68 by a rate which decreases to 0% at age 96, as follows:

Age	up to 67	68	69	70	71	72	73	74	75	76
Rate of increase	18.00%	17.04%	16.10%	14.96%	14.06%	13.20%	12.38%	11.61%	10.62%	9.95%
Age	77	78	79	80	81	82	83	84	85	86
Rate of increase	9.35%	8.52%	7.46%	8.01%	7.39%	6.84%	6.36%	5.95%	5.62%	5.37%
Age	87	88	89	90	91	92	93	94	95	96 and on
Rate of increase	5.20%	4.84%	4.53%	3.91%	3.25%	2.58%	1.88%	1.15%	0.39%	0.00%

Below is a sample of the remaining life expectancy of pensioners, based on this assumption and combined with the assumed improvement in life expectancy.

Age and year	Female	Male
67 at the end of 2010	21.92	20.19
67 at the end of 2020	22.89	20.78
67 at the end of 2030	23.63	21.41

5.3.4 Survivors' mortality

According to the aforementioned study, the assumption for survivors is:

- for males – up to age 60, according to table P2 of the "Pension Circular 2013", decreased by 2%, and applying from age 60 table P5 of the "Pension Circular 2013", decreased by 2%.
- for females – up to age 55, according to table P2 of the "Pension Circular 2013", decreased by 13%, and applying from age 55 until age 67 table P5 of the "Pension Circular 2013" decreased by 13%, and from age 68 by a rate which decreases to 0% at age 96, as follows:

Age	up to 67	68	69	70	71	72	73	74	75	76
Rate of increase	13.00%	12.31%	11.63%	10.80%	10.16%	9.53%	8.94%	8.38%	7.67%	7.19%
Age	77	78	79	80	81	82	83	84	85	86
Rate of increase	6.75%	6.16%	5.39%	5.78%	5.34%	4.94%	4.59%	4.30%	4.06%	3.88%
Age	87	88	89	90	91	92	93	94	95	96 and on
Rate of increase	3.75%	3.50%	3.27%	2.82%	2.35%	1.86%	1.36%	0.83%	0.28%	0.00%

5.3.5 Mortality for active employees

According to the aforementioned study, the assumption for employees is:

- for males – according to table P1 of the "Pension Circular 2013", decreased by 22%.
- for females – according to table P1 of the "Pension Circular 2013", decreased by 16%.

5.3.6 Mortality for disabled pensioners

According to the aforementioned study, the assumption for disabled pensioners is:

- for males – with effect from age 67 according to table P3 of the "Pension Circular 2013", increased by 21%, and below this age a mortality rate of 17% in the first year after retirement, and 1.6% thereafter.
- for females – with effect from age 67 according to table P3 of the "Pension Circular 2013", increased by 15%, and below this age a mortality rate of 17% in the first year after retirement, and 1.6% thereafter.

5.3.7 Disability incidence

– based on Table P8 of the "Pension Circular 2013".

5.3.8 Disability recovery

– no recovery is possible as the liability is in respect of permanent disability.

5.4 Retirement age, leaving and early retirement

5.4.1 As stated in section 5, these assumptions were determined by the Company.

5.4.2 It is assumed that normal retirement will occur at the mandatory retirement age (67 for men and women). Therefore employees over age 67 are assumed to retire immediately.

5.4.3 Leaving rates (prior to normal retirement age), for generation C:

The assumed rates of leaving upon termination and resignation, by age and sex, are detailed in the table below:

For generation C	Leaving rates (resignations) (not entitled to benefits)	Leaving rates (terminations) (From age 60, with service of 10 years and up, entitled to all benefits detailed in section 2.3.2. Below age 60, entitled to supplementation of severance pay at 2.33% only.)	
Age	Women and Men	Women	Men
up to 59	0.16%	0.24%	0.24%
60	—	0.40%	0.40%
61	—	0.40%	0.40%
62	—	0.85%	0.87%
63	—	0.85%	0.87%
64	—	0.85%	0.87%
65	—	1.62%	1.73%
66	—	4.76%	2.56%

5.4.4 Leaving and early retirement rates (prior to normal retirement age), for those insured in the defined benefit pension plan:

It is assumed that there will be no leavers at all, besides for early retirements.

The early retirement rates represent the assumption regarding early retirements that are not defined as "termination benefits" pursuant to IAS 19 since, according to IAS 19, the cost of terminations is not to be recognized in advance except under certain conditions. In practice, this assumption is difficult to make as it is very difficult to distinguish between early retirements that should be defined as termination benefits and others. It is even more difficult to make this assumption because employees' behavior in regard to terminations is highly affected by various past and future special retirement programs.

The early retirement rate assumption was determined by the Company on the basis of past experience, from the years 2002 to 2013, of the rate of early retirements, excluding retirements within a special early retirement program (defined as terminations). This assumption has been updated for the valuation at December 31, 2013 (see section 6 below). The early retirement rate assumption, by age and sex, is detailed in the table below:

Early retirement rates Employees in defined benefit pension plan					
Age	Female	Male	Age	Female	Male
Up to 40	0.00%	0.00%	53	0.20%	0.15%
40	0.03%	0.08%	54	0.20%	0.15%
41	0.03%	0.08%	55	0.24%	0.23%
42	0.03%	0.08%	56	0.24%	0.23%
43	0.03%	0.08%	57	0.24%	0.23%
44	0.03%	0.08%	58	0.24%	0.23%
45	0.09%	0.13%	59	0.24%	0.23%
46	0.09%	0.13%	60	0.24%	0.23%
47	0.09%	0.13%	61	0.24%	0.23%
48	0.09%	0.13%	62	1.70%	1.74%
49	0.09%	0.13%	63	1.70%	1.74%
50	0.20%	0.15%	64	1.70%	1.74%
51	0.20%	0.15%	65	3.23%	3.46%
52	0.20%	0.15%	66	9.52%	5.11%

5.4.5 Leaving in respect of non-permanent employees under special agreements:

The assumed rates of leaving with eligibility for benefits included in this valuation, by service, are detailed in the following table:

Service	Leaving rates (terminations) (eligible for benefits)
0	3.0%
1	1.5%
2+	0.0%

- * For non-permanent employees under special agreements, in addition to these rates, it is assumed that they will leave at the end of the maximum work period based on the special agreements, which is 5 or 10 years from commencement (whether it is 5 or 10 depends on the date of commencement of work), and will receive increased severance pay upon leaving.

5.5 Marriage rates and age difference between spouses

– Marriage rates for males are according to Table P10 of the Pensions Circular 2013-3-1, and for females according to Table P9 of the Pensions Circular 2007-3-6, and from age 68 according to Table P10 of the Pensions Circular 2013-3-1. It is assumed that widow/ers will not remarry, so the payment of a survivor's pension to the widow/er is not assumed to discontinue due to remarriage. The age difference between a man and his spouse is a constant 3.2 years up to age 67, and linearly increases up to an age difference of 8.7 at age 110. The age difference between a female and her spouse is a constant 3 years (the female is younger). This assumption was made by the Company.

5.6 Orphans

The number of children and their ages are determined according to Table P11 of the Circular. These assumptions were made by the Company.

- 5.7 Utilization of sick leave days (for calculating the unused sick leave benefit)
It is assumed that every employee's proportion of unutilized sick leave days will be identical to the proportion of unutilized sick leave for the working period until the valuation date. This assumption was made by the Company.
- 5.8 It is assumed that all non-permanent employees under special agreements will receive increased severance pay.
- 5.9 Future Company expenditure in respect of the operation of the pension plan was not taken into account.
- 5.10 Below are certain issues that were not taken into consideration in the valuation. We believe the overall effect of these issues is immaterial:
- pensions for "dependent orphans" over age 21 for future orphans;
 - possible future pensions for "dependent parents" of deceased employees or pensioners;
 - increases in pensions to future orphans in the absence of widow/ers (not taken into account);
 - the actual dates on which pension is paid for 13th and 14th salaries (we assumed that the 12th portion of the annual allowance is paid monthly);
 - possible grant of discounted electricity and holiday gifts to orphans (we assume that all orphans have a parent receiving these benefits);
 - a few pensioners who received a capitalized amount of future pensions for a period of 6 years. The valuation is not based on the decreased pension during the remaining capitalization period but rather on the full pension;
 - additional severance pay or grants in respect of the difference between the salary reported in the data file and the minimum salary, to be paid to a small number of generation C employees who retire or leave with salary lower than the minimum salary;
 - the supplement to the disability pension with respect to dependants was not taken into account for future disabled pensioners. On the other hand, a reduction to the supplement to the disability pension with respect to dependants was not taken into account for existing disabled pensioners in respect of the future death of the dependants;
 - the liability in respect of the additional benefit for life insurance in the event of an accident was not taken into account;
 - the increased bereaved parent pension in respect of active employees was not taken into account; and
 - the following additional benefits for pensioners / survivors were not taken into account:
 - bonuses on marriage and birth (including tax grossing up);
 - gifts for children of pensioners and survivors serving in the IDF (including grossing up);
 - Company participation in the cost of setting a tombstone and a bouquet of flowers – solely in cases of death as a result of a work accident;
 - compensation in cases of death as a result of a work accident, to the amount of 36 months' salaries;
 - meals partially subsidized by the Company at Company facilities – up to 10 meals per month;

- Higher Education grants for children of widows of employees who died while working for the Company;
- an outing for widows of workers who died while working for the Company; and
- reduction of cost of connecting electricity to the pensioner's apartment as well as transfer or increase of existing connection.

6. **Valuation changes in the current valuation**

For changes made prior to the current valuation, see Appendix E.

Each quarter, interest rates were updated in accordance with market interest rates at the valuation date. In addition, for this valuation, there was a transition to discounting based on the returns of high quality corporate bonds.

The impact, as at the valuation date, of the transition from a discount rate based on Government bonds to a discount rate based on corporate bonds was a decrease in the liability of about NIS 5,166 million.

In the fourth quarter, the salary increase assumption was updated in accordance with our recommendation which is based on actual past experience, the Company's expectations and inflation expectations. The main change is to the assumed salary increase that results from general wage agreements, from -1.38% real (and 1% nominal for 2013 to 2014) to -0.75% real (and 0.8% nominal for the years 2013 to 2016 inclusive), which increased the liability by NIS 1,078 million. Other changes in salary increase assumptions reduced the liability by about NIS 11 million.

In addition, in the current quarter, the assumed increase in the future electricity tariff was updated in accordance with the Company's expectations. This change increased the liability by about NIS 53 million.

In the current quarter, we received updated information regarding the determining service for entitlement to severance pay for generation C employees. This update reduced the liability by about NIS 8 million.

In the year of this report there were no other changes to assumptions or to the rules according to which the liability is calculated.

7. **Valuation results**

The values of the liabilities (in million NIS) as at December 31, 2014, without offsetting against plan assets, are as follows:

7.1	The liabilities, for all the benefits included in this valuation, except for the liability for special agreements on early retirement, for "20 year grant" and for increased severance payments for (non-permanent) employees under special agreement:

Active employees	16,103.3
Pensioners and survivors	10,147.2
Total	26,250.5

7.2	Liability for special agreements on early retirement – in respect of the past:

Pensioners and survivors	82.5

7.3	Liability for 20 year grant:

Active employees	16.2

7.4	Liability for increased severance payments for (non-permanent) employees under special agreement – in respect of the past:

Active employees	22.4

In Appendix A, additional information is provided which is required for the financial statement disclosures according to IAS 19.

8. Uncertainties and risks

8.1 Due to the nature of the benefits and the long term of the valuation, the future payments of benefits are uncertain and may materially differ in practice from this valuation despite the efforts made to assess them as accurately as possible. For this reason, the Company is exposed to a risk that the estimated liability does not properly represent future payments and, consequently, additional costs will be incurred in the future for past accrued rights that are under-estimated and/or additional revenues will be derived from past accrued rights that are over-estimated. Below are the main issues that we believe result in said uncertainties and risks.

8.2 Interest, inflation and returns

Future fluctuations in market interest rates used to estimate the liabilities (using discounted expected cash flows) will change the gross value of the liabilities. Higher or lower plan asset returns compared to these interest rates will result in the decrease or increase of the net liabilities, respectively. At times, these two changes are offset one against the other to a certain extent based on the level of matching between the assets and liabilities.

Sensitivity analysis:

- a) If the discount rate falls by 1%, the liability will increase by NIS 4,880 million (18.5%).
- b) If the discount rate falls by 0.1%, the liability will increase by NIS 442 million.
- c) If the discount rate increases by 0.1%, the liability will decrease by NIS 415 million.

Actual inflationary changes affect the value of the liability (indirectly due to the connection between salary / pension and inflation) and the value of the assets (due to index-linked assets) and in this case, the two changes are offset one against the other to a certain extent.

Anticipated inflationary changes affect the value of the liability and the value of the assets based on the anticipated inflationary influence on market interest rates and the value of unlinked assets.

8.3 Future salary increases

The assumption of general salary increases (in respect of salary and cost-of-living allowance agreements) considerably affects future cash flows. The assumption is 0.8% per year nominal for the period 2013 to 2016 and -0.75% real from 2017 onwards (i.e. the pensionable salary will erode, before taking into account promotion in grade or role, service increment etc.).

Sensitivity analysis:

- a) If the actual change (in respect of salary and cost-of-living allowance agreements) to the overall salary scale is at the actual inflation rate (linked to the CPI), the liability will increase by approximately NIS 876 million (3.3%).
- b) Similarly, if the actual change of salary will be higher than what is assumed, by 0.5% per year, the liability will increase by approximately NIS 730 million. If the actual change of salary will be lower than what is assumed, by 0.5% per year, without a change to the rate of pension increases, the liability will decrease by approximately NIS 684 million.

8.4 Life expectancy

Although the actual mortality rates are relatively stable, and the mortality assumption corresponds with current experience relatively well, the mortality factor contains considerable uncertainty regarding the distant future owing to the increase in life expectancy, whose rate is extremely difficult to assess and may significantly differ from the assumption. The life expectancy increase rate is affected by behavioral and social changes and by medical developments, both past and future, and these factors are liable to affect life expectancy significantly and unexpectedly, in addition to the fact that, even without these new developments, the changes in future life expectancy cannot be clearly foreseen.

Sensitivity analysis: if the annual rates of decline in mortality are double what was assumed⁹, the life expectancy of a 67 year-old male at the end of 2020 (for example) will rise from 20.78 to 22.87 years (for women – from 22.89 to 25.41 years) and the total liability will increase by approximately NIS 1,251 million (4.7%).

For comparison sake: if the actual mortality rates will be 20% lower than assumed, the life expectancy of a 67 year-old male at the end of 2020 (for example) will rise from 20.78 to 22.5 years (for women – from 22.89 to 24.51 years) and the total liability will increase by approximately NIS 1,241 million (4.7%).

8.5 Early retirements

As stated in section 5.4.3 above, the early retirement pattern is relatively unstable and the determination of the assumption is highly challenging both due to the applicable accounting standards and since it is naturally difficult to anticipate employee behavior in an unstable environment. This phenomenon materially affects the payment of benefits and the valuation of the liability since under early retirement the employee will begin receiving the fully accrued pension immediately without any pension reduction that would have offset the added cost of pension payments in the years prior to normal retirement age.

Sensitivity analysis: if the actual early retirement rates are double the assumed rates (see section 5.4.3 above), the total liability will increase by approximately NIS 286 million (1.1%).

Yours truly,

Ernst & Young (Israel) Ltd.

⁹ See section 5.3.2 above.

Appendix A – additional reports for disclosure in the financial statements

Introduction

- In this section, the actuarial liability and the additional results are divided into 3 sections:
 1. Amounts relating to all post-employment benefits which are paid by the Fund, and assets of the Fund. See Tables 1, 4, 6 & 9 below.
 2. Amounts relating to other post-employment benefits (including severance pay, all grants after the termination of employment, discounted electricity, and holiday gifts to pensioners) and assets not in the Fund but designated for the coverage of actuarial obligations. See Tables 2, 3, 5, 7 & 10 below.
 3. Amounts relating to other long-term benefits, including the "20 year benefit". See Table 12 below.

(Table 8 relates to all pension and other post-employment benefits.)

- This report is presented on a real (index-linked) basis.
- All amounts are in NIS millions.

1. Surplus assets at end of the period

	31.12.2014	31.12.2013	31.12.2012
Fair value of plan assets	27,739	24,988	24,103
Present value of the obligation - gross	(23,352)	(22,853)	(22,756)
Subtotal	4,387	2,135	1,347
Obligation at end of period - pensions	(77)	(119)	(171)
Surplus assets	4,310	2,016	1,176

2. Funds in trust – designated for actuarial obligations (116A assets)

	31.12.2014	31.12.2013	31.12.2012
Funds in trust to cover actuarial obligations (assets per Section 116A)	1,909	1,725	1,972

3. Liability at the end of the period for other post-employment benefits (including special agreements for early retirement)

	31.12.2014	31.12.2013	31.12.2012
Present value of obligation for other post-employment benefits	2,928	2,916	3,042

4. Movement in the present value of the obligation

	Year ending 31.12.2014	Year ending 31.12.2013	Year ending 31.12.2012
Present value of the obligation –beginning of period	22,853	22,756	16,967
Interest cost	522	519	533
Current service cost	299	306	257
Past service cost - changes to plan conditions on account of inflation-linking of pensions	0	0	2,810
Benefits paid	(692)	(636)	(616)
Losses (gains) on remeasurement:			
Actuarial losses (gains) from demographic assumption changes	0	(152)	(6)
Actuarial losses (gains) from financial assumption changes	25	(108)	2,362
Experience adjustments	<u>345</u>	<u>168</u>	<u>449</u>
Total actuarial losses (gains) on remeasurement	<u>370</u>	<u>(92)</u>	<u>2,805</u>
Present value of the obligation – end of period	23,352	22,853	22,756

5. Movement in the present value of the obligation for post-employment benefits (including obligation for special agreements for early retirement)

	Year ending 31.12.2014	Year ending 31.12.2013	Year ending 31.12.2012
Present value of the obligation – beginning of period	2,916	3,042	2,631
Interest cost	67	70	72
Current service cost	61	61	50
Cost of new retirements – early retirement	0	0	0
Past service cost - changes to plan conditions on account of inflation-linking of pensions	0	0	42
Benefits paid	(95)	(66)	(63)
Losses (gains) on remeasurement:			
Actuarial losses (gains) from demographic assumption changes	0	(24)	(1)
Actuarial losses (gains) from financial assumption changes	(111)	(160)	507
Experience adjustments	<u>90</u>	<u>(7)</u>	<u>(196)</u>
Total actuarial losses (gains) on remeasurement	<u>(21)</u>	<u>(191)</u>	<u>310</u>
Present value of the obligation – end of period	2,928	2,916	3,042

6. Movement in the fair value of plan assets

	Year ending 31.12.2014	Year ending 31.12.2013	Year ending 31.12.2012
Fair value of plan assets – beginning of period	24,988	24,103	21,948
Interest income on plan assets	570	552	607
Company contributions – including employee contributions	600	795	613
Benefits paid	(706)	(686)	(675)
Gains (losses) on remeasurement:			
Return on plan assets (excluding amounts included in interest income)	2,287	224	1,610
Fair value of plan assets – end of period	27,739	24,988	24,103

7. Movement in the fair value of the funds in trust to cover actuarial obligation (116A assets)

	Year ending 31.12.2014	Year ending 31.12.2013	Year ending 31.12.2012
Fair value of trust assets – beginning of period	1,725	1,972	2,113
Interest income on trust assets	39	40	55
Company contributions	0	0	0
Benefits paid	0	(253)	(355)
Gains (losses) on remeasurement:			
Return on trust assets (excluding amounts included in interest income)	145	(34)	159
Fair value of trust assets – end of period	1,909	1,725	1,972

8. Components of the costs for the period of all the post-employment benefits

	Year ending 31.12.2014	Year ending 31.12.2013	Year ending 31.12.2012
Current service cost	360	367	307
Employee participation	(28)	(27)	(26)
Net current service cost	332	340	281
Interest cost	589	589	605
Past service cost - changes to plan conditions on account of inflation-linking of pensions	0	0	2,852
Interest income from plan assets	(570)	(552)	(607)
Interest income from trust assets (116A assets)	(39)	(40)	(55)
Total costs for the period	312	337	3,076

9. Actual return on assets

	Year ending 31.12.2014	Year ending 31.12.2013	Year ending 31.12.2012
Interest income on plan assets	570	552	607
Return on plan assets (excluding amounts included in interest income)	2,287	224	1,610
Actual return on plan assets	2,857	776	2,217

10. Actual return on assets in trust to cover actuarial obligation (116A assets)

	Year ending 31.12.2014	Year ending 31.12.2013	Year ending 31.12.2012
Interest income on trust assets	39	40	55
Return on trust assets (excluding amounts included in interest income)	145	(34)	159
Actual return on trust assets	184	6	214

11. Obligation for special agreements for early retirement (termination benefits)

	31.12.2014	31.12.2013	31.12.2012
Obligation at end of period - pensions	77	119	171
Obligation at end of period – other benefits**	5	8	10
Obligation at end of period – total	82	127	181

(**) These obligations are included in Tables 3 & 5 above.

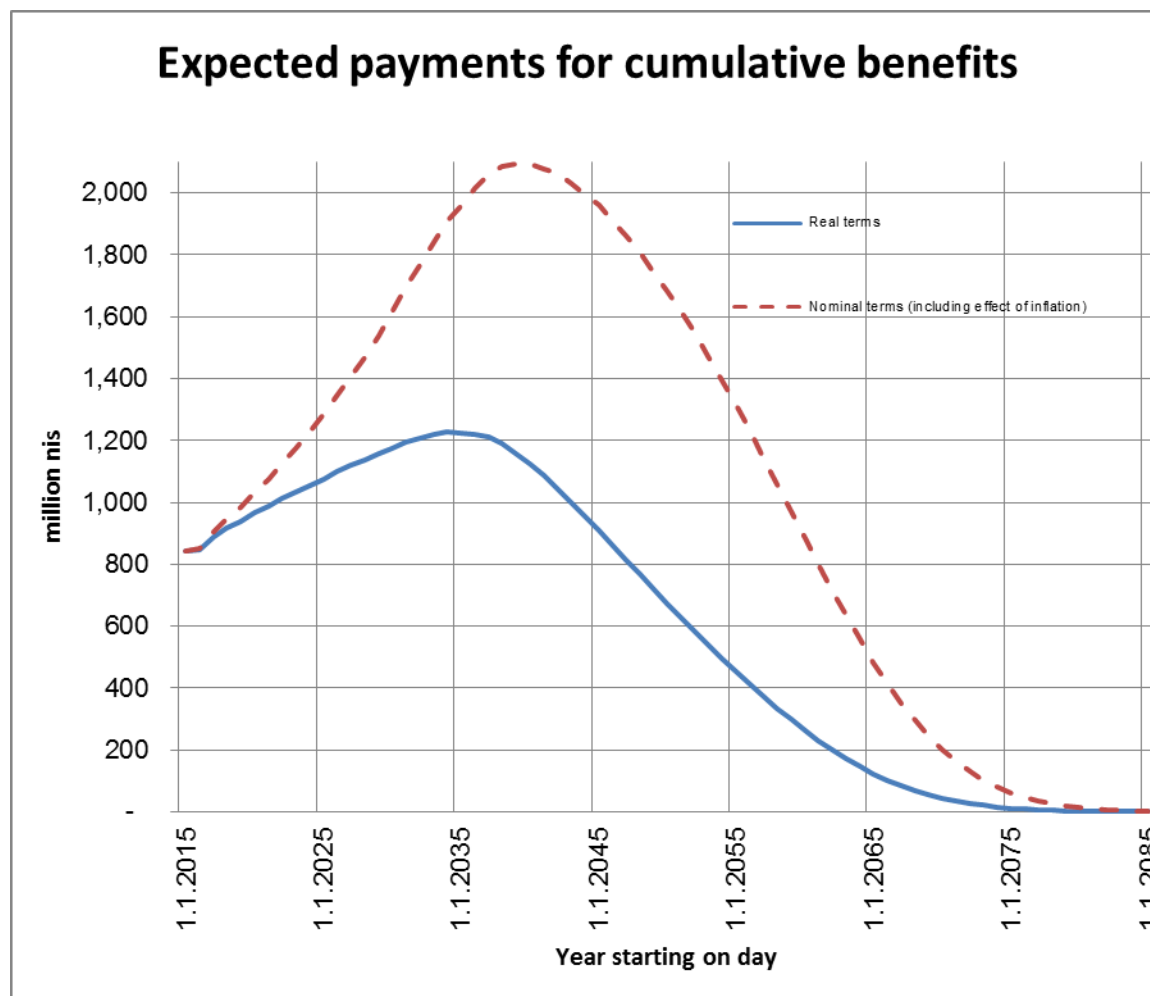
12. Obligation for 20 year grant (other long-term employee benefits)

	31.12.2014	31.12.2013	31.12.2012
Obligation at end of period	16	18	22

Appendix B – forecasted benefit payments

Below is a graph of the expected cash flows included in the valuation (including all benefits for all employees and pensioners), in real terms and in nominal terms (including the future expected influence of inflation).

The payments are annual.



Appendix C – additional detail regarding the financial assumptions (annual rates shown)

	Period ending		
	31.12.2012	31.12.2013	31.12.2014
Weighted average real discount rate used to compute liabilities *	2.28%	2.29%	2.56%
Real interest rate used to compute the interest cost on pension liabilities *	2.77%	2.28%	2.29%
Real interest rate used to compute the interest cost on other post-employment liabilities	2.77%	2.28%	2.29%
Expected real return on plan assets	2.77%	2.28%	2.29%
Expected real return on trust assets (116A assets)	2.77%	2.28%	2.29%
Expected inflation rate	2.60%	2.41%	2.15%

* In practice the valuation was performed according to a vector of interest rates (a yield curve) which was determined by Mervach Hogen Ltd and which we received from the Company (see section 5.1.2). The above rate represents the vector of interest rates in consideration of the expected liability cashflow at each point in time. A valuation according to this constant interest rate leads to the same results as presented in this report.

Appendix D – additional detail regarding the assumptions

List of data files received from the Company:

1. "ong1214" – 15,275 records – data including all employees / retirees / survivors (permanent workers only).
2. "actuarpizuisug13411214" - 689 records – data including all non-permanent workers (special agreement).
3. " 2014 דצמבר פורשי" – updated to include generation C employees – 22 records.
4. "change102014", "change112014", "change122014", "change122014g" – files that describe status changes of employees / retirees in the months October to December 2014.
5. "2014 דצמבר חשמל" – data regarding electricity rates, rate of VAT and grossing up of tax.
6. "2014 דצמבר שי" – value of holiday gifts grossed-up for tax.
7. " רשימת עובדי דור ג' שהחברה לא משכה את כספי השלמת הפיצויים בשיעור 2.33% בגין תקופת ארעיותם נכון 2014 דצמבר" – 453 records – data regarding granting of permanent employee status in respect of generation C employees only.

Appendix E – changes to the valuation that took effect in the 3 years prior to the current year

Changes that took effect in the course of 2013

- The assumed increase in the electricity rate (which is required for calculating the liability in respect of the discounted electricity benefit) was updated in the valuation at June 30, 2013, according to the Company's expectations. The updated assumption is for the years 2013 to 2015 only. The impact of this update was a decrease in the liability of about NIS 3 million. Another update to the assumption for the years 2014 to 2015 according to the Company's expectations was made in the valuation at December 31, 2013, and its impact is a decrease in the liability of about NIS 10 million.
- During July 2013 a new salary agreement was signed, under which salaries would be increased by 0.9456%. Likewise, for pensioners who retired between July 2012 and June 2013, the pension would be increased by a rate of between 0.1576% and 0.9456%, based on the retirement date. The agreement is in respect of the period July 2012 to December 2012. The increase according to the salary agreement, over and above the assumed increase of 0.5% that was taken into account in the valuation at March 31, 2013, increased the valuation liability at June 30, 2013, by about NIS 52 million.
- In the valuation at June 30, 2013, the amounts of life insurance were updated. This update increased the valuation liability by about NIS 13 million.
- In September 2013 we carried out an experience analysis of the electricity consumption among pensioners, from 2005 to 2012. Based on the analysis, we recommended to the Company to adopt an electricity consumption assumption based on age and pensioner group. The Company accepted our recommendation, and the assumption for the valuation at December 31, 2013 was set accordingly. This change to the electricity consumption assumption reduced the valuation liability by about NIS 81 million.
- During December 2013 we conducted an analysis of marriage rates and age differences between pensioners and their spouses. The Company accepted our recommendation and the assumption for the valuation at December 31, 2013 was set accordingly. The impact of the change in assumption was a decrease in the liability of about NIS 98 million.
- During January 2014 we conducted an update to the analysis of historical early retirements, excluding retirements within a special early retirement program (defined as terminations), based on data from 2002 to 2013, in order to make a recommendation for the early retirement rates assumption. The Company accepted our recommendation and the assumption for the valuation at December 31, 2013 was set accordingly. The impact of the change in assumption was a decrease in the liability of about NIS 78 million.

Changes that took effect in the course of 2012

In December 2012 we carried out an analysis of the disability incidence experience among active employees, in the years 2004 to 2011, relative to the disability incidence tables of Pension Circular 2012-3-4 (replaced in January 2013 by Pension Circular 2013-3-1, with no change to the tables). On the basis of the study we recommended the Company to adopt the new disability incidence table, P8 of this Circular. The company accepted our recommendation and the assumption in this quarter was set accordingly. The aforementioned change to the disability incidence table reduced the liability by about NIS 142 million.

In the valuation as at December 31, 2012, the liability in respect of life insurance benefits totaling about NIS 88 million was taken into account. This liability was not taken into account in previous valuations. The comparative figures for previous periods in Appendix A have been amended to reflect this benefit.

After giving consideration to the leaving rates assumption in reference to a generation C employee, for the valuation as at September 30, 2012 this assumption was changed: The leaving rates for generation C employees were set to a rate of 0.4% up to age 61 (inclusive), where up to age 59 (inclusive) the proportion of resignations among the leavers is assumed to be 40% and the proportion of terminations is assumed to be 60%, and at ages 60-61 all are assumed to be terminations. The assumed rates of terminations beyond age 61 were set to be 50% of the early retirement rates of generation A and B employees. This change had an immaterial impact on the value of the liability, to the amount of about NIS 1.5 million (decrease in the liability).

In the valuation as at March 31, 2012, the assumption regarding the future annual increase of salary and cost-of-living allowance agreements (the general update of the salary scale) was changed to the actual increase in the CPI index minus 1.38% per year. This rate is determined by the Company on the basis of salary growth for the years 1990-2012. In the previous valuation the assumption was as stated, minus 1.54% (see section 5.2.2.1) – this change increased the liability before the implementation of the CPI index link agreement by about NIS 419 million. The impact of this assumption was partially offset by about NIS 229 million, due to the implementation of the CPI index link agreement, so that the total impact of the assumption change, considering the existence of the agreement, was an increase of about NIS 190 million.

In the valuation as at March 31, 2012, the pension updating mechanism was changed on account of the linked pensions agreement, which came into force in February 2012. According to the agreement, with effect from January 1, 2012, the determining salary components for calculating monthly pensions will be updated in January each year, in accordance with the rate of annual change in consumer price index (the ratio of the index for the most recent month of December to the index for the December previous to that). This change increased the liability by NIS 2,771 million, of which a total of NIS 768 million is unrecognized past service cost.

In the valuation as at June 30, 2012, the following assumptions changed:

- On July 11, 2012 the Ministry of Finance published a draft working paper that includes, among others, a proposal for new mortality assumptions. Although this constitutes a draft proposal, and it is possible for draft proposals to change, the Company decided that it is correct to consider the information and opinions of the Ministry of Finance, which are contained in the draft working paper. In addition, in order to test the suitability of the proposed new assumptions of the Ministry of Finance, a mortality study was carried out for the Company's employees, pensioners and survivors. As a result of this process, we made recommendations to the Company regarding changes to mortality assumptions, the overall effect of which is about a NIS 125 million increase in the liabilities. The changes are:

- a) Adoption of the proposed new assumption of the Ministry of Finance regarding future changes in current mortality rates. This change led to most of the aforementioned effect.
 - b) Adoption of the proposed new mortality tables of the Ministry of Finance, inasmuch as they are adjusted based on the mortality experience of the Company (except for male pensioners where an adjustment was not required). Note that since the previous assumptions were reasonable overall for the Company, these changes (adoption of the new tables with adjustments) did not cause a significant change in the liabilities.
- Just before the valuation as at June 30, 2012, a study was conducted to quantify those changes in employees' salaries which do not stem from general salary agreements or from ongoing and regular increases (such as promotion in grade and service increment). The findings of this study indicate that, on average, there has been an additional salary increase of about 0.2% per year on average. This additional increase is due to employee promotions (the transfer of employees from one role to another, where the employee begins the new role at a higher grade, or another grade scale, in accordance with the definitions of the role). Therefore, the Company decided to assume the average additional salary increase at rates which vary by age group, which are detailed in 5.2.2.3 above, in accordance with the findings of the study. The impact of this assumption change in the valuation is an increase of about NIS 240 million.
 - The assumed increase in the electricity rate (which is required for calculating the liability in respect of the discounted electricity benefit) has been updated to reflect the change in the Electricity Authority's outline of the electricity rate increase in coming years. The essence of the change, in relation to the previous assumption, is the spread over several years of the required rate increase and the addition of "interest" due to the spread, rather than a once-off increase in 2012, as was assumed in the previous valuation. Since this does not constitute a significant change in the expected overall increase (but only to the timing of the increase), this change caused an immaterial increase in the liabilities.

Changes that took effect in the course of 2011

For the valuation in September 2011, the yield curve that the Company used for discounting the actuarial liabilities was as quoted by Mervach Hogen Ltd, in light of it having been chosen as the company to quote prices and interest rates, when previously the Company used a quote of the yield curve from Shaarey Ribbit Ltd. Accordingly, the move led to an increase in liabilities, as at September 30, 2011, of NIS 320 million, which is attributed to actuarial losses which have not been recognized.

For the valuation in December 2011, a change to the assumed increase in the cost of discounted electricity was made. Up to the third quarter of 2011, the cost of electricity was assumed to be linked to CPI. For this valuation, the price of discounted electricity was assumed to increase at a real rate of 21% in April 2012, then decrease at a real rate of 16.5% in June 2013 (relative to the current rate - that is, the cumulative real increase from the valuation date to June 2013 will be 4.5%) and then, from the start of 2014 will grow at a real rate of 0.25% per year.

In parallel with this change, it is assumed that 8.12% of pensioners will not receive discounted electricity. This new assumption offset most of the impact of the stated change to the assumed increase in cost.

In addition, another change was made with regards to the payment of discounted electricity and holiday gifts for pensioners before retirement age in order to more accurately reflect the grossed up tax. The impact of this change was negligible.

Overall, these changes have increased the liability by approximately NIS 10 million.

Additional influences of the salary agreement are expressed in the cancellation of the Commissioner's position regarding:

- (a) eligibility to the 14th salary:
 - starting from the 1st quarter of 2011, eligibility to the 14th salary is after 25 or 20 years' service for males and females respectively, in place of 30 or 25 years.
- (b) rank promotion for pensioners:
 - starting from the valuation date until the 1st quarter of 2011, there is no adjustment of rank granted until the valuation date (every two years), whereas, previously, rank promotion until the valuation date was adjusted every 3 years.

This change is defined by the Company as a "plan change", and its influence is charged as pension expenses for the period (see section "Prior service cost – changes in plan conditions due to decisions by MOF" in section 4 of Appendix A above).

Description of the Main Rights which Should be Taken into Consideration in Determining the Actuarial Obligation with respect to Benefits After Termination of Employment

The Determining Salary Components for Calculating the Pension:

1. **Normal Salary** - including combined salary, service increment (up to a 40 year maximum), extra effort increment, continuing education payments, job classification increment, personal extra, cost of living allowance.

Normal Salary Calculation Formula (will be paid to pensioners/survivors according to the pension rate):

$$\text{Normal salary} = \left[\text{Extra Effort} + \text{Continuing Education} + \text{Personal Extra} \right] + (1.01)^N \times \left[\text{Command Increment} \times \text{Percentage} + 1 \right] \times \left[\text{Cost of Living Allowance Rate} + 1 \right] \times \text{Salary Grade}$$

N – number of years of service for calculating the service increment for payment

Normal Salary Components:

The Combined Salary is according to accepted salary tables in the Company.

On July 18, 2013, a new collective agreement (salary agreement) was signed for a period until December 31, 2014. The Company's salary agreement is based on the salary agreement signed by the civil service in May, 2013, and entered into effect upon legislation of the Law - "Participation of employees, officers and other officials in the public service in measures to stabilize the fiscal situation in the country during the years 2013 and 2014 (Temporary Order), 5773-2013"

The previous salary agreement of the Company as of January 31, 2011, granted the Company's employees a salary increment of 5.75% for the period ended on June 30, 2012. Under the current salary agreement, that exhausts the demands of the employees regarding salary increments for the period until December 31, 2012, the employees are entitled to a salary increment of approximately 1% (completion to 6.75%) commencing on July 1, 2013. Despite the aforesaid, the beginning of entitlement to the above mentioned salary increment was postponed by consent to January 1, 2015 (the increment will be paid currently and not retrospectively), except for the purpose of executing Company provisions and/or payments relating to, inter alia, the following sections:

- Single payments paid at the time of termination of employee-employer relations (severance payments, grants).
- Pension payments to a pensioner (or survivor) whose termination of employment is reported starting from July 1, 2013.

Appendix F – Details of Benefits

A pensioner (or survivor) whose termination of employment was reported during the period of July 2012 – June 2013 received a graded increment to the pension according to the month of termination of employment (up to a maximum of 0.945%). It should be noted that these are not retroactive payments.

The combined salary of Management level members includes global payment for overtime.

Regarding this matter also see the reference by the Supervisor of Wages in his address of October 10, 2013, regarding global overtime for pension of members of the management of the Company, members of the management ranking at Heads of Divisions/Districts and above receive salary having a structure of “comprehensive salary”, which is composed of a rank value and a global overtime value, and are not entitled to a separate payment with respect to overtime. The Supervisor of Wages instructs not to include the global overtime in the pension salary of the Company management members who were appointed after 1996. The Supervisor of Wages intends to consider a demand to return payments paid in excess to active and pensioner members of management .

In legal proceedings held in the months of March - September 2014, the Court ruled that at this stage the stated decision by the Supervisor of Wages will not enter into force, and that the parties will later on submit an update to the Court with regard to the recommendations of the Steering Team or the discussions regarding the implementation of the recommendations, and a continued hearing of the application will accordingly be determined.

On December 11, 2014, the Supervisor of Wages sent a letter with respect to his decision regarding the salary irregularities and the retirement terms of the Company. In his letter, the Supervisor of Wages continues to demand the implementation of his decision of October 10, 2013. In this letter, he repeated the main points of the previous decision, with only slight changes. At the same time, there is continued communication with the Supervisor of Wages regarding the Company's proposal for an alternative arrangement. The procedure is scheduled for a hearing on January 4, 2015 and, if necessary, for January 7, 2015 as well.

As of the date of the report, the matter is pending in Court.

(a) Service increment:

1. The annual service increment rate is 1% for each year of service.
2. The Service Increment Calculation Formula:

Service Increment Amount for Payment = $[(1.01)^N - 1] \times (\text{job classification increment} + \text{salary grade})$.

N – number of service years for payments where $N \leq 40$ (as detailed in HR procedure "Service Increment" No. 04-01-02).

3. Masters Degree Service:

Another service increment at a 50% rate, starting from completing the studies for a master's degree, for employees at the grade of engineers, academics and lawyers only (instead of a service increment of one year, each year, such an employee is entitled to a service increment of 1.5 years for each year from the Master's studies completion date onwards).

4. Service Increment/ Pension Percentages with respect to Security Service prior to Establishing the State of Israel/ Prisoners of Zion:

An employee who served a full active service period in one of the recognized service units (Palmach, Hagana, Etzel, Lehi, British Army Jewish Brigade, Palestinian Ghaffir, Policeman in the Mandate Police) - 80% of the service period will be added to the work service factor for determining the pension rate.

- An employee who served as a volunteer in the Hagana, Etzel or Lehi and is entitled to ALEH decoration – is entitled to a 3% increase in his pension.
- A "Prisoner of Zion" employee – will receive a 1% increase in pension for each year of recognized imprisonment, up to a total of 5%.
In any event, the total pension rate will not exceed 70%.

(b) Extra Effort Increment:

1. An increment paid according to entitlement groups and updated for active employees with each cost of living allowance and each work agreement.
2. The Main Entitlement Groups are:
 - Group A – Maintenance employees.
 - Group B – Other workers, meter readers.
 - Group C – The population that is not defined in groups A, B, D.
 - Group D – Trainees in a shift.

(c) Managers continuing education payment:

1. Monetary increment paid to employees of management rank, who meet the entitlement terms.
2. Entitlement terms are:

Employees whose nominal grade is 14 at least.

- Who are high school/vocational school graduates, including 11 years of education.
- Who completed two study years in a higher education institution or completed a pre-defined number of study hours related to their occupation or profession, as detailed below:

<u>Service years in the field of occupation/ profession</u>	<u>Required study hours related to the occupation or the profession</u>
Up to one year	800
Up to two years	700
Up to four years	600
Up to six years	500
Up to eight years	400
Up to ten years	300
Up to twelve years	200
Twelve years and up	100

Note: An employee with long tenure in his occupation requires a smaller number of study hours.

3. Employees who fulfill all the terms specified in section 2 and also accumulated 400 study hours according to the tests listed in Section 5 of HR procedure "Continuing Education Payments to Employees in Managerial Grade" (No.04-01-04).

4. Threshold Terms (for section 3):
Courses/continuing education recognized by the "Committee for Recognizing Courses and Continuing Education of the Ministry of Education and Culture" and listed in the Approved Courses List, that ended within a period of 5 years prior to the request for payment filing date.
5. Rate Update:
Managerial continuing education payments rate is updated for active employees according to each cost of living increment. Rate update derived from a wages agreement – if specified in the agreement.

(d) Professional Continuing Education Payment:

1. A monetary increment paid to employees in the professional rank (academic degrees, engineers, lawyers, practical engineers and technicians) who fulfill the terms of entitlement, as detailed in HR procedure 04-01-05.
2. The entitlement to continuing education payment A and B is determined by a joint committee of representatives of the professional Histadrut and representatives of the Ministry of Finance.
3. Recognition of Studies Period for Payment A:
Courses and continuing education that ended in a period of up to 5 years prior to submitting the request for continuing education payment to the payment committee will be recognized, even when these occurred before the employee was entitled to the degree.
4. Recognition of Studies Period for Payment B:
An employee in a professional grade who received continuing education payment A, who completed a continuing education of 400 study hours at least and fulfilled the entitlement terms specified in HR procedure "Continuing Education Payment to Employees in a Professional Grade" (No. 04-01-05) is entitled to payment B.
5. Rate Update:
 - Rates of payment for professional continuing education A + B are published and updated from time to time for active employees by the Supervisor of Wages and Work Agreements in the Ministry of Finance. The rate update that is derived from the salary agreement provided it is specified in the agreement.
 - Employees in the professional grade, at grade 44 (nominal) and up will receive payment at the rate of continuing education B, at a rate of 9% of the salary grade and the service increment of the employee (without the part with respect to job classification increment), up to the ceiling specified in the related HR procedure or according to the standard rate, the higher of the two.

(e) Job Classification Increment:

1. Employees defined as managers are entitled to Job Classification Increment according to the defined group to which they belong:
 - M – Professional group: 2.5% (*)
 - P – 1 Unit leaders, deputy unit leaders, group leaders and their equivalents: 5.5%
 - P – 2 "Large" units leaders, foremen and their equivalents: 6.5%
 - P – 3 Deputy Department Managers, Senior unit leaders
Senior foremen and their equivalents, special roles and senior experts: 7.5%
 - P – 4 Department Managers, Special roles and senior experts
at peak rank: 10.0%
 - Note: Defined as Equivalent 5960, 1960, 5521, 3861 will receive an
18% job classification increment after serving two years at peak grade.
 - P – 5 Standard Department Managers at peak grade: 21.0%
 - Senior Managers (salary groups C, D, E): 23.5%
 - Senior Managers (salary groups A, B): 26.0%

(*) Including employees employed by the Company for 20 years at least who were not entitled to any Job Classification Increment.

2. Calculation of Job Classification Increment:
(Job classification factor rate x salary grade).

Regarding this matter, see also the reference of the Supervisor of Wages in his letter of October 10, 2013, concerning the command increment. According to the letter of the Supervisor of Wages, the command increment should only be paid in accordance with a collective agreement of 1994, that is - at lower rates than those that some of the employees of command ranking are receiving at present. The Supervisor of Wages intends to demand the return of payments that were paid in excess to employees and pensioners. In legal proceedings held in the months of March - September, the Court ruled that the stated decision by the Supervisor of Wages will not enter into force at this stage, and that the parties will later on submit an update to the Court with regard to the recommendations of the Steering Team or the discussions regarding the implementation of the recommendations, and a continued hearing of the application will accordingly be determined.

On December 11, 2014, the Supervisor of Wages sent a letter with respect to his decision regarding the salary irregularities and the retirement terms of the Company. In his letter, the Supervisor of Wages continues to demand the implementation of his decision of October 10, 2013. In this letter, he repeated the main points of the previous decision, with only slight changes. At the same time, there is continued communication with the Supervisor of Wages regarding the Company's proposal for an alternative arrangement. The procedure is scheduled for a hearing on January 4, 2015 and, if necessary, for January 7, 2015 as well.

As of the date of the report, the matter is pending in Court.

(f) Personal Extra:

1. A fixed monetary increment, paid to a closed group of employees in whose combined salary a gap was created when a uniform salaries grade was defined for all employees in April 1, 1973. Following general wage agreements in 1978, the salaries schedule was updated again, aiming to simplify the salary structure and create a uniform and clear salaries grade, while cancelling certain additions, once again causing the creation of this increment.
2. The personal extra component is intended to maintain the level of the base salary paid to employees prior to the changes in the salary tables.

3. The addition is updated for active employees with every cost of living allowance and wages agreement.

2. Payment of 13th Salary

1. Employees from their 2nd year of employment and pensioners/survivors are entitled to 13th salary payment.
2. The 13th salary consists of a normal salary for the payment month, divided by 12 and multiplied by 6 months, generally payable in two parts: the 1st part before Passover and the 2nd part before the Jewish New Year (Rosh Hashana).
3. The 13th salary is paid to pensioners/survivors according to the pension rate.

3. 20/25 years Salary Payment (14th Salary Bonus)

An addition at the rate of one normal salary, payable once a year, to a woman after 20 years and to a man after 25 years, provided that the employee started working in the Company before January 1, 2004.

The 20/25 year salary is paid to entitled pensioners/survivors according to the pension rate.

Entitlement to payment is according to years of work in the Company, less all unpaid leave periods the employee took after the salary agreement signing date, January 31, 2011, unless and insofar as the employee purchased rights with respect to the unpaid leave period, by paying the Company a payment at the rate of 18.5% of the determining components for calculating the monthly pension (including an increment of 1/12 for convalescence pay).

The aforesaid does not affect an unpaid leave of an employee taken before the signing date of the salary agreement on January 31, 2011, for a period that does not exceed one year and was or will be taken into account by the Company for the purpose of time periods specified in this section.

Pensioners/survivors who fulfilled the aforesaid terms on the eve of their retirement, are entitled to payment of 20/25 years salary. The salary of 20/25 years will be paid as before to an employee entitled to budgetary pension who retired/will retire from the Company and who, on the eve of retirement, was/will be entitled to 20/25 years salary, according to the aforementioned terms.

4. Convalescence Payments

1. An annual payment of a convalescence allowance.
2. An employee is entitled to convalescence payment only after completing the 1st year of work in the Company. At the end of the year the employee will also be entitled to convalescence payments with respect to parts of the year, relative to the number of paid days.
3. The following are Convalescence Days Quotas (to permanent employees, pensioners and survivors):

<u>Number of work years</u>	<u>Number of Convalescence days per year</u>
1. After one year of work (for the 2 nd year)	13
2. After two years of work	14
3. After three years of work	16
4. After eight years of work	18
5. After twelve years of work	20

4. Convalescence Day Rate:

The rate per one convalescence day is updated once a year on June 15, according to the cumulative changes in the CPI from the CPI of May to the CPI in May on the following year.

5. Payment Date:

An advance on account of convalescence payment is paid in the salary for April and the balance is paid with the salary for July.

6. Convalescence payments are paid to pensioners/survivors according to the pension rate.

5. Arava Addition

1. Arava addition is paid to an employee whose permanent work site and base are located in the Negev, south of latitude 30.
2. Arava addition will be included in calculations of pension to eligible employees who received the addition for at least three years before retiring from work, and will be paid to entitled pensioners/survivors according to the pension rate.
3. The Arava addition rate is updated for active employees after each cost of living allowance. Rate update derived from a wages agreement – if specified in the agreement.

6. Home Service Payment

1. An addition paid to employees on home service, according to the grading of the Company, included in the calculation of the pension.
2. The criteria for including home service payment in the calculation of the pension are:
 - An employee who retired to pension and received a monthly payment for home service of eight hours per evening and/or night for 10 consecutive years just before his retirement is entitled to an addition of 50% paid to him with respect to the home service before the retirement in the pension payment, according to his pension rates.

For every year over the aforementioned 10 years, the pensioner is entitled to an addition of up to 5% (for part of the year: up to 6 months – 2.5%; more than 6 months – 5%) of the payment paid before the retirement for home service, according to the pension rate due to him, up to a maximum of 100% of the amount of the addition after 20 years of payment with respect to the home service paid on the eve of the retirement and according to his pension rates.

- Maximum payment in the pension for fixed or non-fixed home service will not exceed 10 home services per month, multiplied by the pension rate, multiplied by the home service rate, multiplied by the home service increment to the pension.
 - An inspector who was transferred to another role whose entitlement to have the shift percentages included in his pension was recognized and during shift work received payment for home service for 10 consecutive years at least, is entitled to home service payment in the pension, even if the home service was terminated before the retirement date.
3. Home service rate is updated for active employees with every cost of living allowance. Rate update derived from a wages agreement – if specified in the agreement.

7. Payment for Shift Work

1. An addition paid to employees on shift work, according to the grading of the Company, included in the calculation of the pension.
2. The criteria for including shift work percentage increment in the calculation of the pension are:
 1. A shift worker, according to the Company's grade, who worked for at least 10 years in two shifts (morning and evening only) and retires to pension from shift work, will receive an addition of shift percentages in the pension at a rate of 20% of the pension.
 2. A shift worker who is a CCGT operator, according to the Electric Company's grade, who worked for at least 10 years in shifts and retires to pension from shift work, will receive an increment of shift percentages in the pension at a rate of 40% of the pension.
 3. A shift worker, according to the Electric Company's grade, who worked for at least 10 years in three shifts (morning and evening and night) and retires to pension from shift work, will receive an increment of shift percentages in the pension at a rate of 40% of the pension.
 4. A shift worker according to the grade of the Electric Company, who was permanently transferred to another position due to re-organization or an illness approved by a medical board and upon approval of the VP of Human Resources, who worked for at least 10 years in shifts prior to being transferred to another position, will receive shift percentages upon retirement, as follows:
 - Shift worker in three shifts: 2% for each year up to a maximum of 40%.
 - CCGT Operator: 2% for each year up to a maximum of 40%.
 - Shift worker in two shifts: 1% for each year up to a maximum of 20%.

Proper Description of all the Rights which should be Taken into Consideration in Determining the Actuarial Obligation with respect to Benefits After Termination of Employment

Electricity Rate for Company Employees

1. Permanent employees and receivers of pension (pensioners/survivors), insured in the budgetary pension arrangement, as defined in the labor constitution and according to the directives of the pension regulations are entitled to the electricity rate for Company employees. The obligation of the Company includes the cost of the benefit, the VAT and the grossed up income tax with respect to them.
2. Generation C employees and pensioners and their survivors are entitled to electricity at the Company electricity rate in each of the following cases:
 - An active generation C employee.
 - Upon retiring from work in the Company due to a disability which is recognized as an entitling event by the pension insurer of the employee, as long as the employee is recognized as a disabled person by the insurer.
 - Upon retirement from work at the Company due to dismissal, at the age of 60 or later, provided that the employee has 10 years of work at least.
 - Upon retirement from work at the Company due to age, provided that the employee has worked for the Company for at least 10 years.
 - Survivors are entitled to pension from the pension insurer of an entitled generation C employee.
3. The aforementioned entitled employee will be entitled to electricity at the rate of Company employees for one residential unit only, at his actual residence, provided that the electricity is intended for domestic consumption and personal use only.
4. In the event that two entitled persons reside together in the same residence, only one of them is entitled to the electricity rate for Company employees.
5. Pensioners/survivors are entitled to electricity at the rate of Company employees without doubling the pension rate.
6. Pension recipients are entitled to electricity on condition that the pension from the Company is their main source of subsistence.

Holiday Presents

1. The Company grants holiday presents to its employees, pensioners and their survivors, handed out on two dates: just before Passover and just before the Jewish New Year (Rosh Hashana). The Company liability includes the cost of the benefit and also the grossed up income tax with respect to them. The amount of the gift is linked to the Consumer Price Index.
2. Generation C employees and pensioners and their survivors are entitled to holiday presents in each of the following cases:
 - An active generation C employee.
 - Upon retiring from the Company due to a disability which is recognized as an entitling event by the pension insurer of the employee, as long as the employee is recognized as a disabled person by the insurer.
 - Upon retiring from work at the Company at the age of 60 years or later, provided that the employee has 10 years of work at least.
 - Upon retirement from work at the Company due to age, provided that the employee has worked for the Company for at least 10 years.
 - Survivors are entitled to pension from the pension insurer of an entitled generation C employee.
3. In the event that in one family the pension is paid to survivors in separate payments, only one family member is entitled to holiday presents.
4. Pensioners/survivors are entitled to holiday presents without doubling the pension rate.

Life Insurance and Compensation for Successors

1. “Risk” Insurance – CPI-linked Amounts (Benefits and Premiums)

- 1.1. Insurance applies to: employees upon starting work, pensioners, and spouses.
- 1.2. The benefit – Two thirds of the premium is paid by the Company (the amount is credited to the employee as value for tax purposes).
- 1.3. One third of the premium is paid by the employee.

2. “Risk – Additional Layer” Insurance – CPI-linked Amounts (Benefits and Premiums)

- 2.1 Insurance applies to: Permanent employees, executives, temporary employees under special contract (after two years of work), special veteran agreements (after one year of work) and pensioners up to the age of 70 as well as pensioners aged 72 and over who have a spouse.
- 2.2 The benefit – Two thirds of the premium is paid by the Company (the amount is credited to the employee as value for tax purposes).
- 2.3 One third of the premium is paid by the employee.

From July 1, 2013, the “Risk – Additional Layer” insurance replaced the mutual insurance as well as the grant for pensioners aged over 72 that was paid by the Company.

Raise of Salary Grade for Active Employees

1. An employee in the managerial grades up to grade 15 (inclusive), or an employee in the professional grades up to grade 40 (inclusive), will be promoted by one grade every year. An employee in the managerial grades, from grade 16 and up, or an employee in the professional grades from grade 41 and up, will be promoted by one rank once every two years.
2. Employees employed at managerial grade 27 / 46 professional will not be promoted until their retirement.
3. Senior employees - in principle, promotion in salary grade usually occurs after promotion to a higher position (deputy section manager/section manager/Deputy CEO). Promotion to senior department manager is not automatic and may only be granted after at least 5 years at the previous grade, by recommendation of supervising section manager and Deputy CEO and with CEO approval. With respect to senior department managers, to date, grade C only serves as a retirement grade.

Star Grade

A male employee who has 25 years of service and a female employee who had 20 years of service are entitled to a payment equivalent to one additional salary grade to their grade, without changing the nominal grade, provided they began work at the Company before January 1, 2004.

Entitlement to payment is determined according to years of work in the Company, less all unpaid leave periods of the employee after entering the salary agreement, on January 31, 2011, unless and insofar as the employee purchased rights with respect to the unpaid leave period by paying the Company payments at the rate of 18.5% of the determining components for calculating the monthly pension (including and increment of 1/12 for convalescence pay).

Appendix F – Details of Benefits

The aforesaid does not affect an unpaid leave of an employee taken before the signing date of the salary agreement on January 31, 2011, for a period that does not exceed one year and was or will be taken into account by the Company for the purpose of time periods specified in this section.

Pensioners/survivors who fulfilled the aforesaid conditions on the eve of their retirement are entitled to a star grade. A star grade will be paid as before to an employee entitled to budgetary pension who retired/will retire from the Company and who, on the eve of his/her retirement, was/will be entitled to a star grade, according to the aforementioned description.

Employee who is entitled to a grade promotion and to a star grade on the same date, will be concurrently promoted to both grades.

Additional Grade at Eilat

A permanent employee employed at Eilat under a special tenure agreement and a temporary employee under a special agreement is entitled from starting work in this region to payment equivalent to one additional salary grade, without changing the nominal grade.

The aforementioned employee, who moves out of the Eilat region to another region at the end of seven years of work or more, will carry over the entitlement to payment of the additional salary grade.

Promotion in Grade upon Retirement

1. Starting from the date of the "Changing the Update Method of Budgetary Pension Law, 2012", an employee entitled to budgetary pension who will retire from the Company (and in the event of the demise of such an employee, his survivor), will be entitled to one salary grade on the retirement date from the Company, regardless of the date on which he was promoted by one salary grade as an employee.
2. If an active employee is entitled on April 1, 20XX, to a salary grade according to the work agreements and is scheduled to retire to pension on this date, he will be entitled on April 1, 20XX to both a salary grade according to the work agreements and to a retirement salary grade.
3. An employee who is entitled to a star grade will receive a retirement grade, as detailed above, as if he had the subsequent grade.
4. The following table details the granting mode of retirement salary grades to retiring employees at present:

Grade before retirement date	Granting retirement grade on the retirement date (after 12 months at least in the former grade)
+43 / 22	44 / 23
44 / 23	+44 / 24
+44 / 24	45 / 25
45 / 25	+45 / 26
+45 / 26	46 / 27
46 / 27	+46 / +27
(f) 46 / (f) 27	+ (f) 46 / + (f) 27
*46 / *27	+*46 / +*27
*(f) 46 / *(f) 27	+ *(f) 46 / + *(f) 27

5. Retirement Grade for Senior Employees
A Deputy CEO / section manager / deputy section manager (of grades A and B) are not entitled, to date, to a retirement grade (with the exception of a closed list which was approved by the authorized entities).

Pension Updating Mechanism

1. From January 1, 2012, the determining components of the salary for calculating the monthly pension of a pensioner/ survivor entitled to budgetary pension are not updated through any grades, except promotion by one salary grade upon retirement.
2. From January 1, 2012, all the instructions to update the determining salary for calculating the pension were cancelled, including any component included in it, whether they derive from an agreement or an arrangement. Therefore, the determining components of the salary for calculating the monthly pension of a pensioner/survivor entitled to budgetary pension are not updated according to changes in the salary granted to any active employee of the Company at any time, e.g. salary agreement, CPI increment, changed reward rate for advanced studies/effort, command supplement, etc.
3. From this date, the pensions update mechanism of employees entitled to budgetary pension from the Company has changed. The determining salary components for calculating the monthly pension of every pensioner/survivor entitled to budgetary pension will be as follows: normal salary, shift percentage increment (to those entitled), 1/12 of the 13th salary, home service (to those entitled), 1/12 of the 14th salary (to those entitled), Arava increment (to those entitled), and CPI increment (see section 5 below).

These components are updated in January of each year only, according to the rate of the annual change in the CPI (the first update, according to the specified in this section, occurred in the pension for January 2013). The aforementioned applies to every pensioner/survivor entitled to budgetary pension and retired from the Company before the date on which the law became effective and also to employees entitled to budgetary pension (or their survivors), starting from their retirement date from the Company.

4. In the event that the annual change in the CPI rate will be negative, the determining components of the salary for calculating the monthly pension will not be updated on the following January of the year for which the CPI is negative. However, in the first update, and where needed in the following pension updated (in each January), the changes in the CPI with respect to the said period or periods will be fully included in the calculations for those updates.
5. CPI Calculation Increment:

From January 1, 2012, a monthly increment to the pension with respect to the months from March 2012 onwards, was paid to the every aforementioned pensioner/survivor, who retired from the Company before January 1, 2011, as follows:

- a. An 8% monthly increment to the pension:

A pensioner/survivor who received a managerial grade of 27 and up (or a professional grade of 46 and up) before January 1, 2011, or alternately, whoever received a retirement grade of 27 and up (managerial grade) or 46 and up (professional grade), or alternately, received a grade of the senior employees' grade scale before January 1, 2011.

Or alternately

A 12% monthly increment to the pension:

A pensioner/survivor who was not graded at a managerial grade of 27 and up (or a professional grade of 46 and up) before January 1, 2011, whose retirement grade is not an increment to grade 27 and up (managerial grade) or 46 and up (professional grade), or alternately, did not receive a grade of the senior employees' grade scale before January 1, 2011.

An employee/survivor who was promoted to a grade (which is not a retirement grade) in 2011, received a CPI calculation increment at the rate of the difference between 12% and the rate of the change in the pension deriving from receiving a grade in 2011.

b. Increasing the CPI Calculation Increment at an additional rate of 6%:

The CPI calculation increment of a pensioner/survivor who retired from the Company before January 1, 2011, and on January 2, 2012, was graded in a managerial salary grade of 23 and below, or in a professional salary grade of 44 and below, will be increased at the end of four years from the approval date of the law (March 2016), at an additional rate of 6% of the base pension.

A pensioner/survivor who retired from the Company after December 31, 2011, is not entitled to a CPI calculation increment at all.

Deduction of Payments from Salaries of Employees Insured in Budgetary Pension

1. The "Plan for the Recovery of Israel's Economy" Law – 2003, states (in chapter P to the law, on "Payments of Employees to Budgetary Pension") that an employer whose employees or part of them are subject to a budget arrangement of pension paid by the treasury of the State or from the employer's fund (budgetary pension), will deduct 1% (starting on January 1, 2005 the deduction is at the rate of 2%) from the determining salary paid to the employee, whose pension arrangement is budgetary pension.
2. According to a legal opinion, the instructions of this chapter apply to the Electric Company and its employees, insured in a pension out of the Company's budget, namely, permanent employees who began to work at the Company before June 11, 1996 (employees insured in the budgetary pension arrangement).
3. Determining salary for paragraph 1 above: "Salary components paid to an employee, which would have been included for the purpose of calculation of the pension, had that employee retired to pension at that time." Namely, normal salary, shift work payment, convalescence, fraction of 13th salary and 14th salary, permanent home service and Arava addition.
4. The pension liability is not reduced due to the participation of employees insured in the budgetary pension arrangement in the cost of the budgetary pension.

Obligation of the Company to Welfare Activities for Employees and Pensioners / Survivors

- a. In addition to salaries paid to employees and pensions paid to pensioners/survivors, the Company has an obligation to incur costs of welfare activities of 0.49% of the salary of each employee, or of the pension and grants to which each pensioner/survivor is entitled (this obligation is not calculated for the components that are not normal salary or those that are not affected by a rate per hour: convalescence, electricity, gift, permanent home service and Arava addition).
- b. Starting on January 2, 2012, the Company is allocating to a fund, that is managed by the representatives of the employees (in a dedicated bank account that was opened for this purpose) with respect to each pensioner (without survivors) who is entitled to budgetary pension only, an annual sum for the following welfare activities:

The allocated sum is updated on January of each year according to the annual change rate in the CPI. The sum to be transferred with respect to a pensioner who receives pension in the month of December and has retired during that calendar year (will be entitled to a pension for the period in which he was a pensioner only), will be calculated proportional to the period in which he was a pensioner. It is clarified that only a pensioner entitled to a pension from the employer in the month of December of every year will be considered for the purpose of calculating the total sum with respect to that year. Therefore, a pensioner who is not entitled to a pension in the month of December as stated (for example: a pensioner who has passed away during the year will not be taken into account as entitled to receive any sum from the fund) will not be taken into account for the purpose of calculating the total sum each year.

The objective of the fund is to act for the welfare of pensioners in the cultural, health, recreation and leisure fields.

The fund is managed according to accounting measures from aspects of detailed audit and reporting of all actions made by the fund and funds expended by the fund, respectively.

Despite the aforesaid, from January 2, 2012 through July 1, 2023, only half (50%) of the aforementioned total amount is allocated to the welfare of pensioners entitled to budgetary pension, until the CPI calculation increment, detailed in section 5 above under section "Pension Updating mechanism", is fully financed.

Details of Grants Paid upon Termination of Employer-Employee relations:

1. **Excess years grant** (for employees insured under the budgetary pension arrangement) -

The grant is calculated as one monthly salary for every additional year worked beyond 35 years' service. The grant is based on the normal salary plus 13th and 14th salaries. The entitlement is subject to retirement after age 60 for males or after age 55 for females. For fractions of a year, the proportionate share of the grant is paid.

In the event of death after 35 years worked in the Company after age 55 for females or age 60 for males, eligibility to the grant exists. In the event that the death is after 35 years worked at the Company, but the age on date of death is under 55 for females or 60 for males, the entitlement is at a rate of 10% (10% of the normal salary only, multiplied by the number of excess years).

2. **Disability retirement grant**

An employee retiring with a disability pension is eligible to a grant of 50% of one monthly salary for each year worked. The grant is limited to a total amount of 15 monthly salaries (up to 30 years worked in the Company). The grant is calculated on the basis of the normal salary only. The grant for 35 years of work will not be paid when this grant is paid.

3. **20 Year grant** (including Generation C employees)

Permanent employees who have completed 20 years of employment with the Company are entitled to a one-time grant equal to the normal monthly salary.

4. **Grant for Up To 35 Years** (including Generation C employees)

A monetary grant given to an employee retiring to pension, equal to one normal monthly salary for every ten years of actual employment (according to service factor for pension), up to a maximum of only 3.5 salaries (up to 35 years of employment). For a period of less than ten years, the proportional amount of ten years benefit is paid. This grant will not be paid to an employee who has worked less than 10 years and in respect of years for which another compensation is payable. In the event of the employee's death, the grant will be paid to the survivors.

Applies to Generation C employees only upon retirement due to dismissal at the age of 60 or later and provided they have worked for the Company for at least 10 years or, alternatively, upon retirement due to age.

5. Unused sick days benefit (including Generation C employees)

A sum of money paid to an employee upon retirement to pension (including early retirement and disability retirement), or to survivors of a deceased employee, according to the percentage of sick days used to which he was entitled during all his years of employment in the Company and in accordance with the number of unused sick days accumulated to his credit as of the retirement date:

- For an employee whose percentage of used sick days is less than 36%, a grant equal to 26.66% of the unused sick days accumulated to his credit is paid.
- For an employee whose percentage of used sick days is between 36% and 65%, a grant benefit equal to 20% of the unused sick days accumulated to his credit is paid.
- For an employee who used 65% or more of the sick days, a grant is not paid.

It should be noted that until April 1, 1990, the annual quota of sick days benefit was 26 days per year and from this date the annual quota of sick days benefit is 30 days per year.

The salary per sick day for purposes of calculation of the grant is 1/25 of the normal monthly salary (including the 13th salary). The salary per sick day after 35 years of service and after age 60 (55 for women) includes the 25/20 years salary. Attributing the balance of sick days accumulated to the credit of the employee at the date of his retirement (at least 55/60) will be performed according to the FIFO method. Namely, first using accumulated sick days up to 35 years and after them those that were accumulated beyond 35 years. Payment of the benefit will first be for the sick days accumulated beyond 35 years (namely, including 20/25 years salary) and after them for sick days that were accumulated up to 35 years (namely, not including 20/25 years salary, only 13th part).

Applies to Generation C employees only upon retirement due to dismissal at the age of 60 or later and provided they have worked for the Company for at least 10 years or, alternatively, upon retirement due to age.

6. Supplement of Company obligation for severance payments to Generation C employees (permanent employees who began work after June 10, 1996)

Generation C employees who received tenure by March 2012 - according to the relevant collective agreement, the Company provides a sum each month equal to 6% of employees' monthly insurable salary for the severance pay obligation to these employees who are insured by an external cumulative pension fund. This provision is under the conditions of Section 14 of the Severance Pay Law ("in place of supplement") and therefore, the Company has no obligation to supplement it.

In addition, these employees will receive a severance benefit of 2.33% of their last salary only if they are entitled to severance pay in any case of dismissal or, alternatively, upon retirement due to age.

Generation C employees who received tenure from March 2012 - employer deposits for severance pay at a rate of 8.33% for these employees (with respect to their employment period as temporary employees and until the date of transition to tenure) were deposited in full - in the pension fund (the Company has not withdrawn the completion of severance pay at a rate of 2.33%). It is noted that as of the date of transition to tenure, the Company provides each month 6% of the monthly insurable salary for the severance pay obligations to these employees. Completion of the severance pay at a rate of 2.33% according to their last salary will be paid only if they are entitled to severance pay in any case of dismissal or, alternatively, upon retirement due to age.

An employee who terminates his employment is not entitled to supplementary severance pay.

The supplementary severance payments for generation C employees are as follows: last normal salary (including the 13th salary fraction) multiplied by the years of employment with the Company and multiplied by 28% (an employee who started work before January 1, 2004 and will be entitled to a 14th salary, the 14th salary will be calculated for him even for years exceeding 35 years). The supplementary severance payment will be also paid in the event of death (to survivors), disability and compulsory retirement.

7. Increased severance payments for employees under special agreement

According to the relevant collective agreement, Company employees under special agreement (non-permanent staff) are eligible for increased severance payments beyond those covered by monthly contributions of 8.33% of salary deposited in an external cumulative pension fund (provision under the directives of Section 14 of the Severance Payments Law). These employees are entitled to additional severance pay from Company funds equal to one monthly salary for each of the first two years of employment; from the 3rd year onwards, two additional monthly salaries. An employee who resigns from work voluntarily is not eligible for this extra severance benefit in excess of that provided for him in the pension plan.

The maximum term of employment for these employees is ten years for those who began work before or on December 31, 2004 and five years for those who began work from January 1, 2005 (except for a final group of welders that are employed under a special agreement, and a group of older employees that are employed under a special agreement – collective agreements have been signed with respect to these groups, for extending their employment, beyond 5/10 years. In total, there are a few dozen employees in all the groups).

Increased severance payments will also be paid in the event of death (employee survivors), disability and at the end of the employment period according to the agreement.

Note: Company procedures include extended details of the rights specified in this document.

Rights of Employees Entitled to Pension from the Pension Fund of Company Employees and Rights of Pensioners

1. Retirement Pension

1.1 Upon retiring from work according to work agreements, the status of the employee will change from an entitled active employee in the fund to the status of an entitled pensioner.

1.2 Advance Notice

An entitled employee due to retire receives at last four months advance notice from the Electric Company about reaching the compulsory retirement age, with a corresponding notice to the managing company.

A female employee due to retire receives at least six months advance notice before reaching the retirement age. A female employee who chooses to retire after the retirement age and before the compulsory retirement age will notify the Company in advance about her intention and will indicate her retirement age, four months in advance at least.

1.3 Entitlement to Retirement Pension

An active entitled employee, who ends his employment with the Electric Company due to one of the following circumstances will become an entitled pensioner and will receive a retirement pension for life:

– **Retirement for Age Reasons** ("Age Retirement"):

An entitled, active male / female employee who worked for at least ten years in the Electric Company and reached the compulsory retirement age will be entitled to receive retirement pension for life.

The 1st retirement pension will be paid in the calendar month following the month on which the employee retired from work, for the current month. Retirement from work when retiring on the compulsory retirement age will be at the end of the month on which the employee reached the compulsory retirement age.

- A female employee is entitled to retire on age retirement if she worked in the Company for at least 10 years and chose to retire between the retirement age and the compulsory retirement age. It should be mentioned that, based on the experience of the recent years, there were only a few cases of women retiring voluntarily in the range between retirement age and compulsory retirement age, therefore the subject is immaterial.

– **Retirement due to Employment Termination** ("Termination Retirement"):

An entitled active employee who worked in the Company for ten years at least and is over age 40 and was dismissed from the Company under circumstances detailed in work agreements, will be entitled to receive a retirement pension for life.

– **Early Retirement** ("Early Retirement"):

An entitled active employee who worked for at least 30 years, aged 55 or older (if male) or 50 or older (if female), who wishes to retire from work voluntarily and the Electric Company consented or, where the Electric Company would like the employee to retire and the workers committee consented to this move, will be entitled to receive a retirement pension for life.

– **Special Retirement** ("Special Retirement"):

An entitled employee is entitled to retirement pension under a special retirement framework, if – and to the extent that – it will be established according to a specific agreement, made and approved by the legally authorized authorities, according to the approved principles.

– **Disability Retirement** – see above.

1.4 **Pension Rate**

In age retirement, termination retirement, early retirement or special retirement, the pension rate shall not be less than 25% and not more than 70% of the determining salary of the employee for calculating the pension, and the rate will always be a calculation of the number of work years, determined by the Electric Company, according to the following principles:

- After ten years of work: 25% of the determining salary of the employee.
- For each additional year until 30 years of work: 25% with respect to the first 10 work years and an addition of 2% for each full year of work after the first 10 years (up to a maximum of: $25\% + 20 \times 2\% = 65\%$).

For calculating entitlement for a fraction of a year, the employee will be entitled to an addition of 2% if he/she worked more than half a year and a 1% addition only when working for a shorter period.

- For each additional year over 30 years and up to 35 years of work - 65% with respect to the first 30 years of work and an addition of 1% for each full year or a fraction thereof, of work after the first 30 years (up to a maximum of: $25\% + 20 \times 2\% + 5 \times 1\% = 70\%$).

2. **Pension to Survivors of a Pensioner:**

2.1 **Eligibility of Pensioner Survivors to Pension**

The widow, orphans and also parents who were dependent on the employee while employed are entitled to receive a pension subject to the following:

- **A widow** - is entitled to pension until she remarries.
- **An orphan** – is entitled to pension until he/she reaches age 18, or until age 21 if and as long as he/she does compulsory service in the army/national service, or without any age limitation if he/she cannot support him/herself due to an illness.
- **A parent** – is entitled to pension if he/she was dependent on the deceased when he/she was alive.

2.2 **Pension Rates to Survivors**

- The pensioner's widow will be paid a monthly pension equal to 60% of the pension paid to her deceased husband. In addition, 25% of the pension paid to the deceased pensioner will be paid to all other dependants jointly. Eligibility of a widow will stop when she remarries.

- When a deceased pensioner has no widow, or upon the death of a widow, a monthly pension of 15% of the pension paid to the deceased pensioner will be paid to each of the survivors. In addition, 45% of the pension paid to the deceased pensioner will be paid to all survivors, even if there is only one, provided that the total pension payments to all survivors will not exceed 80% of the deceased's pension.

3. Pension to Survivors of an Active Employee:

Following the death of an active employee, his survivors will be eligible to a pension, as detailed below:

3.1 Entitlement of Active Employee Survivors to Pension

The widow, orphans and also parents who were dependent on the active employee while employed are entitled to receive a pension as detailed below and according to the entitlement and tests thereof, as stated in section 2.1 above.

3.2 Pension Rate to a Widow

The widow of an active employee will receive a monthly pension according to the number of the employee's work years in the Company, at the following rates:

- Widow of an employee who worked in the Company – after one or two years of work – 20% of his determining salary.
- Widow of an employee who worked in the Company – after three or four years of work – 25% of his determining salary.
- Widow of an employee who worked in the Company – after five years of work and up – 42% of his determining salary.

3.3 Pension Rates to all Other Survivors

- Up to 5 years of work, the other survivors will each receive a pension of 10% of the determining salary, provided that the total pension to the widow and all other survivors jointly shall not exceed 50% of the determining salary of the employee just before his death.
- Starting from the fifth year of work onwards, the other survivors will each receive a pension of 15% of the determining salary, provided that the total pension to the widow and all other survivors jointly shall not exceed 70% of the determining salary of the employee just before his death.

3.4 Survivors Pension in the Absence of a Widow or after her Death

- Up to 5 years of work, each of the survivors will be entitled to a pension of 10% of the determining salary of the employee just before his death, with the addition:
 - Of 10% to all survivors, even when there is only one survivor, if the deceased worked for up to two years.
 - 15% to all survivors, even when there is only one survivor, if the deceased worked for 3 to 4 years.
 - The aforesaid is subject to the principle that payments to survivors of an employee according to this section will not exceed 50% of the determining salary of the employee just before his death.

- Starting from the fifth year of work onwards, each of the survivors will be entitled to a pension of 15% of the determining salary of the employee just before his death, with an addition of 25% to all the survivors, even if there is only one survivor, provided that the total payments to the employee's survivors according to this section shall not exceed 70% of the determining salary of the employee just before his death.

4. Survivors Pension to a Common-Law Wife of a Deceased Pensioner/ Employee:

In the absence of a widow, a common-law wife (as defined in Section 4.9 of HR Procedure No. 04-12-11 "Pension to Survivors") will be eligible to a pension as if she is a widow, subject to the following conditions:

- 4.1 A common-law wife who is entitled to a widow's pension from any other source on the date of death of the employee/pensioner, will be entitled to a pension from the Company only if the pension to which she is entitled from the Electric Company is higher than the pension to which she is entitled from another source. In this case, the common-law wife is entitled to a pension from the Electric Company according to the difference between the pension to which she is entitled from the Electric Company and the pension she receives as a widow from another source.
- 4.2 A common-law wife, whose pension from another source as a widow is higher than the pension she would have been eligible to from the Electric Company if she would not have received a pension from another source, is not entitled to a pension from the Electric Company and/or any other entitlement due to a pensioner of the Electric Company (electricity rate for Company employees, gifts).

5. Disability Pension:

5.1 Determining the Eligibility to Disability Pension

The disability of an active employee will be determined as follows:

The employee will be examined by a medical board. If the medical board decides on permanent disability, an interdisciplinary team will be appointed, headed by the Human Resources Manager, the welfare officer and a representative of the workers committee. Based on the recommendations of the medical board, the interdisciplinary team will determine if the permanent disability of the employee prevents him from fulfilling any other position in the Company. In the event that the interdisciplinary team decides that the employee cannot fulfill any other function in the Company and upon approval of the Senior Vice President - Human Resources, the employee will retire to disability pension.

5.2 Pension Rate

An employee entitled to a disability pension will receive a pension, at the rate calculated according to the number of work years as determined by the Electric Company, according to the following principles:

- After one work year and up to the end of two work years - 20% of the determining salary.
- Starting from the 3rd year and up to the end of four work years – 25% of the determining salary.
- Starting from the 5th year and up to the end of the 5th year – 30% of the determining salary.
- Starting from the 6th year and up to the end of 25 work years – a 2% addition for each work year after the 5th year and up to the 25th year (up to a maximum of: $30\% + 20 \times 2\% = 70\%$).

There is no incremental disability pension with respect to work years exceeding 25 years.

5.3 **Supplements to the Disability Pension with respect to Dependants**

5.3.1 **A dependant for the purpose of this section:**

- Wife/ husband.
- Child, including a step child or an adopted child until age 18, or without age limit if the child is unable to support himself due to an illness.
- Parents of the disabled employee, if they are dependent on the disabled employee.

5.3.2 After 1 year to the end of 5 years of work – the pension is increased by 10% of the determining salary for each dependant of the disabled person as long as the total payments to the disabled person do not exceed 50% of his final determining salary. After 6 years of work – the pension is increased by 10% of the determining salary for each dependant of the disabled person as long as the total payments to the disabled person do not exceed 70% of his final determining salary.

5.3.3 The additional entitlement to disability pension with respect to dependants will be paid for each dependant at any time and as long as the definition of a dependant applies to the dependant, as detailed above.

5.3.4 A divorced employee who retired due to disability is entitled to a percentage of increment with respect to children until age 18, even if these children are not in the employee's care.

5.3.5 Marriage of an employee who retires due to disability, or birth of children to such a pensioner, after the retirement date, **do not** entitle the pensioner to additional percentage increments of the pension.

5.3.6 Following a change in their marital status (divorce/death of the spouse) or when children reach the age of 18, the percentage of the pension will be decreased accordingly.

6. **Pension – General Instructions:**

6.1 **Pension Payment Dates**

Pensions of eligible pensioners/survivors will be paid on the same dates as salaries to active permanent employees in the Company.

6.2 **Work up to age 18**

The years during which the employee served in the Company before reaching age 18 will not be considered as work years for the purpose of pension according to these rules.

6.3 **Breaks from Work**

Calculation of the number of work years of a Company employee will include the following breaks during the work period:

- Leave granted to the employee according to labor law.
- Absence caused by an accident at work.
- Break in work over which the employee had no control.
- Army service in its meaning in the Discharged Soldiers Law (return to work) - 1949 and any absence afterwards if it occurs during a period regarded by law as military service according to Section 12 of the said law.
- Partial military service in its meaning in the said Discharged Soldiers Law.
- Absence for a period of up to one year due to continued studies or appointment to a mission on behalf of institutions, upon written approval of the Company. Cases of absence from work for a period exceeding one year will be submitted to a discussion between the Company's management and the workers committee.

6.4 Complete Entitlement of an Orphan to Pension

An orphan's right to receive pension according to these rules is complete and does not depend on the economic condition, employment or marital status of the surviving parent.

6.5 Responsibility of the Surviving Parent to a Pension for the Orphan

The widow or widower will be responsible for drawing the pension due to orphans, for their support. If proven that pension funds paid for the orphans are not used for the intended purpose, the Company and/or the Fund and/or the Managing Company have the right to pay the pension to the said orphans in another appropriate way.

6.6 Pension Payment to Parents

Pensions to parents will be paid to them directly, together or separately, according to their wishes.

6.7 Payment of One Time Only Amounts and Pension Capitalization

The fund is not permitted to pay to an eligible employee or his survivors one time only amounts, including capitalization of his/her pension, except capitalization permitted by work agreements, as valid on the joining date, or according to any law, subject to the directives of the Central Provident Fund for Pension Statutes and the income tax regulations. When all the above are fulfilled, an employee who retires to pension or a pensioner up to two years from his retirement date, are entitled to capitalize up to 25% of the respective pension. The capitalization is for six years. A reduced pension, based on the proportion capitalized, is paid for six years to the pensioner. Following the death of a pensioner, his survivors are entitled to a pension, according to pension regulations, as if there was no capitalization.

6.8 Prevention of Double Pensions

The person who is eligible to two pensions of the same type according to these rules has the option to choose only one of them. In this case, each of the following will be regarded as separate types: retirement pension, survivors pension, disability pension.

6.9 Minimum Pension

An employee who retires due to age or disability, whose pension rate is less than 40%, may have the pension increased to 40%, provided that the two following conditions are fulfilled:

- The pension paid according to these rules is the only income of the pensioner, for as long as it is the sole source of income. An allowance from the National Insurance Institute will not be considered as additional income in this case.
- The pensioner was accepted as an employee of the Company before reaching age 55.

6.10 Rights of Company Employees who are Members of Bereaved Families

- 6.10.1 The law requires an employer to employ a widow/widower or a parent of a person who was killed in certain circumstances (soldier/policeman/jailor that were killed, and a victim of hostilities that passed away as a result of the injury), including a step parent and an adopting parent (subject to the Families of Soldiers Killed in Action Law – 1950), who is qualified to work, for the period as follows:
- until they turn 72 years old for men and 67 years old for women, following Amendment 35 to the “Families of Soldiers Killed in Action (Compensation and Rehabilitation)” Law. In effect from January 1, 2014.

- 6.10.2 The pension of a bereaved parent (a parent of a soldier who was killed) who retires as a pensioner will be increased by 50% provided that it does not exceed full doubling of the pension with respect to the actual service period of the bereaved parent in the Company.

Notwithstanding the above mentioned, if a bereaved person deserves to receive a pension of 45% and more before increase of the pension rate, his pension will be increased by 6% only, up to a maximum of 70% pension.

7. Pension to Survivors Shortly after the Death of an Employee/Pensioner

- 7.1 In the case of the death of an employee/pensioner, survivors will receive, respectively, full determining salary (100%) for the 3 months after the death, or the full pension paid to the deceased pensioner before his death. Pension payments to survivors according to pension regulations will begin from the fourth month after the death of the employee/pensioner.
- 7.2 Survivors of an employee whose death was caused by a work accident will receive the determining salary for pension (100%) paid to the employee for the 1st 6 months after the date of death. Pension payments to survivors of a deceased employee according to pension regulations will begin from the seventh month after the death of the employee/pensioner.
- 7.3 The pension rate for survivors of a pensioner who capitalized the pension and died will be equal to the pension rate without capitalization.

8. No Frozen Rights

Rights cannot be frozen (as applied to civil servants); namely, a person who resigns from the Company will not be eligible for a pension upon reaching the retirement age.

9. No Continuation of Rights from Former Employers

Pension rates are calculated only according to work years in the Company.

Additional Right Not Taken Into Consideration in Determining the Actuarial Obligation with respect to Benefits After Termination of Employment

Early retirement to pension grant (due to severance)

A grant of 50% of one monthly salary for each year worked. The grant is calculated on the basis of a normal salary with the addition of the 13th salary. This grant is not calculated for the years for which the retiring employee is entitled to receive excess years grant.

The grant rate (50%) will be offset at the rate of 1.111% for each month of work over age 62 and up to age 65, consequently, the grant rate starting from age 65 after the offset is 10% (similar to the grant for up to 35 years of work).

It is noted, that when a female employee chooses to continue working in the Company after retirement age and retires from the Company due to severance, she will be entitled to a grant at the rate of 50% of the salary, according and subject to the aforementioned, as applied to any other employee.

Severance payments for employment termination without pension

Upon termination without pension entitlement, an employee is eligible to a severance payment of one monthly salary for each year of employment. Upon resigning after a prolonged employment period, the aforesaid severance payment is paid if the authorized authorities approve it. The severance pay is calculated on the basis of the normal salary with the addition of the 13th salary.

Additional rights and benefits for Pensioners

In addition to the aforesaid, the pensioners of the Company are entitled to the following rights and benefits:

- Bonuses for marriage and birth (includes the grossing up of tax).
- Gifts for children of pensioners and successors serving in the IDF (including tax grossing up).
- Company participation in cost of setting a tombstone – solely in cases of death as a result of a work accident.
- Compensation in cases of death as a result of a work accident.
- Partial participation of the Company in meals at Company facilities – up to 10 meals per month.
- Higher Education grants for children of widows of employees who died while working for the Company.
- An outing for widows of workers who died while working for the Company.
- Reduction of cost of connecting electricity to the apartment as well as transfer or increase of existing connection.

These benefits are not material and therefore no actuarial liability is calculated in respect thereof.



The Israel Electric Corporation Ltd.

*Asset impairment test as of December 31, 2014 in
accordance with IAS 36*

March 2015



GIZA SINGER EVEN

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Disclaimer

- As requested by the Company's management, this report has been prepared by Giza Singer Even for the Israel Electric Corporation Ltd. ("IEC" and/or "the Company") for the purpose of asset impairment test in accordance with IAS 36, as of December 31, 2014.
- This report has been prepared by Giza Singer Even ("GSE"), and is intended solely for the Company use. It is not to be used in any other way, including distribution, copying or transferring by any other means, without receipt of our authorization in advance and in writing, except for the report's publication in the Company's financial statements as of December 31, 2014.
- For the preparation of this report, we have relied on information and/or explanations and/or forecasts and/or exhibits the Company and/or anyone on its behalf have provided us with. Giza Singer Even assumes that this information is credible and does not perform an independent examination of the information. Also, nothing which may point to the data being unreasonable has come to our attention. The data has not been examined in an independent manner, and therefore the report presented to you does not constitute a verification of these data's correctness, completeness and accuracy. An economic evaluation should reflect in a reasonable and fair manner a given state of being at a given time, based on known data, while considering the basic assumptions and estimated forecasts.
- This report does not constitute a due diligence review and is not to replace such. Furthermore, this report is not intended to determine the Company's value for a specific investor, and there is nothing within this report to constitute any legal advice or opinion.
- This report does not include any accounting auditing regarding the compliance with the accounting rules. Giza Singer Even is not liable for the manner of the Company's accounting presentation of the financial reports in all that regards the accuracy and completeness of the data and the implications of that accounting presentation, as far as such exist.
- This report includes a description of the methodological principles and analysis principles. The description refers to the main substantial practices which we have implemented, and does not constitute a complete and detailed description of the Company and its environment.
- If the case may be that the data Giza Singer Even has relied upon is not complete nor accurate or credible, the results of this report might change. We reserve the right to return and update this report in light of new data which might have not been brought before us. For the avoidance of any doubt, this report is valid only for the time it has been signed.
- This report includes Forward-Looking Information as defined in the Securities Law, 1968, received, inter alia, from the Company. In this opinion, we referred, inter alia, to evaluations, projections and assessments provided by Company management. Realization of this information is not certain. The information is based in part on knowledge existing in the Company as of the date of the report, as well as on various assumptions and expectations pertaining both to the Company and to various outside elements, including the state of the market in which the Company is active, potential competition and the state of the economy as a whole. We emphasize that there is no certainty that these conjectures and expectations will be realized, in whole or in part.
- We hereby confirm that we are not dependent on the report or on the Company, with the exception of the fact that we are receiving a fee for this report. Likewise, we hereby confirm that our fee is not dependent on the results of the report.



Sources of Information

Giza Singer Even

- Giza Singer Even has not prepared asset impairment tests for the Company before. We provide advisory services for the Company regarding its financial instruments.
- We hereby confirm that we have no personal interest in the Company or its controlling interest.

Main sources of information

- Audited annual financial statements of IEC for the fiscal years 2012-2014
- The Company's budget for the year 2015 and long-term financial planning for the year 2016
- Various other data received by the company as per our request
- Public information
- Publications of the Bank of Israel and the Central Bureau of Statistics
- Publications of the Public Utilities Authority, and specifically the charge rate basis book
- Capital IQ database and Bloomberg information system
- Meetings, correspondences, and phone calls with various Company officials



Details of the Valuating Company

Giza Singer Even

- Giza Singer Even is one of Israel's leading financial consulting and investment banking firms. The firm has extensive experience with the large companies, the prominent privatizations and the important transactions in the Israeli economy, which it has accumulated throughout its twenty-five years of activity. Giza Singer Even operates in three areas, by means of independent and autonomous business divisions: economic consultation; investment banking; analytical research and corporate governance.
- This Report has been prepared by a team headed by Udi Rosenberg. Mr. Rosenberg, Giza Singer Even's CEO, holds an MBA and a BA in Economics, both from Ben-Gurion University of the Negev, and has 20 years experience in the field of corporate debt.

Sincerely yours,

*GSE Financial
Advisory Ltd.*

Giza Singer Even

3.24.2015





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Executive Summary





Executive Summary

Valuation summary

Scope of services

- We were requested by the Company's management to perform an asset impairment test in accordance with IAS 36 for Israel Electric Corporation , as of December 31, 2014.
- We estimated the value in use of the Company's generation, transmission and distribution segments, which together constitute one cash generating unit.

Notable events that can affect the valuation

- **Charge rate basis for the transmission and distribution segments:** on January 1, 2015 the Company received a draft of an internal document from the Public Utilities Authority, which constitutes as a foundation for a new charge rate basis for the transmission and distribution segments for the years 2012-2016. However, since the Company received this document after the valuation date, and as this date a new charge rate basis has yet to be announced, we did not include its potential effect in the valuation (see sensitivity analysis for the estimated effect).

Valuation Results

We compared the recoverable amount to the carrying amount of the assets in accordance with IFRS, and concluded that the recoverable amount is greater than the carrying amount.

	NIS M
Recoverable Amount	69,749
Carrying amount	69,193
Surplus (deficit) in recoverable amount over carrying amount	556



Executive Summary

Sensitivity analysis

The following are the key assumptions we applied in the valuation and the results which would have occurred had we applied different assumptions (assuming maximum influence in each case):

NIS M		Maximum change in recoverable amount			Surplus (deficit) of recoverable amount over carrying amount
Implementation of a new charge rate basis for the transmission and distribution segments according to the internal PUA document (Navigant’s report)*		(2,127)			(1,570)
Recognition of only 80% of investment costs in environmental projects		(1,047)			(490)
Non-recognition of full pension costs for the “new” units in the generation segment		(146)			411
Non-recognition of fixed assets liquidation costs		(386)			171
Non-recognition of irregular construction costs		(102)			454
Non-realization of fuel profit forecasts		(98)			458
Weighted Average Cost of Capital					
	4.70%	4.20%	3.70%	3.20%	2.70%
Surplus in recoverable amount over carrying amount	90	322	556	794	1,034
Change in recoverable amount	(466)	(234)	0	237	477
Leverage Ratio					
	85.00%	80.00%	78.65%	75.00%	70.00%
Surplus in recoverable amount over carrying amount	509	556	556	556	604
Change in recoverable amount	(47)	0	0	0	47
Market Premium					
	6.50%	6.25%	6.00%	5.75%	5.50%
Surplus in recoverable amount over carrying amount	509	509	556	604	604
Change in recoverable amount	(47)	(47)	0	47	47

Chapter A – Description of the Company





Description of the Company

Description of the company

General description

- The Israel Electric Corporation Ltd. was incorporated in Israel on March 29, 1923, and is engaged in the generation, transmission, distribution, sale and supply of electricity to consumers in Israel.
- The validity of the Concessions was set for a period of seventy years, which ended on March 3, 1996, and from that time on, the provisions of the Electricity Sector Law - 1996, which replaced the Electricity Concessions Order.
- The Company generates, transmits, distributes and supplies most of the electricity consumed in the Israeli national economy pursuant to the licenses that have been granted to it for each such type of operation, in accordance with the Electricity Sector Law, which have been extended over the years. The Company also operates as an electricity system administrator.
- The licenses of the Company have been extended by the Ministers, from time to time over the years.
- The Company is an “essential service supplier license” holder and is also engaged in the construction and setup of the infrastructure that is required for its other operations.
- As of the date of the valuation, the State of Israel holds approximately 99.8% of the issued, paid-up share capital of the Company, and therefore, the Company is a “government company”, and is also subject to the provisions of that law. The balance of the issued and paid up capital of the Company is held by approximately 120 individuals and corporations.

Description of fields of activity

- The Company operates as a single combined, coordinated system that engages, as set forth, in the supply of electricity to consumers, from the stage of generation of the electricity to its transmission, distribution, supply and trade. In addition, the Company engages in the establishment of infrastructures that are required for the operations that have been set forth above and operates as the administrator of the electricity system.
- As of the time of the valuation, the Company has three primary fields of activity:
 - **Generation of electricity** – the operations of the Company in this field include all of the operations that are involved in the generation of electricity at the generation sites of the Company.
 - **Transmission and transformation of electricity** – the operations of the Company in this field include the transmission of electricity from the generation sites using high and extra high voltage lines to the switching stations and major substations, and between the switching stations and major substations to the substations.
 - **Electricity distribution** – the operations of the Company in this field include the transfer of electricity from substations to consumers via high voltage lines and low voltage lines and the supply and sale of electricity to consumers.
- It shall be noted that the sectors of activity in accordance with the Electricity Sector Law include also system administration, supply and trading of electricity.



The Generation Segment

Description of the generation segment

The generation segment

- The electricity generating system is based on five steam driven power stations, which are powered by steam force that turns the blades of turbines, and which are spread along the country's shores, located in Haifa, Hadera ("Orot Rabin"), Tel Aviv ("Reading"), Ashdod ("Eshkol") and Ashkelon ("Rothenberg"). The steam driven power stations are powered by coal or natural gas, or fuel oil. In addition to the steam driven power stations, another generation array of gas turbines operates, which are powered by diesel or natural gas.
- As of December 31, 2014, the Company possesses and operates 17 sites of power stations (of which five are steam driven power stations sites) with a total installed generation capacity of approximately 13,483 megawatts.
- As of December 31, 2014, the Company generates approximately 84% of the electricity in the State of Israel, while the remaining is generated by private electricity producers and small photo voltaic installations, from which the Company purchases electricity at low rates (approximately 16% and 7% of the total electricity that the Company supplied in 2014 and 2013, respectively).

Steam generation units

- The steam generation units of the Company, which generate electricity using gas turbines, are powered, in accordance with what has been stated above, using coal as their primary fuel, or fuel oil or natural gas. Some of the generation units are "dual fuel". As of the time of the valuation, their total installed generation capacity is approximately 6,462 megawatts.

- After commencement of the flow of natural gas from the Tamar Reservoir, another part of the fuel oil generation units that have been converted to natural gas power has been run by natural gas.

Gas turbines

- As of December 31, 2014, the Company has 16 jet gas turbines and 15 industrial gas turbines, with a combined installed generation capacity of 1,570 megawatts and 504 megawatts, respectively. In addition, the Company has an additional industrial gas turbine that runs with natural gas combustion ("Eshkol"), which was converted in March 2014 to combined cycle with an installed capacity of 394 megawatts.

Combined cycle generation units

- The combined cycle is a combination of an industrial gas turbine and a steam turbine. Using combined cycle technology, the residual heat that is emitted from industrial gas turbines is exploited and used to run an additional steam turbine with no addition of fuel, meaning that instead of the gases being emitted into the air, they are used for additional generation of electricity. This action contributes to considerable saving in the utilization of fuel and protection of the environment, because production capacity increases without an increase of emission of pollutants into the air.
- As of December 31, 2014, the Company had 14 combined cycle units, all of which are natural gas and diesel powered and whose (combined) generation capacity is approximately 5,081 megawatts.



Changes in the Field of Electricity Generation

Changes in the field of electricity generation

Market entry of private electricity producers

- Since the enactment of the Electricity Sector Law, it has been the policy of the Government of Israel to encourage competition in the Electricity Sector while increasing the electricity generation capacity by private electricity producers. Since the enactment of the Electricity Sector Law, it has been the policy of the Government of Israel to encourage competition in the Electricity Sector while increasing the electricity generation capacity by private electricity producers.
- Accordingly, the objective determined by the Government of Israel for increasing the generation capacity of private electricity producers is 20% of the installed generation capacity in the State of Israel by 2020 (excluding renewable energy). As of the valuation date, the total installed generation capacity of private electricity producers stands at approximately 15.8% including renewable energy (excluding – 12.1%), and following the commencement of operation by three private power plants (Dorad, Ashdod Energy and Ramat Negev Energy) in 2015, it is expected to stand at approximately 24.8% (excluding renewable energy – 18.3%).

Encouragement of renewable energy

- In addition to this objective, in later resolutions a guiding objective for generation of electricity from renewable energy was set at 10% of the electric energy needs of the State for 2020. In addition, there is a guiding intermediate objective of generation of 5% of electricity in Israel at the end of 2014 by renewable energies. As of the time of the valuation, this objective has not yet been met.

Repercussions for the Company

- The Company assesses that in the upcoming years a significant increase can be expected in the installed generation volume of the private electricity producers. Such an increase may have a number of repercussions, including the following:
 - The Company estimates that part of the electricity consumption currently supplied by it and the increase in electricity consumption at the national scale will be supplied in the future by the private electricity producers. As a result of this, there will be a reduction in the actual generation of electricity by the Company, and accordingly a decrease in the generation segment revenues and thus to a potential loss of strategic consumers.
 - Notwithstanding, following the decrease in the volume of generation, a decrease mainly in the fuels expenses and marginally in the operation expenses that are variable is expected.
 - As the Public Utilities Authority (“PUA”) encourages the entry of private electricity producers into the Electricity Sector, a safety net and preferential conditions have been extended to the private electricity producers, covering, inter alia, the use of the transmission and distribution system of the Company and a commitment of the Company to serve as a backup source in the case of failure of private electricity producers to supply electricity to consumers. Because of these preferential conditions, there is no certainty that the Company will be able to compete with the private electricity producers. Notwithstanding the above, the Company assesses that the entry of private electricity producers into the Electricity Sector in Israel will not change the monopolistic status of the Company in the field of generation in the Electricity Sector in the coming years either.



The Transmission and Distribution Segments

Description of the transmission and distribution segments

The transmission segment

- Within the framework of this field of activity, the majority of electricity that is generated, as described by the Company, and partly by private electricity producers, is transferred by the Company via its transmission grid. The transmission grid is deployed throughout the State of Israel and the territories that have been subject to its rule since June 1967 (East Jerusalem, the West Bank and Gaza).
- The transmission grid consists of extra high voltage lines (400 kV) and a high voltage grid (161 kV), through which electrical energy is transmitted from the generation units to the switching stations (stations of 400 kV voltage) and to the major substations (stations of 161 kV voltage) and from the switching stations and the major substations to substations that are built nationwide.
- At the switching stations and substations of the Company, transformation activity is performed, changing the electricity voltage levels from extra high or high voltage (through connection transformers) and from high to medium (through the output transformers at the substations). The electricity transmission at extra high voltage facilitates the transfer of energy between the power stations generating the energy and the switching stations and substations of the transmission segment, at low energy losses.
- Operation, maintenance and handling malfunctions should also be included in the execution of activity of the segment of electric energy transmission.

- The Company has three types of substations: permanent, temporary, and mobile. Mobile substations are built on land that is not usually zoned for the construction of a permanent substation, until the construction of a permanent substation in the area, for a period of five to ten years.
- In addition, there are private substations divided into 2 types:
 - New substations owned by a consumer or producer of high voltage. The operational and maintenance responsibility of the high voltage and extra high voltage lies with the Electric Company.
 - Old substations that are owned by a consumer of high voltage.

The distribution segment

- The distribution segment of the Company conveys electric energy from the substations, at which the voltage level drops to the level of the distribution voltage, for consumption purposes. The distribution system consists of distribution lines of 33 kilovolt, 22 kilovolt and 6.3 to 12.6 kilovolt tension levels (all of these are high voltage lines), low voltage lines and a distribution transformer that interconnects them.
- The Company delivers to most consumers electricity at low voltage, and to major consumers (that is, consumers that consume a large amount of electricity, such as major factories and private producers) electricity at medium voltage.
- The distribution segment has five districts, which cover the entire country, through which most of the work and service relations between the Company and its companies are held, whose number as of the date of this report is approximately 2.62 million.



The Electricity Charge Rate

The electricity charge rate

The manner of determining the charge rate

- The revenues of the Company are based on the electricity charge rate that the Company charges consumers. In accordance with the Electricity Sector Law, the electricity charge rates and their manners of update are determined by the PUA, under the main principle that **the electricity charge rate should cover all of the costs sustained by the Company due to the operation of its assets that are required for fulfilling the duties of the Company as an essential service supplier. These costs consist mainly of the costs of fuels, costs of operation and maintenance, and costs of capital (depreciation, financing and return on capital).**
- Every few years, the PUA is supposed to establish a **charge rate basis** for a certain test period. The charge rate basis has a number of components, some applying to all activity segments and some relevant to only a certain segment. The electricity charge rates for the various consumers are set in accordance with the type of consumption and the supply voltage.
- In accordance with the Electricity Sector Law, the electricity charge rates are to be updated according to an update formula that the PUA will determine. Since the charge rate for consumers is not updated following each theoretical update, a gap forms between the revenues for the actual charge rate and the theoretical update. This gap may be positive or negative in accordance with the recognized cost for the Company. In accordance with the accounting rules implemented by the Company, this gap is imputed to a regulatory asset (or liability) called “compensation for delay in update” and is included in the charge rate calculation applying from the next annual update date.



The Generation Segment Charge Rate

The generation segment charge rate

The charge rate basis for generation segment

- **On February 1, 2010, the resolution of the PUA was adopted with respect to the update of the charge rate basis for the generation segment for 2010-2014** (“the New Generation Charge Rate Basis Book”). This resolution and the charge rates derived from it took effect on February 15, 2010.
- **The new generation charge rate basis** states the cost basket recognized for the Company in the generation segment for 2010-2014, including costs of capital, costs of operation, the fuels mix and more. The recognized costs were determined after audit of the costs of the Company that were carried out by the PUA, as they were listed in the books of the Company.
- “new” generation units – the recognition of the costs of these units is in accordance with normative parameters such as operation dates, construction times and normative interest rates.
- **Financing costs (recognized return rate):** the recognized return rate is used starting as a basis for recognition of capitalization of financing costs of assets at the time of their construction. The rate of return is derived from three variables: the financial leverage level, return on equity capital rate, and interest on foreign capital.
- **Operating costs: the recognized operating costs for the test period are derived from the average operating costs according to the financial statements of the Company for 2002-2006** while separating labor costs and other costs and after performing certain adjustments. A depreciation coefficient of 2% per year is applied to these recognized costs. Prior to June 2013 the PUA recognized all costs as variable costs, and adjusted them through the years by kWh produced each year. After June 2013, the PUA recognized 88% of the costs as fixed costs, which were adjusted by installed capacity, and 12% as variable costs, which continued to be adjusted by kWh produced.
- **Pension costs:** the examination of the pension costs has not yet been completed by the PUA. As of the time of the valuation, the recognized pension costs shall include the following:

Components of the generation charge rate basis

- **Calculating the fuel mix:** the recognized fuels mix for a certain year is calculated at the beginning and at the end of the year. Within the annual update of the subsequent year, an accounting will be made according to the difference between the revenues of the Company from the fuels mix in retrospect and the revenues that was calculated in advance. The difference will be returned to consumers or to the Company with the addition of interest and linkage.
- **Recognized assets and depreciation:** the assets that were recognized in the new charge rate basis were established according to a future outline for 2010-2014. The PUA has determined that the recognized cost for active assets will relate to two categories:
 - “old” generation units (activated before December 31, 2002) – the recognition of the costs of these units is based mainly on the costs listed in the books.
 - “Old units” – was taken off the books of the Company and included in the pension costs of the employees of the Company.
 - “New units” – shall only include costs of accumulating pensions of third generation employees. The costs shall not include actuarial pension costs of first generation employees, second generation employees or third generation employees relating to free electricity, gift for holidays and bonuses.



The Generation Segment Charge Rate

The generation segment charge rate – overview of potential gaps between the recognized costs and the actual costs

Potential gaps between recognized and actual costs

- As mentioned before, the charge rate basis should cover all of the costs sustained by the Company due to the operation of its assets, including financial costs and shareholders' required return.
- Theoretically, the calculated electricity charge rate should cover all of the Company's costs, and as such, there should not be a positive nor negative gap between the assets' carrying amount and their value in use (as defined in Chapter B of this report).
- Notwithstanding, the charge rate basis is not identical to the actual cost structure which changes over time, and the determined rate of return is not the same as the rate of return used to discount the free cash flows. Therefore, there may be positive or negative gaps, which may detach the discounted cash flow from the carrying amount.
- **The following is a brief recap of the major costs of the generation segment and their coverage according to the charge rate basis:**
 - **Fuel mix** – the charge rate basis covers the complete actual fuel costs, thus there should not be any gaps between the value in use and its carrying amount for this item. Notwithstanding, the Company may gain profits from the usage of diesel oil inventory, since its book value is higher than its recognized price.
 - **Asset costs: "old" units** – the charge rate covers all actual costs, therefore there should not be any negative gaps between value in use and carrying amount.
 - **Asset costs: "new" units** – the charge rate covers normative costs, which are not necessarily identical to actual costs. Therefore, there should be positive gaps between the value in use and the carrying amount if the normative costs are higher than the actual costs, and negative gaps otherwise.
 - **Financial costs (recognized rate of return)** – the return on assets is intended to reimburse the Company for the time differentials between cash outflow and cash inflows. The recognized rate of return is different from the discount rate, and as long as the difference between them are positive, there should be positive gaps, and vice versa.
 - **Operating costs** – the recognized operating costs are based on the average operating costs from the Company's financial statements of 2002-2006 while factoring a depreciation coefficient of 2% per year and adjusting these costs by kWh produced each year prior to 2013, and by installed capacity (for 88% of the costs) since 2013. If the actual streamlining would be different than 2%, and the decrease in kWh would not result in a similar decrease in operating costs, there should be gaps between actual and recognized operating costs, and hence a gap between the value in use and the carrying amount.
 - **Spare parts** – spare parts are included in the operating costs, and originally only 50% of the average cost calculated by the PUA are covered. However, and in 2014 another 50% was paid to the Company (total of 100%) since 2010 (in retrospect). Even still, the recognized cost of spare parts does not cover the complete book value of spare parts, and there is a negative gap between the value in use and the carrying amount.
 - **Pension costs** – the determination of recognized pension costs is different from the actual costs. However, it is the Company's view that in the future the Company will receive full and complete coverage of these costs, and therefore there should not be any gaps between the value in use and the carrying amount.



The Transmission and Distribution Segments Charge Rate

The transmission and distribution segments charge rate

The charge rate basis for transmission and distribution segments

- The electricity charge rate for the transmission and distribution segments was set in accordance with the resolution of the PUA dated July 1, 2002 ("**2002 Charge Rate Basis Book**"), which took effect on July 5, 2002.
- The 2002 Charge Rate Basis Book stated that if until December 31, 2005 no new charge rates would be set with respect to January 1, 2006 onward, then the resolutions of the PUA would be valid until the date of setting new charge rate bases.
- As of the date of the report, the PUA has not yet set new charge rate bases for the transmission and distribution segments, therefore it is the Company's view that it will receive full coverage of its operating and capital expenditures for these segments. This is based upon the PUA's resolution from March 22, 2012, which determined that the new charge rate basis for the transmission and distribution segments will take effect retrospectively from April 1, 2012.
- It should be noted that in January 2015 the Company received a draft of an internal document from the PUA, which constitutes as a foundation for a new charge rate basis for the transmission and distribution segments starting 2012 (Navigant's report).

Components of the current charge rate basis

- **Recognized assets and depreciation:** the asset basis in the transmission and distribution segments was calculated based on the average net active fixed data in 2000, while making certain adjustments. Accordingly, the recognized depreciation costs were based on the recognized assets as mentioned above.
- **Financing costs (return on assets):** like the new charge rate basis for the generation segment, the calculation of the recognized return on its assets is derived from three variables: leverage level, return on equity capital and return on foreign capital. The recognized normative leverage ratio in the charge rate and the rate of return on foreign capital are in accordance with the new **generation** charge rate basis book.
- **Operational costs:** the recognized costs of operation for the transmission and distribution segments were based on the operation costs listed in the books of the Company based on 2000, while making certain adjustments.
- **Pension costs:** within the operational costs in the charge rate, as prescribed in the charge rate bases in 2002, the wage and pension costs of the employees of the Company are recognized. The PUA has also recognized changes in the assessment of the actuarial debt for pension for second generation employees.
- **Depreciation coefficients:** depreciation coefficients per sold kWh have been set within the charge rate formulas, which represent the expectation of cost saving in the Company and that are supposed to reflect economy of scale at cumulative annual rates.

Chapter B – Value in Use



The Accounting Standard

The accounting standard

- As requested by the Company, the valuation shall be used to implement International Accounting Standard 36, Impairment of Assets ("the Standard") in its financial statements.
- The purpose of the Standard is to establish procedures a corporation must implement in order to ensure that its assets are not presented at a sum higher than their recoverable sum. An asset is at a sum higher than its recoverable amount when its book value is higher than the sum received from the use or sale of the asset. In this case the asset has an impairment and the Standard demands that the corporation recognize an impairment loss. The Standard also specifies when a corporation must write off impairment loss and requires certain disclosure regarding assets undergoing impairment, and regarding investment in investees not constituting subsidiaries presented in the Financial Statements at sums significantly exceeding their market value or net sales price.
- The Standard prescribes the accounting treatment and presentation required in the event of impairment of assets. If a corporation prepares consolidated financial statements (including through relative consolidation), the standard shall be applied to the accounting treatment of the impairment of all the assets appearing in the corporation's consolidated balance sheet, including investment in investees not constituting subsidiaries, goodwill deriving from the purchase of subsidiaries and fair value adjustments. This standard also applies to investments in subsidiaries and jointly-controlled companies in such a manner that impairment provisions recognized in the consolidated financial statements for the assets of the subsidiary or the jointly controlled company, including goodwill and fair value adjustments, shall be presented in the parent company's separate financial statements as a reduction of the balance of the investment in the subsidiary or the jointly-controlled company.
- The Standard states that the asset's recoverable sum shall be assessed whenever signs indicate the possibility of the asset's impairment. This standard requires recognition of the impairment loss of an asset (meaning that the value of the asset has dropped) at any time the book value of the asset supersedes its recoverable sum. Impairment loss shall be recognized in the Statement of Income regarding those assets presented at cost and shall be treated as a reduction of a new assessment, this only regarding those assets presented at the re-assessed sum, in accordance with other accounting standard or as required by law.
- The Standard states that the recoverable sum shall be calculated as the fair value (less sales costs) or the value of use, whichever is higher:
 - The fair value (less sales costs) is the sum that may be received from the sale of the asset in a good faith transaction between a willing buyer and a willing seller, acting in an enlightened manner, less any direct added sales costs.
 - The value of use of an asset is the current value of estimated future cash flow expected to be derived from the continuous use of the asset and its sale at the end of its useful life span.
- In determining an asset's value of use, this standard requires that a corporation use, among other things:
 - cash flow projections on the basis of reasonable and established assumptions that:
 1. Reflect the asset's current value.
 2. Represent the management's best estimate regarding the economic conditions that will apply throughout the balance of the asset's useful life span.
 - Pre-tax capitalization rate, which reflects current market estimates of the money's time value and the risks specific to the asset. The capitalization rate will not reflect risk to which future cash flows have already been adjusted.
- Estimated recoverable amount will be calculated for each asset separately. If this is impossible, this standard requires that the corporation set the recoverable sum for the cash-generating unit to which the asset belongs. A cash-generating unit is the smallest identified group of assets that yield cash inflows from continuous use, which are largely independent of inflows from other assets or from other groups of assets. At the same time, if the output created by an asset or a group of assets is traded on the open market, the asset or group of assets shall be recognized as a separate cash-generating unit, even if part or all of the output produced by the asset or the group of assets is intended for internal use.
- When examining the impairment of a cash-generating unit, this standard demands taking into account goodwill and shared assets (such as head office assets) related to that cash-generating unit.



Valuation Methodology

Methodology

Discounted Cash Flows (DCF)

- The valuation was conducted according to the discounted cash flow approach (DCF). The discounted unlevered cash flows in a commonly accepted method in the Theory of Finance, and in mentioned as the preferred method in IAS 36.
- A DCF analysis is appropriate and reasonable as long as the basic assumptions it is based on are correct and accurate. Furthermore, the analysis is sensitive to the determination of the appropriate discount rate, which by itself is not an easy task and is somewhat subjective.
- According to the Standard, the cash flows shall be discounted by a pre-tax discount rate, that reflects current market expectations of the time value of money and the specific risks relevant for the asset. The discount rate shall not reflect uncertainties that the forecasted cash flows had already been adjusted for.
- Theoretically, discounting pre-tax cash flows by a pre-tax discount rate, should arrive to the same result as discounting post-tax cash flows by a post-tax discount rate, as long as the pre-tax discount rate is equivalent to the post-tax discount rate after certain adjustments to reflect the amount and the timing of tax payments. In accordance with common practice, we discounted post-tax cash flows by post-tax discount rate.

Cash Generating Units

- **According to the Company's view, the generation, transmission and distribution segments together constitute one CGU**, for the following reasons:
 - According to its license, the Company is obligated to operate in all three segments and cannot discontinue the operation in one segment or any part of it, even if it is unprofitable, due to the fact the Company is a "government company", whose shareholder's (the State of Israel) concern are not necessarily pure economic.
 - The Company is a vertically integrated company which generates cash flows as a whole, where practically nearly all its consumers purchase its final product, utilizing all of its segments.
 - It should be noted the definition of an active market in IFRS 13 is a market where transactions are conducted frequently and in a sufficient extent that may provide information regarding the prices on a continuous basis. In this case, there is no active market for electricity generation, transmission and distribution, and it is the Company's opinion that the fact that the regulator determined different charge rates for each segment does not change the accounting conclusion that there are no different active markets for each segment.
 - A benchmark analysis conducted by the Company revealed there are other vertically integrated companies in the line of electricity that defined the whole chain as one CGU (e.g. Fortis Inc, BC Hydro).



Key Assumptions

General assumptions

General Assumptions

- **Full coverage:** as mentioned above, once every few years the PUA updates the charge rate basis. With no specific information about future charge rate basis, it is assumed that the company will receive full coverage of its operating and capital expenses from the new charge rate basis update going forward. This implies that there will be no positive or negative gaps between book asset value and value in use from this moment on.
- **The transmission and distribution segments:** as of the date of the valuation, a new charge rate basis for these segments has yet to be announced. Therefore, it is assumed that the Company will receive full coverage for these segments.
- **The Palestinian Authority and East Jerusalem Electricity Company:**
 - As of the date of the valuation, the Palestinian Authority has an outstanding debt to the company of ~NIS 1.2bn. The company estimates that some of it would be difficult to collect.
 - It is the Company's view that the entire amount will eventually be collected, and the Company will be affected in the value of time. Therefore, we calculated the time value separately, and subtracted it from the value in use derived from the DCF. We assumed that a debt restructuring will take place in early 2016.
 - **The time value effect of the Palestinian Authority's outstanding debt is estimated at NIS 25M.**
- **Deep market:** in the end of 2014, Israel Security Authority determined that the local corporate bond market is deep. The meaning of this resolution is that companies may apply corporate bonds yield to maturity to value its pension liabilities, instead of government bonds which had been used before. By doing so, the present value of the pension liabilities will decrease.
- **Retirement agreement:** On February 25, 2015 the company signed a collective agreement with the Histadrut and the Company's labor union, which includes an early retirement of approximately 440 employees (the agreement is subject to the approval of the Director of Wages and the Government Companies Authority). As a consequence of the agreement, the Company will sustain a one time increase in costs in 2015, and a permanent cost reduction in the future. However, since the Company was not obliged to sign this agreement as of the date of the valuation, we did not take it into account in the valuation.
- **Regulatory assets and liabilities:** the valuation did not include cash flows deriving from regulatory assets and liabilities, and these balances were treated as financial assets/liabilities and thus excluded from the carrying amount. These balances were taken into account in the calculation of the leverage ratio in the WACC analysis.

Chapter C – The Generation Segment



The Generation Segment – Assumptions for the Forecasted Period

Assumptions for the generation segment

Forecasted period

- In accordance with the Company's management's clarifications, which were based on its discussions with the PUA, we assumed that the new charge rate basis for the generation segment will be announced and will take effect on June 30, 2016. Accordingly, we assumed that from this day forward, the Company will received full coverage of its operating and capital expenses .

Income from capital services

- **Return on assets:**

- The return on assets is calculated according to the depreciated amount of the recognized assets, as can be shown in the tables in the new generation charge rate basis book. The recognized assets are divided into old generation units and new generation units.
- The rate of return is calculated according to certain parameters defined by the PUA (see page 15). The calculated rates of return are 6.37% in 2015 and 6.14% in 2016.

- **Depreciation cost:**

- The depreciation cost is calculated according to the recognized assets as can be shown in the tables in the new generation charge rate basis book.

- **Adjustments to the assets:** some adjustments are conducted to the assets in accordance with the clarifications in the chare rate basis book, and other adjustments are conducted due to costs arising from statutory obligations:

- Environmental costs – we assumed the Company will receive full coverage of its investments in environmental projects due to the fact that these costs arise from a statutory obligation.
- Consumer funding – the PUA instructed that a sum representing the Company's capital expenditures funded by its consumers, shall be deducted from the recognized assets.
- Irregular costs – the gap between actual and normative construction costs of new generation units, factored by a probability in accordance with the Company's assumptions.
- Gas conversion – the recognized assets were adjusted to natural gas conversion costs, according to the provisions of the PUA.
- Liquidation reserves – the recognized assets should be adjusted for liquidation reserves according to the PUA. However, since we did not take these reserves into account for the recognized assets, we also deducted them from the carrying amount.
- Net pension costs included in the "new" units and the effect of implementing IAS 19 – although the subject is still examined by the PUA, the Company expects to receive full coverage for its pension costs. Therefore, we deducted the debated amount from the book value.
- Retirement costs – as mentioned before, we did not take into account expenses caused by the collective agreement.



The Generation Segment – Assumptions for the Forecasted Period

Assumptions for the generation segment

Income from fuels

- **Profit from fuels:** the Company estimates that the recognized diesel oil price will be higher than its carrying amount, thus it is expected to generate profit.
- **Working capital – fuel inventory:** according to the provisions of the charge rate basis, the Company should be reimbursed for the financial costs of maintaining its fuel inventory.
- **Working capital trade receivables – fuels:** according to the provisions of the charge rate basis, the Company should be reimbursed for the fuel component of its customer credit.

Recognized operating costs

- Recognized operating costs are calculated according to the provisions of the charge rate basis (see Chapter A for details).
- Due to entry of private electricity producers, the total kWh generated by the Company had decreased, while the Company is still obliged to serve as a backup source in the case private producers fail to supply electricity. Therefore, the PUA made certain adjustments to the recognized costs in accordance with kWh forecasted to be generated by the private producers.

Other income

- Other income constitutes mainly sales of vehicles, heavy equipment and inventory.

Expenses

- In accordance with the Company's budget documents for 2015 and forecasted costs and investments for 2016, its expenses mainly include fuel costs, operating costs for the generation segment, general and administrative costs attributed to the generation segment, and current investments in power plants.

Investments

- **Investments in environmental projects:** investments such as emission reduction that the Company is obliged to carry out.
- **Investments in joint assets and newly installed computer systems:** the generation segment's share in joint investments.
- **Other investments:** completion works in operating units.

Changes in working capital

- **Account receivables:** the balance of trade receivables was calculated according to the Company's historical day sales outstanding.
- **Inventory:** the Company does not expect to purchase diesel oil nor fuel oil during the forecasted period due to increase in natural gas usage. Any usage of these fuels will result in a decrease in inventory.
- According to the Company's estimates, other working capital balances are expected to remain constant over the years.



The Generation Segment – Assumptions for the Residual Value

Assumptions for the generation segment

Full coverage

- As previously mentioned, in accordance with the Company's management's assumptions, which were based on its discussions with the PUA, we assumed that the new charge rate basis for the generation segment will be announced and will take effect on June 30, 2016.
- We assumed that from this day forward, the Company will received full coverage of its operating and capital expenses in the generation segment. Accordingly, the residual value of the recognized assets the company will own as of this date, reflects the present value (as of this date) of future cash flows the Company is expected to obtain from the generation segment, which in turn reflects the recoverable amount.

Residual value of recognized assets

- The residual value of the recognized assets is the depreciated amount of these assets as of the date of the new charge rate basis for the generation segment.
- This amount also takes into account the depreciated amount of investments in environmental projects, since it is a statutory obligation and therefore we assumed the Company will receive full coverage for these costs.

Residual value of other operating balances

- Working capital – in accordance with the Company's view, we assumed that the net balance of working capital as of the date of the full coverage assumption (i.e. June 30, 2016) is its recoverable amount.
- Joint assets – in accordance with the Company's view, the Company will receive full coverage of costs related to its joint assets. Therefore, we added the generation segment's share in joint assets to the residual value.

Other operational assets

- Rogozin land – According to the Company, this land should also be included in the generation segment, since the Company intends to construct a new generation unit on this land. Therefore, the value of this land, which is based on an independent appraisal we received from the Company, was added to the carrying amount.
- Project D – The Company's management assumes that the project's value in use deriving from its future expected cash flows, should at the very least be the same as the carrying amount. Therefore, we added the project's carrying amount to the value in use.



The Generation Segment – Cash Flow

Cash flow for the generation segment

<i>NIS M</i>	<i>1-12.2015</i>	<i>1-6.3016</i>	<i>Residual Value as of June 30, 2016</i>
Financing costs for active assets	1,320	590	
Depreciation costs	2,037	981	
Total income from capital services	3,358	1,571	
Recognized operating costs	2,793	1,303	
Fuel basket costs	7,747	4,015	
Working capital – fuel inventory	87	37	
Working capital trade receivables – fuels	33	17	
Profit from fuels	100	37	
Total income from fuels	7,967	4,107	
Other income	131	62	
Total income from the generation segment	14,249	7,042	
Expenses:			
Fuel costs	(7,747)	(4,015)	
Total operating costs	(2,583)	(1,307)	
Investments in operating power plants	(156)	(72)	
Cyclical renovations	(168)	(163)	
Depreciation expenses	(2,157)	(1,074)	
Total expenses	(12,811)	(6,632)	
Operating profit	1,438	410	
Depreciation expenses	2,157	1,074	
EBITDA	3,595	1,485	27,022

<i>NIS M</i>	<i>1-12.2015</i>	<i>1-6.3016</i>	<i>Residual Value as of June 30, 2016</i>
Tax expenses	(381)	(109)	
Investments in fixed assets:			
Investments in environmental projects	(1,132)	(478)	
Investments in joint assets and newly installed computer systems	(233)	(134)	
Other investments	(185)	(130)	
Total investments in fixed assets	(1,551)	(742)	
Changes in working capital	1,847	97	
Residual value of other operating assets			5,602
Free cash flow	3,510	731	32,624
Other operational assets, net	263		

Chapter D – Cost of Capital



Cost of Capital

Weighted Average Cost of Capital

Weighted Average Cost of Capital

For the purpose of the valuation, we used a Weighted Average Cost of Capital (WACC) of 3.7%.

We used the Capital Asset Pricing Model (CAPM) to determine the required return on the Company's equity, and made certain assumptions to determine the Company's appropriate cost of debt and capital structure.

Cost of equity

Parameter	Value	Note
Risk free rate	1.10%	1
Market premium	6.0%	2
Beta	1.12	3
Cost of equity	7.8%	

1. Real yield to maturity of government bond with a duration of 13.2 years, as of December 31, 2014. The duration was selected according to the average duration of the generation segment's assets.
2. The market premium in Israel is estimated at 6.0%.*
3. In order to determine the Company's Beta, we selected a number of publicly traded companies which operate in the generation, transmission and distribution segments together (see Appendix 5 for list of comparables).

The following is the calculation of the Company's re-levered Beta:

Parameter	Beta calculation
Unlevered Beta – industry average	0.30
Selected leverage ration	368%
Long term tax rate	26.5%
Re-levered Beta	1.12

Leverage ratio and cost of debt

The selected leverage ration (D/E) is the Company's specific leverage ratio. To determine the ratio, we implemented an iterative calculation using the Company's asset value as is calculated in the valuation.

The value of debt was determined according to the Company's fair value of the debt raised from banks, financial corporations and the public, net of the value of regulatory liabilities, as we received from the Company.

The long term tax rate was determined according to Israel's corporate tax rate, as of December 31, 2014 – 26.5%.



Cost of Capital

Weighted Average Cost of Capital

WACC summary

The following tables summarizes the WACC calculation:

Parameter	Value	Note
Risk free rate	1.10%	
Market premium	6.00%	
Beta	1.12	
The Company's cost of equity	7.8%	
Cost of debt	3.52%	4
Tax rate	26.5%	5
D/V	79%	
WACC	3.70%	

4. The cost of debt was determined according to the rate of return of corporate inflation-linked bonds rated Aaa3 with a duration of 13.2 years, as quoted by "Mirvah Hogen"* as of December 31, 2014 (for further details, see Appendix 4).
5. The long term tax rate was determined according to the Israel's corporate tax rate, as of December 31, 2014 – 26.5%.

Chapter E – Valuation Results



Valuation Results

Valuation results

	<i>NIS M</i>
The generation segment – discounted cash flow and residual value	35,302
The transmission and distribution segments	34,472
Total value of segments	69,774
Net of: adjustments for the Palestinian Authority debt restructuring	(25)
Recoverable amount	69,749
Carrying amount	69,193
Surplus (deficit) of recoverable amount over carrying amount	556

We compared the recoverable amount to the carrying amount of the assets in accordance with IFRS, and concluded that the recoverable amount is greater than the carrying amount.



Sensitivity Analysis

Sensitivity analysis

The following are the key assumptions we applied in the valuation and the results which would have occurred had we applied different assumptions (assuming maximum influence in each case):

NIS M		Maximum change in recoverable amount			Surplus (deficit) of recoverable amount over carrying amount
Implementation of a new charge rate basis for the transmission and distribution segments according to the internal PUA document (Navigant’s report) *		(2,127)			(1,570)
Recognition of only 80% of investment costs in environmental projects		(1,047)			(490)
Non-recognition of full pension costs for the “new” units in the generation segment		(146)			411
Non-recognition of fixed assets liquidation costs		(386)			171
Non-recognition of irregular construction costs		(102)			454
Non-realization of fuel profit forecasts		(98)			458
Weighted Average Cost of Capital					
	4.70%	4.20%	3.70%	3.20%	2.70%
Surplus in recoverable amount over carrying amount	90	322	556	794	1,034
Change in recoverable amount	(466)	(234)	0	237	477
Leverage Ratio					
	85.00%	80.00%	78.65%	75.00%	70.00%
Surplus in recoverable amount over carrying amount	509	556	556	556	604
Change in recoverable amount	(47)	0	0	0	47
Market Premium					
	6.50%	6.25%	6.00%	5.75%	5.50%
Surplus in recoverable amount over carrying amount	509	509	556	604	604
Change in recoverable amount	(47)	(47)	0	47	47

Appendices



Appendix 1 – Consolidated Balance Sheet

Consolidated Balance Sheet

Assets, NIS M	12.31.2013	12.31.2014	Liabilities and Equity, NIS M	12.31.2013	12.31.2014
Current assets			Current liabilities		
Cash and cash equivalents	3,394	4,504	Credit from banks and other credit providers	7,104	8,351
Short-term investments	492	2,559	Trade payable	1,721	1,757
Trade receivables for sales of electricity	4,383	4,546	Other current liabilities	1,739	1,799
Other current assets	328	537	Regulatory liabilities, net	0	400
Inventory – fuel	1,065	1,057	Customer advances, net of work in progress	397	453
Inventory – stores	144	146	Provisions	729	719
Regulatory assets, net	2,966	0		11,690	13,479
	12,772	13,349	Non-current liabilities		
Non-current assets			Debentures	32,704	35,695
Inventory – fuel	1,733	1,539	Liabilities to banks	8,555	4,737
Long-term receivables	1,176	1,833	Liabilities with respect to other benefits after employment termination	2,918	2,930
Investment in an investee company	98	86	Regulatory liabilities	1,395	261
Regulatory assets	695	0	Provisions for funding amounts to customers	2,560	2,675
Assets with respect to benefits after employment termination	3,741	6,219	Deferred taxes, net	5,078	5,537
Fixed assets, net			Debentures to the State of Israel	2,531	2,534
Fixed assets in use, net	58,528	57,020	Liabilities to the State of Israel	2,850	2,902
Fixed assets under construction	6,063	6,497	Other liabilities	690	683
	64,591	63,517		59,281	57,954
Intangible assets, net	946	974	Equity		
	72,980	74,168	Shareholders' equity	14,781	16,084
Total assets	85,752	87,517	Total liabilities and equity	85,752	87,517



Appendix 2 – Consolidated Income Statement

Consolidated Income Statement

Income Statement, NIS M	12.31.2014	12.31.2013	12.31.2012
Revenues	25,195	27,601	28,263
Cost of operating the electricity system			
Wages	1,718	1,887	2,361
Fuels	7,884	10,941	19,871
Transfer of regulatory asset to fuels	3,435	4,324	(5,258)
Purchases of electricity	1,709	1,004	877
Transfer of regulatory asset to electricity purchases	12	310	0
Operation of the generation system	732	754	839
Operation of the transmission and distribution system	394	334	306
Depreciation and amortizations	4,260	4,653	4,399
Provision	0	0	0
Profit from operating the electricity system	5,051	3,394	4,868
Sales and marketing expenses	902	903	1,065
Administrative and general expenses	1,136	1,111	869
Expenses for liabilities to pensioners, net	2	20	1,544
Income from current operations	3,011	1,360	1,390
Financing expenses, net	2,787	2,167	2,685
Profit (loss) before income taxes	224	(807)	(1,295)
Taxes on income	61	125	(293)
Profit (loss) for the year	163	(932)	(1,002)
Company's share of the loss of associated companies, net	(12)	(2)	0
Net Profit (loss)	151	(934)	(1,002)
Re-measurement of a defined benefit plan after tax	1,576	344	(1,046)
Hedge accounting, net	(6)	0	0
Other comprehensive income (loss) for the year, after taxes	1,152	279	(784)
Comprehensive profit (loss) for the year	1,303	(655)	(1,786)



Appendix 3 – Carrying Amount

Carrying amount

<i>NIS M</i>	<i>Generation Segment</i>	<i>Transmission Segment</i>	<i>Distribution Segment</i>	<i>Total</i>
Fixed assets in use, net	25,730	12,015	19,261	57,006
Fixed assets under construction	4,071	1,997	411	6,479
Other fixed assets	436	205	329	970
Working capital, net	5,006	193	61	5,260
<i>Net of:</i>				
Liquidation reserves	(386)	–	–	(386)
Adjustments for pension costs in the generation units	(136)	–	–	(136)
Total	34,721	14,410	20,062	69,193



Appendix 4 – Determination of Cost of Debt

Determination of cost of debt

- The cost of debt was determined according to the rate of return of corporate inflation-linked bonds rated Aaa3 (The Company's rating) with a duration of 13.2 years, as quoted by "Mirvah Hogen"* as of December 31, 2014.
- Accordingly, the pre-tax cost of debt was set at 3.52%.
- We conducted the following sensitivity analysis for the cost of debt:

The Company's bonds' information as quoted by "Mirvah Hogen":

- We reviewed yield to maturity and duration of the Company's bonds as quoted by "Mirvah Hogen".
- We determined the equivalent rating range for each of the bonds, according to "Mirvah Hogen"'s matrix for non-traded corporate bonds with the same duration. Most of these bonds obtained higher rating range than the Company's rating, while some even obtained rating in the range of the government bonds.

- We reviewed the relevant yield for the relevant rating for a duration of 13.2 years.
- The average calculated cost of debt is **lower** than the cost of debt we applied in the valuation.

Fair interest rate "translated" into indexed-linked NIS:

We reviewed the fair interest rates that the Company's financial liabilities bear in different currencies, as provided by the company.

- We adjusted the currencies based on the basic spread according to the risk free rates for each currency (non-linked NIS, USD and JPY). Consequently, we calculated the equivalent real NIS interest rate for these liabilities.
- We calculated the weighted average of these interest rates, according to the amount of each loan.
- The average calculated cost of debt is **lower** than the cost of debt we applied in the valuation.



Appendix 5 – Determination of Unlevered Beta

List of comparables

Company	Unlevered Beta
Duke Energy Corporation	0.26
Electricite de France SA	0.44
NextEra Energy, Inc.	0.43
Southern Company	0.25
Exelon Corporation	0.37
American Electric Power Co., Inc.	0.39
Korea Electric Power Corp.	0.19
SSE plc	0.30
PPL Corporation	0.23
Xcel Energy Inc.	0.25
Northeast Utilities	0.28
FirstEnergy Corp.	0.29
Entergy Corporation	0.17
Chubu Electric Power Company, Incorporated	0.26
Pinnacle West Capital Corporation	0.36
OGE Energy Corp.	0.51
Tokyo Electric Power Company, Incorporated	0.19
Tohoku Electric Power Co. Inc.	0.07
VERBUND AG	0.44
CPFL Energia S.A.	0.16
Companhia Energética de Minas Gerais S.A.	0.41
Westar Energy, Inc.	0.42
The Chugoku Electric Power Co.,Inc.	0.12
Emera Incorporated	0.30
Great Plains Energy Incorporated	0.46
Average	0.30