The Israel Electric Corporation Ltd.

Financial Reports

For The Year Ended
December 31, 2013

FILES INDEX

The financial reports, for the year ended December 31, 2013, 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, 2013
**Prominent Disclaimer**

This English translation of the “*Description of the Company's Business Affairs*” for the year ended December 31, 2013 ("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

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 Israel Electric Corporation Ltd. The Company is engaged in the generation, transmission, distribution, sale and supply of electricity to 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”). Pursuant to the Concessions, the Company was granted the exclusive right to generate, supply and distribute electricity and to sell it throughout the Mandate for Palestine, except in Jerusalem and its environs.

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 22.1 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 operates as an electricity system administrator. To the date of this report, the Company is exclusively licensed to distribute and supply electricity in the area of the State of Israel. Additionally, the Company holds licenses for the generation of 91% of the total output of the power stations in the electricity sector for which generation licenses have been issued. See section 9.4.1 and 7.4.3.4, respectively, with respect to distribution operations and generation. The system administration activity is performed by the Company within the framework of the “the General License” (as this has been defined in Section 22.1.2) although it has not been given a special purpose license on this matter. See Section 22.1.2 for details.

The licenses of the Company have been extended by the Ministers\(^2\), from time to time over the years, with an order, usually for periods of one year each time, for all of its activities, pursuant to their authority under Section 60 (D11) of the Electricity Sector Law in its version prior to Amendment No. 10 to the Electricity Sector Law\(^3\) (hereinafter: “Amendment 10 to the Electricity Sector Law”). Within Amendment 12 to the Electricity Sector Law\(^4\), the licenses of the Company were extended until January 1, 2015. Accordingly, on January 23, 2014, and February 12, 2014, the Public Services Authority Electricity (“Electricity Authority”) and the Minister of National

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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 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 Energy and Water).

3 The Electricity Sector Law (Amendment No. 10 and Provisional Order), 2012, Codex of 2006, p. 208.

4 The Electricity Sector Law (Amendment No. 12), 2013, Codex of 2426, p. 251.
Infrastructure, Energy and Water (the “Minister” or “Minister of Energy and Water”), respectively, approved the extension of the new generation licenses of the Company (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 until January 1, 2009) until January 1, 2015. An additional extension of the Company’s licenses, until January 1, 2016, entails an order to be granted by the Ministers, after consultation with the Electricity Authority and 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 Company is an “essential service supplier license” holder (as this term is defined in the Electricity Sector Law) and is also engaged in the construction and setup of the infrastructure that is required for its other operations.

The shares of the Company were traded for a certain period 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 from the public, the shares of the Company ceased to be traded on the Stock Exchange, and as of the date of the report, bonds of the Company (series 22) are being traded on the Stock Exchange according to a prospectus of the Company from May 21, 2002. Additionally, the Company has bonds (series 24) and (series 25) which are being traded on the stock exchange 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 and corporations. See Section 22.5 for a description of the main points of the Government Companies Law.

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”).

5 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

Additional subsidiaries and sub-subsidiaries of the Company, which are inactive, have not been included in the diagram. 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., the Israel Farmers Company Ltd. and in a government company, Mekorot Water Company Ltd. 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 31.2 below. The Company consolidates the statements of the National Coal Supply Corporation Ltd. in its own Financial Statements. See Note 11 a to the Financial Statements) of the Company for December 31, 2013 (the “Annual Financial Statements”).

** 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’s holdings in the I.B.C. Israel Broadband Company (2013) Ltd. (“IBC”) is 40% of the share capital and voting rights. Additionally, 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.

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

See Note 1.f. to the Annual Financial Statements for details on differences of opinion between the Company and the State on the rights of the Company to property and assets of the Company that it possessed on the date of expiry of the Concession.
1.3 **The nature and the results of each significant structural change, merger or acquisition**

Details on the structural change in the Company that is required by the provisions of the Electricity Sector Law and the government resolutions and the preparations of the Company to implement it follow:

The Electricity Sector Law states that the purpose of the law is to regulate activity in the Electricity Sector for the benefit of the public, while securing reliability, availability, quality, efficiency and creating conditions for competition and the minimization of costs.

In recent years, a number of amendments have been made to the Electricity Sector Law, which lay down separation between the generation, transmission, distribution, supply and system administration activities, under the conditions that are prescribed in the Electricity Sector Law, through their decentralization into a number of separate entities (hereafter: the “Structural Change”), while establishing transitional provisions and a schedule for the implementation of the instructions that allow the Company to generate, transmit, distribute, supply, sell and trade electricity, and to serve as the administrator of the electricity system, in accordance with the licenses that have been granted to it pursuant to the Electricity Sector Law, through to January 1, 2015.

During the course of the years that have elapsed since the date of the enactment of the Electricity Sector Law, the Government of Israel and the Government Ministries adopted a number of resolutions and recommendations with respect to the Electricity Sector, as described in greater detail below, some of which have been subsequently adopted as amendments to the Electricity Sector Law while others have not been implemented.

In addition, throughout 2010, discussions were held between the management of the Company and the labor union of the Company and representatives of the Ministry of Finance, the Ministry of National Infrastructures, Energy and Water (the former Ministry of National Infrastructures) and the National Labor Federation, at the end of which, in September 2010, a document was formulated, stating a possible outline of a structural change in the Company (hereafter: the “Outline of Understandings”), and which is inconsistent with the provisions of the Electricity Sector Law as worded at the time of the report.

On July 22, 2013, the Minister of Finance and the Minister of Energy and Water appointed a steering team to execute a reform in the electricity sector and the Electric Company, headed by Mr. Uri Yogev, the Director General of the Government Companies Authority, and with the participation of senior members of the Ministry of Energy and Water, the Ministry of Finance and others (“Steering Team”). In the letter of appointment of the Steering Team (hereinafter: the “Letter of Appointment”) it was written as follows: “Since 1996, upon the enactment of the Electricity Sector Law - 1966, the electricity sector in Israel is operating within a regime of licenses for all the activity carried on in it. The Electric Company has a license for transmission, distribution, supply, sale of electricity and trade in it, as well as licenses to generate electricity. The licenses of the Electric Company have been extended from time to time, and are going to expire at the end of this year. According to the provisions of the Electricity Sector Law, at its present version, new licenses cannot be granted to the Electric Company in its present structure. The licenses are obviously required for the continuation of the activity and supply of essential services in the electricity sector. The economic and financial position of the Electric Company at present also requires a significant reform and change for the continuation of the operation of the Company and supplying the essential services.” According to the Letter of Appointment, the tasks of the Steering Team are: to examine the optimal structure for the electricity sector and the Electric Company, while paying attention to globally accepted models, and those that have been discussed so far, including the model that was presented to the Company in recent years. The team will examine the various models, while emphasizing the implementation of competition in the competitive segments; to understand the financial strength of the Company so far and to bring it to an adequate financial position, as part of the reform: to examine a plan for increasing efficiency in the Electric Company and to propose, in view of the above, a comprehensive reform in the electricity sector and the Company.

In July 2013, the General Director of the Antitrust Authority presented the Ministers with the position of the Antitrust Authority regarding the structural change, according to which, among others, the parallel activity of the Company in electricity generation, transmission, distribution and supply to customers prevents the development of competition in electricity generation, and the dominant position of the Company in each of the activity segments creates an inherent apprehension of it operating a market force in a segment in which it is a single
supplier, while pushing competitors and reducing competition in another segment in which it is exposed to attempts by others to compete with it. The Company is conducting a dialog with the General Director on this subject.

On October 27, 2010, the head of the Steering Team announced that a team will be appointed to hold discussions with the employee union and the management of the Company, in order to reach consents in subjects pertaining to the rights of the Company employees and the implications of the structural change on them. This at the same time as the discussions of the Steering team and according to the developments outlined there. Following this, negotiations were held, but the consents of the parties have not yet been received as of the date of the financial statements.

On March 23, 2014, closely prior to the date of publication of the report, the draft of recommendations of the steering team (hereinafter: the “Draft Report”) was published for comments by the public. For details of the major recommendations included in the Draft Report, see Note 1e to the Financial Statements.

The issues included in the Draft Report may be of great importance to the Company, its financial position and its continued functioning as an essential service supplier. The Company is studying the Draft Report in detail and intends to present a detailed reaction to all the issues detailed in it within the hearing that will be held.

It should be noted that approximately one week before the date of publication of the Draft Report, the Company decided to take a number of administrative steps regarding various salary issues. As a result, the employee union decided to take a series of sanctions (without disrupting the electricity supply) whose aim is to disrupt and interfere with the orderly course of work of the Company. On March 20, 2014, the Board of Directors of the Company decided that as part of the Company’s preparations for possible scenarios in the circumstances of standstill in the reform discussions, the Board of Directors is instructing the management to continue to work to reduce the expenses of the Company. For this purpose, the CEO will hold immediate intensive talks with the employee union in order to find suitable solutions as soon as possible, including alternative solutions.

As of the date of this report, the implementation of the structural change in any outline has not yet commenced in practice, and there is uncertainty with respect to the final form of a structural change, the time of its implementation and its consequences for the Company, its business affairs and outcomes. It should be clarified that the recommendations of the steering committee have not yet been approved or adopted and performing the structural change in accordance with their recommendations will require approvals of the authorized entities in the country, including Government approval and executing legislation amendments.

For details of the main points of the provisions in the Electricity Sector Law with respect to the structural change, transitory provisions and milestones for its execution, resolutions of the Government and Government entities with respect to the structural change, the Company’s position on its implementation and its effect on the Company’s creditors, as well as with respect to steps and actions taken by the Company with respect to the structural change, the outline of understandings and the Steering Team, see Note 1.e to the Annual Financial Statements.

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, including the possibility of implementing a structural change in the Electricity Sector in accordance with the Outline of Understandings or the recommendations of the Steering team, insofar as will be adopted, 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, including in relation with the Steering Team 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 below:

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 stations and major substations, 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 **Details in respect of dividends in the two years preceding the date of the Report**

For 2012 and 2013, no dividends were distributed or calculated by the Company, since in 2012 the Company recorded a loss of approximately NIS 1,004 million, adjusted for December 31, 2013 and in 2013 recorded a loss of approximately NIS 936 million. For additional information see note 26 of the Financial Statements.

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6 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.

7 A switching station is a station that has 161 kV input voltage.

8 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.
4.3 Distributable profits
The balance of the distributable profits of the Company as of December 31, 2013 is approximately NIS 13,669 million.

4.4 Restrictions on the distribution of dividends
In some of the financing agreements of the Company the Company undertook to act to the effect that its subsidiaries would not execute transactions that would restrict their ability to distribute dividends.
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, 2013

**Data for 2013 – segments**

<table>
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<th>Generation</th>
<th>Transmission</th>
<th>Distribution</th>
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<td><strong>Fixed:</strong></td>
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<tr>
<td>Wages</td>
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<td>Depreciation</td>
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<td>Financing</td>
<td>983</td>
<td>485</td>
<td>702</td>
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<td>Others</td>
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<td><strong>Variable:</strong></td>
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<td>Fuels</td>
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<td>10,962</td>
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<tr>
<td>Transfer of fuels to</td>
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<tr>
<td>regulatory asset</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>15,295</td>
</tr>
<tr>
<td><strong>Total assigned costs</strong></td>
<td></td>
<td></td>
<td></td>
<td>22,188</td>
</tr>
</tbody>
</table>

### For the year ended December 31, 2012

**Data for 2012 – segments**

<table>
<thead>
<tr>
<th></th>
<th>Generation</th>
<th>Transmission</th>
<th>Distribution</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fixed:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wages</td>
<td>1,885</td>
<td>325</td>
<td>1,417</td>
<td>3,627</td>
</tr>
<tr>
<td>Depreciation</td>
<td>2,666</td>
<td>854</td>
<td>1,164</td>
<td>4,684</td>
</tr>
<tr>
<td>Financing</td>
<td>1,217</td>
<td>603</td>
<td>871</td>
<td>2,691</td>
</tr>
<tr>
<td>Others</td>
<td>2,070</td>
<td>915</td>
<td>696</td>
<td>3,681</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>7,838</td>
</tr>
<tr>
<td><strong>Variable:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fuels</td>
<td>19,910</td>
<td></td>
<td></td>
<td>19,910</td>
</tr>
<tr>
<td>Transfer of fuels to</td>
<td>(5,269)</td>
<td></td>
<td></td>
<td>(5,269)</td>
</tr>
<tr>
<td>regulatory asset</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>14,641</td>
</tr>
<tr>
<td><strong>Total assigned costs</strong></td>
<td></td>
<td></td>
<td></td>
<td>22,479</td>
</tr>
</tbody>
</table>
For the year ended December 31, 2011

Data for 2011– segments

<table>
<thead>
<tr>
<th>In million NIS adjusted to December 2013</th>
<th>Generation</th>
<th>Transmission</th>
<th>Distribution</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wages</td>
<td>1,414</td>
<td>238</td>
<td>1,043</td>
<td>2,695</td>
</tr>
<tr>
<td>Depreciation</td>
<td>2,409</td>
<td>925</td>
<td>1,162</td>
<td>4,496</td>
</tr>
<tr>
<td>Financing</td>
<td>1,028</td>
<td>518</td>
<td>714</td>
<td>2,260</td>
</tr>
<tr>
<td>Others</td>
<td>2,370</td>
<td>459</td>
<td>788</td>
<td>3,617</td>
</tr>
<tr>
<td></td>
<td>7,221</td>
<td>2,140</td>
<td>3,707</td>
<td>13,068</td>
</tr>
<tr>
<td>Variable:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fuels</td>
<td>13,151</td>
<td></td>
<td></td>
<td>13,151</td>
</tr>
<tr>
<td>Total assigned costs</td>
<td>20,372</td>
<td>2,140</td>
<td>3,707</td>
<td>28,219</td>
</tr>
</tbody>
</table>

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 A2 and A3 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, 2013 (“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 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 corporation, the manner of adoption of resolutions by its organs, the 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 the Securities Law (pursuant to it being a reporting corporation), 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 7.13, 8.9 and 9.11). See Section 22 for details on restrictions to and regulation of the activity of the Company. See Section 1.3 and section 29.3.7 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 addition, there is no certainty as to the effect of the lack of political stability in Syria or other countries in the region, if any, on 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. 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.

In addition, there is no certainty with respect to the impact that the political instability in Syria or other countries in the region will have, if any, on the Company.

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, as have occurred in the past, including as a result of deliberate explosions and terrorist attacks on the gas transmitting pipelines, the depletion of 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 recognition 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 recommendations of the Steering Team with regard to trade in natural gas see Note 1 e to the Financial Statements.
6.4 Changes in the exchange rates

Because almost all of the revenues of the Company are quoted in NIS and approximately 53% of the long term financial liabilities of the Company, including permanent bonds and before executing hedging transactions were, as of December 31, 2013 quoted in foreign currencies (dollars, euros and Japanese yen), the Company is exposed to changes in the exchange rates of these currencies. The weighted revaluation rate of the shekel against the currencies in which the financial liabilities of the Company are quoted in 2013 was approximately 9.2% compared with a weighted revaluation of approximately 3.5% in 2012. 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 29.1.5 for details on the exposure; see Sections 7.1.3.2, 8.1.3 and 9.1.4 for details on the electricity charge rate.

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 2020 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 2020\(^9\).

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 tender that was published, stands at 6,281 megawatts. If all of the project for which provisional licenses have been issued and that have won the State tender\(^10\) (except renewable energy projects whose energy availability depends on sunlight, water, etc.) materialize, they will constitute approximately 23% 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 7.7.5 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, one producer (with an output of 820 megawatts) is at present completing the acceptance tests of the power station and is expected to join the generation array. A second producer (with an output of 870 megawatts) is in advanced construction stages and is expected to complete the power station by May-July 2015. An additional electricity producer (pumped energy with an output of 300 megawatts) has completed financial closure and began constructing the power station, and another producer (with an output of 428 megawatts) has not yet reached financial closure. 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

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

\(^10\) The Company has no means of evaluating which of the projects, if any, will be established and when.
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 (4) companies operating in it. See Section 1.3 for further information.

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, 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 electricity. 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 7.4.1.1.

For 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 6) to the Financial Statements.

6.6 Raising finances

The Company finances its operations, inter alia, using bank credit and/or non-bank credit in Israel and overseas. Accordingly, global economic crises and weakness in world bond markets may lead to a reduction in the availability of credit resources. However, in recent years, the Company has succeeded in raising all the amounts it requires in Israel and abroad. It should be noted that the Company’s ability to raise the debt it requires depends on many factors and there is therefore no certainty as to its ability to raise, at any time, all the sums it requires. See Section 29.2.2 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.

An exceptionally powerful storm hit the country in the winter of 2013, causing damage to the electricity grid and leading to disruptions to the electricity supply throughout the country. The Company vigorously acted to restore the electricity supply and repair the damage caused by the storm. The Company incurred expenses as a result of the exceptional storm and the actions the Company had to perform in connection with it, and for minimizing winter risks. On December 16, 2013, the Company approached the Electricity Authority, requesting to receive rate recognition for the full costs that were spent and that will be spent with respect to restoring the electricity grid and supply as a result of the storm. The Company has not yet received a response. The Company is working on the preparation of a report to the Electricity Authority that will include the full costs that were incurred by the Company as a result of the storm, including the expected costs for 2014.

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, 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 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

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

See Section 29 for further information on the risk factors of the Company and their impact on its operations.
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 General

In accordance with what has been stated above, the Company is engaged in the supply of electricity to customers, that is, to all consumers in the State of Israel, from the stage of electricity generation, transmission, distribution and supply and trading. The Company also engages in the construction of the infrastructures that are required for those operations and for the administration of the system. For details of the recommendations of the Steering team with regard to the system administration see Note 1e to the Financial Statements.

The electricity generating system of the Company in Israel is based on five (5) 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, 2012, the Company possesses and operates seventeen (17) sites of power stations (of which five are steam driven power stations sites as mentioned above) with a total installed generation capacity of approximately 13,483 megawatts. The sites, which are located, in accordance with what 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, 2013, the Company had sixty three (63) generation units, of which eighteen (18) are steam generation units; thirteen (13) are combined cycle gas turbine units; sixteen (16) are jet gas turbine units; fifteen (15) are industrial gas turbine units, 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 natural gas in combined cycle units; (B) generation by coal; (C) lower efficiency 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 curve, the Company runs the generation units in accordance with the criterion of cost of fuels per generated kWh, and considering operational constraints. Therefore, the Company runs at top

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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.
priority natural gas powered combined cycle units and coal powered steam generation units, after which gas converted steam generation units are run, followed by natural gas powered turbine units. 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 electricity generation volumes and timing are dictated by the figures of electricity consumption by the end consumers at any given moment. See Section 12 for details on seasonality in the consumption of electricity. See Sections 7.5 and 7.7.4 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 order to maintain 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, 2013, the Company generates most of the electricity in the State of Israel, while the remaining electricity is generated by private electricity producers and small photo voltaic installations from which the Company purchases electricity at low rates (approximately 1.27% and 1.91% of the total electricity that the Company supplied in 2012 and 2013, respectively). 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 recommendations of the Steering Committee with regard to the generation segment, see Note 1e to the Financial Statements.

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16 Kilowatt hour (kWh). A “kilowatt” (kW) is a unit for measuring available electric energy. One (1) kilowatt equals a thousand (1,000) watts. A “kWh” is a quantitative measure of electric current that is equal in value to continuous consumption of a kilowatt for one (1) hour.

17 A generation unit that can be powered by at least two (2) types of fuel.
A table follows that lists the generation units of all types, and the generation capacity in megawatts as of December 31, 2013, which is included in the Company’s load monitoring and control system:

<table>
<thead>
<tr>
<th>Type of unit</th>
<th>Site</th>
<th>Number of units</th>
<th>Installed generation capacity (in MW)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Steam driven power station generation units</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Coal powered units</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Coal primary fuel, fuel oil secondary fuel</td>
<td>Orot Rabin (Maor David A, B)</td>
<td>6</td>
<td>2,590</td>
</tr>
<tr>
<td>Coal primary fuel, fuel oil secondary fuel</td>
<td>Rothenberg</td>
<td>4</td>
<td>2,250</td>
</tr>
<tr>
<td><strong>Total coal units</strong></td>
<td></td>
<td>10</td>
<td><strong>4,840</strong></td>
</tr>
<tr>
<td><strong>Gas converted units</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gas primary fuel, fuel oil secondary fuel</td>
<td>Eshkol</td>
<td>4</td>
<td>912</td>
</tr>
<tr>
<td>Gas primary fuel, fuel oil secondary fuel</td>
<td>Haifa</td>
<td>2</td>
<td>282</td>
</tr>
<tr>
<td><strong>Gas only</strong></td>
<td>Reading</td>
<td>2</td>
<td>428</td>
</tr>
<tr>
<td><strong>Total gas converted steam units</strong></td>
<td></td>
<td>8</td>
<td><strong>1,622</strong></td>
</tr>
<tr>
<td><strong>Total steam driven power station generation units</strong></td>
<td></td>
<td>18</td>
<td><strong>6,462</strong></td>
</tr>
<tr>
<td><strong>Gas turbines</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Industrial gas turbine</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ramat Hovav</td>
<td></td>
<td>4</td>
<td>436</td>
</tr>
<tr>
<td>Tzafit</td>
<td></td>
<td>2</td>
<td>220</td>
</tr>
<tr>
<td>Alon Tavor</td>
<td></td>
<td>2</td>
<td>220</td>
</tr>
<tr>
<td>Elat</td>
<td></td>
<td>1</td>
<td>34</td>
</tr>
<tr>
<td>Atarot</td>
<td></td>
<td>2</td>
<td>68</td>
</tr>
<tr>
<td>Gezer</td>
<td></td>
<td>4</td>
<td>592</td>
</tr>
<tr>
<td><strong>Total industrial gas turbines</strong></td>
<td></td>
<td>15</td>
<td><strong>1,570</strong></td>
</tr>
<tr>
<td>Type of unit</td>
<td>Site</td>
<td>Number of units</td>
<td>Installed generation capacity (in MW)</td>
</tr>
<tr>
<td>------------------------------</td>
<td>-------</td>
<td>-----------------</td>
<td>--------------------------------------</td>
</tr>
<tr>
<td><strong>Jet gas turbines</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hartov</td>
<td>1</td>
<td></td>
<td>40</td>
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<tr>
<td>Eitan</td>
<td>1</td>
<td></td>
<td>40</td>
</tr>
<tr>
<td>Ra’anana</td>
<td>1</td>
<td></td>
<td>11</td>
</tr>
<tr>
<td>Caesarea</td>
<td>3</td>
<td></td>
<td>130</td>
</tr>
<tr>
<td>Haifa</td>
<td>2</td>
<td></td>
<td>80</td>
</tr>
<tr>
<td>Kinarot</td>
<td>2</td>
<td></td>
<td>80</td>
</tr>
<tr>
<td>Orot Rabin</td>
<td>1</td>
<td></td>
<td>15</td>
</tr>
<tr>
<td>Rothenberg</td>
<td>2</td>
<td></td>
<td>40</td>
</tr>
<tr>
<td>Eshkol</td>
<td>1</td>
<td></td>
<td>10</td>
</tr>
<tr>
<td>Eilat</td>
<td>2</td>
<td></td>
<td>58</td>
</tr>
<tr>
<td><strong>Total jet gas turbine</strong></td>
<td>16</td>
<td></td>
<td>504</td>
</tr>
<tr>
<td><strong>Total gas turbines</strong></td>
<td>31</td>
<td></td>
<td>2,074</td>
</tr>
<tr>
<td><strong>Combined cycle gas turbines</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ramat Hovav</td>
<td>22</td>
<td></td>
<td>701</td>
</tr>
<tr>
<td>Hagit</td>
<td>34</td>
<td></td>
<td>1,394</td>
</tr>
<tr>
<td>Eshkol</td>
<td>1</td>
<td></td>
<td>377</td>
</tr>
<tr>
<td>Gezer 3, 4</td>
<td>2</td>
<td></td>
<td>744</td>
</tr>
<tr>
<td>Tzafit</td>
<td>1</td>
<td></td>
<td>360</td>
</tr>
<tr>
<td>Alon Tavor</td>
<td>1</td>
<td></td>
<td>363</td>
</tr>
<tr>
<td>Haifa</td>
<td>2</td>
<td></td>
<td>748</td>
</tr>
<tr>
<td><strong>Total combined cycle units</strong></td>
<td>13</td>
<td></td>
<td>4,687</td>
</tr>
<tr>
<td><strong>Industrial Gas turbines that are scheduled to operate in the future in combined cycle form</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Eshkol</td>
<td>1</td>
<td></td>
<td>260</td>
</tr>
<tr>
<td><strong>Total combined gas cycle turbines and industrial turbines scheduled to operate in the future in combined cycle form</strong></td>
<td>14</td>
<td>4,947</td>
<td></td>
</tr>
<tr>
<td><strong>Total generation units in the Company</strong></td>
<td>63</td>
<td>13,483</td>
<td></td>
</tr>
</tbody>
</table>

7.1.1.2 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 diesel oil (liquid fuel) or fuel oil.
The steam generation units of the Company are designed to supply the basic levels of demand for electricity, and 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. The fuel oil powered generation units were used for generation of electricity at baseline load until the energy crisis in the 1970s, following which it was decided to diversify the use of fuels by constructing dual fuel power stations, which may be powered, in accordance with what has been stated above, by coal as well. 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 7.10.9.2 (B) for details on the Tamar reserve; see Section 7.1.1.3 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, 2013, the Company has sixteen (16) jet gas turbines with a combined installed generation capacity of 504 megawatts, and fifteen (15) industrial gas turbines with a combined installed generation capacity of 1,570 megawatts. 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 generation capacity of 394 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. However, 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, 2013, the Company had thirteen (13) combined cycle units, all of which are natural gas and diesel powered and whose (combined) generation capacity is approximately 4,687 megawatts.

For details of the recommendations of the Steering team with regard to the generation segment and selling stations to private producers, see Note 1e to the Financial Statements.
7.1.1.3 Conversion of generation units to natural gas combustion

The Company started to use natural gas in February 2004 at the Eshkol site and thereafter at the Reading Power Station, the Gezer site, the Hagit site, the Tzafit site and at Ramat Hovav, Alon Tavor and Haifa.

As of December 31, 2013, approximately 56% of the total installed generation capacity of the Company is by units that may be powered by natural gas.

A table listing the generation units of the Company that may be powered by natural gas, as of the date of the report, follows:

<table>
<thead>
<tr>
<th>Name of site</th>
<th>Number of generation units</th>
<th>Total installed generation capacity (in megawatts)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eshkol</td>
<td>6</td>
<td>1,549</td>
</tr>
<tr>
<td>Reading</td>
<td>2</td>
<td>428</td>
</tr>
<tr>
<td>Ramat Hovav</td>
<td>6</td>
<td>1,137</td>
</tr>
<tr>
<td>Tzafit</td>
<td>1</td>
<td>360</td>
</tr>
<tr>
<td>Hagit</td>
<td>4</td>
<td>1,394</td>
</tr>
<tr>
<td>Gezer</td>
<td>6</td>
<td>1,336</td>
</tr>
<tr>
<td>Alon Tavor</td>
<td>1</td>
<td>363</td>
</tr>
<tr>
<td>Haifa</td>
<td>4</td>
<td>1,030</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>30</strong></td>
<td><strong>7,597</strong></td>
</tr>
</tbody>
</table>

7.1.1.4 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 (30) years at least. The useful lifetime of gas turbines is approximately twenty five (25) years for industrial gas turbines and approximately fifteen (15) 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 good relative to comparable electricity generators. See Note 2h to the Financial Statements for details.

7.1.2 The structure of the field of activity and the changes that have occurred in it

In accordance with what has been stated above, as of the time of the report, the Company generates most of the electricity in the State of Israel, whereas the rest of the electricity is generated by private electricity producers and photovoltaic installations. See Section 7.4 for further information. For details of the recommendations of the Steering team with regard to the generation reserve, see Note 1e to the Financial Statements.

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

7.1.3.1 General, the licenses of the Company in the generation segment

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 22 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”), of which one license, for unit 30 at Haifa, was given to the Company in 2013. The validity of the Generation Licenses has been extended until January 1, 2015.
On February 12, 2014, the Minister of National Infrastructures, Energy and Water approved the decision of the Electricity Authority of January 23, 2014, within which the 13 new generation licenses of the Company (that were granted to the Company in accordance with the transitional orders of the Electricity Sector law for power stations that were included in the development plan of the Company up to January 1, 2009) were extended until January 1\textsuperscript{18}, 2015.

7.1.3.2 The electricity charge rate

(A) General

(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.

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. 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 medium voltage bulk) and load and time charge rates (low voltage, medium voltage and 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, 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 Criteria\(^{19}\), 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.

(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 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.

(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 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.

(4) **Discounted social charge rates**

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

(5) **The current electricity charge rate**

(a) **The current electricity charge rate is:** the uniform domestic charge rate – 54.03 agorot per kWh (not including Value Added Tax) and the general uniform charge rate – 55.61 agorot per kWh (not including Value Added Tax).

(b) **Annual update –**

On May 6, 2013, the Electricity Authority reached its decisions on the subject of the update of the electricity rates for 2012-2013 and update of the spread of the increase of the electricity rates\(^{20}\). The update of the spread of the electricity rates stems from the actual increase in fuels costs compared to the assessments under which the decision of the Authority of March 22, 2012 was determined. In it, the Authority determined an outline for the spread of the update of the electricity rates for 2012-2014 (see details of the decision in Note 3 a 3) to the Financial Statements.

\(^{19}\) See Section 7.4.1.1 for details on the Criteria.

\(^{20}\) Electricity Authority decision no. 4 of meeting no. 400 of May 6, 2013, regarding ”Annual Update for 2012-2013”. 
In accordance with the decision of the Electricity Authority, the electricity rates will increase on May 16, 2013 by an average rate of 5.5% for 2013, and the Authority will continue to update the rate in 2014 until payment of all the addition to the fuels cost due to the gas crisis.

The following are the main points of the decision of the Electricity Authority as stated above:

(1) **Update of recognized costs and spread of the addition to the fuels cost:**

The Electricity Authority has updated the debt balance of the electricity consumers to the Electric Company with respect to the addition to the fuels cost for 2012 to an amount of NIS 6.84 billion (as of the end of 2012).

The addition is spread according to the following distribution:

- In 2013 - NIS 3.07 billion.
- In 2014 - NIS 3.77 billion.

Linkage differentials and interest will be added to these amounts.

(2) **Addition to the recognized cost of the transmission and distribution sectors**

The rate increase in 2013 includes an additional advance in the amount of approximately NIS 100 million a year as an addition to the recognized cost of the transmission and distribution rates. This advance is added to the advance of approximately NIS 300 million that was given in the decision of March 2012, so that the advance included in the recognized cost in accordance with the decision is approximately NIS 400 million a year.

The addition will be in effect until a new rate base is determined for the transmission and distribution segment.

(3) **Shortening the period of return of debt to consumers**

The Authority decided to update its decision of March 7, 2011 such that the period of returning the loan provided to the Company in the amount of NIS 2 billion for financing Stage B of the emergency project will be shortened to 7 years instead of 15 years as was determined in the original decision.

According to this update, the principal and interest repayments in 2013 will be approximately NIS 504 million instead of NIS 204 million. The significance of the shortening of the period of returning the debt for the Company is the increase of the volume of the annual loan repayment in 2013-2017 in an amount of approximately NIS 300 million a year (see Note 9i).

(c) **Regular update** —

As stated above, in accordance with the decision of the Electricity Authority of May 6, 2013, the electricity rates increased on May 16, 2013, by an average rate of 5.5% for 2013.

1) **Cash flow bridging measures**

As an outline for financing Stage B of the emergency plan, on March 7, 2011, the Electricity Authority decided to spread the Company’s debt to consumers, of NIS 2 billion, until the end of 2025. In accordance with this decision, the Company opened a separate and special purpose account for administrating the money with regard to the financing of Stage B of the Emergency Plan (“Special Purpose Emergency Plan Account”).

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21 Decision 1 of Meeting 328 of March 7, 2011: “Spreading the debt of the Electric Company to prevent electricity distress”.
On November 26, 2012, the Electricity Authority decided\(^{22}\) to authorize the professional team of the Electricity Authority to update, as necessary, the sums and dates of deposits the Company will be obliged to transfer to the Special Purpose Emergency Plan Account. In addition, this decision enabled an examination of postponing the duty to deposit NIS 600 million which the Company undertook to return to the Special Purpose Emergency Plan Account by the end of December 2012, and some of the monthly deposits of NIS 167 million which the Company was required to deposit no later than by the end of 2013 so that the Company will complete all the deposits into the Special Purpose Emergency Plan Account, in the amount of NIS 2 billion, by this date.

The Company deposited the amounts in accordance with the milestones that were set in the decision of the Electricity Authority and identical sums were simultaneously released for current use in the projects.

On July 23, 2013, a letter was received from the professional team of the Electricity Authority, under which the Company is required to update the deposits into the Special Purpose Emergency Plan Account as follows: a first payment of NIS 160 million will be paid in July 2013 and the rest, in the amount of approximately NIS 640 million, will be paid in five monthly equal installments, starting from August 2013 and until December 2013. The Company has deposited the sums into the special purpose account according to the required timetable and as of the date of the report, the full amount of NIS 2 billion has been deposited into the Special Purpose Emergency Plan Account, and it has a balance of approximately NIS 0.5 billion.

2) Special purpose fuels account:

Between 2011 and 2012, significant disruptions occurred in the supply of natural gas from Egypt and the Yam-Thetis reservoir, which led to a significant surcharge to the costs of duels required in the production of electricity, and a very material cash flow burden on the Company. Within the decision of the Electricity Authority of March 22, 2012\(^{23}\), the Electricity Authority recognized the stated surcharge to the fuels costs and determined a unique mechanism for managing the surcharge money for the fuels costs, and in accordance with this decision, the Company opened a separate, special purpose account for purchasing the addition to the fuels cost (hereinafter: the “Special Purpose Fuel Account”) and deposited in it the debt raising amounts backed by State guarantees (for details of debentures and loans backed by State guarantees which the Company raised in 2012 and 2013, see Note 20 to the Financial Statements), the addition to the fuels cost in the charge rate (as detailed at the top of this sub-section c)), and the amounts that were supposed to be deposited in April and May 2012 in the Special Purpose Emergency Plan Account. The Special Purpose Fuels Account is managed by the Company and monitored by the Electricity Authority, which is supervising the deposits into the account and the release of the money from it in accordance with a reporting mechanism that was determined by the Electricity Authority.

The management of the Special Purpose Fuels Account is carried out in accordance with the list of principles which was determined by the Electricity Authority and which regulates, inter alia, the financial sources from which money will be deposited into this account. Additionally, the list of principles includes instructions with regard to the reports that the Company has to deliver to the Electricity Authority with respect to the deposits executed into the account, the manner in which the supplement to the fuel cost which will be recognized is determined, and conditions for withdrawal of money from the account by the Company.

\(^{22}\) Decision 7 of Meeting 387 of November 26, 2012: “Depositing money in the special purpose account”.

\(^{23}\) Decision 1 of Meeting 367 of March 22, 2012: “Spreading the increase of electricity rates for 2012-2014 in a period of shortage of supply of natural gas to the energy sector in Israel”.
This list of principles is used by the Electricity Authority solely for the purposes of deposits and withdrawals from the Special Purpose Fuels Account and not for purposes of charge rate recognition of the fuels basket. During 2013 there were no transactions in the Special Purpose Fuel Account beyond commissions and interest of some several hundred NIS and the account stands at present with a few hundred NIS. For additional details of the deposits to and withdrawals from the Special Purpose Fuel Account, see Note 3 to the Financial Statements.

(B) The generation segment charge rate

(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)\(^{24}\) in accordance with the "charge rate basis book – recognized costs for the generation segment for 2010-2014" (in this Report, "the New Generation Charge Rate Basis Book" and "the New Generation Charge Rate Basis", respectively), which canceled the previous charge rate base for the generation segment (see also the Immediate Report dated March 11, 2010 (Reference No.: 2010-01-411228)) for further information. This resolution and the charge rates derived from it took effect on February 15, 2010.

In the resolution of the Electricity Authority on the update of the charge rate basis it was determined 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, 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 construing 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.

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. The Company disputes the recognition of its costs and in its opinion, within this cost control, the following costs have not been recognized by the Electricity Authority: (A) fixed assets: non-recognition of all construction costs of new generation units. As a result of this there is a gap of approximately NIS 1 billion between the recognized construction costs and the costs estimated by the Company relative to generation units that have been operating and generation units that have not yet been operating but whose construction has started. In addition, there are specific investments for which the Electricity Authority stated as having no charge rate coverage, such as: costs of the combined cycle supply division in Haifa, cooling by drinking water arrangement at Alon Tavor and some gas conversion costs at the Gezer site. From the recognized construction

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\(^{24}\) 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.
costs of the new units, the Electricity Authority has deducted the pension costs of first and second
generation employees in the amount of approximately NIS 350 million until making a final resolution
on this matter (this sum is before restatement that was executed in the 2009 Financial Statements);
and (B) operational expenses: the Electricity Authority is basing the recognition of the operational
costs for 2010-2014 on the average operation costs of the Company in 2002-2006, while applying an
annual depreciation coefficient of 2%. In 2012, the lack of coverage of operational costs was
estimated at approximately NIS 580 million adjusted, most of which stemmed from non-coverage of
renovation costs of approximately NIS 250 million and from the influence of the agreement of linking
the pension to the CPI in the amount of approximately NIS 200 million adjusted. In addition, the
Electricity Authority recognized only half of the capital costs for spare parts inventory. The amounts
that have not been recognized stand at approximately NIS 30 million per year for the current charge
rate period. In addition, the Electricity Authority does not recognize the costs of free electricity for
employees benefit, which are higher than the average domestic consumption.

For details with respect to a petition that was filed by the Company, which addresses the Company’s
request to order the Electricity Authority to provide it with all of the minutes of Electricity Authority
plenum meetings with respect to the Electricity Authority decision of February 15, 2010, in regard to
the charge rate basis for the generation segment for 2010-2014 see note 3.b.3) in the Financial
Statements.

(2) Components of the generation charge rate base

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

(a) 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
accounting 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.

(b) Recognized assets and depreciation

The assets that were recognized in the new charge rate basis in the generation segment were
established according to a future outline for 2010-2014. The recognized cost for the generation
units was established according to a plan that includes the list of the recognized generation units
and their operation dates. 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 reductions made in the Financial Statements.

(c) 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 fuel basket with respect to these generation units.

If the Company does not uphold 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 decreasing mechanism 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, 2011\(^{25}\), 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, 2011\(^{26}\), on the subject of spreading of the debt of the Company to consumers (a debt that results from excess billing in the charge rate that occurred in 2009 for the fuel basket - see details on this matter in Section 7.7.6 of this report), the 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.

As of the date of the report, the Company has not met the normative operation date that was set for Generation Unit No. 3 in Haifa, which is included in the Development Plan of the Company. Accordingly, there is exposure to an estimated reduction of approximately NIS 20 million (adjusted to New Israeli Shekels December 2013) in the recognized cost in the charge rate.

According to the decision of the Electricity Authority of May 6, 2013\(^{27}\), and in accordance with the Company’s request, the emergency Alon Tavor combined cycle has been derecognized from

\(^{25}\) Resolution No. 1 of meeting 331 dated March 24, 2011, on the matter of “Generation licenses for Israel Electric Corporation Ltd.”

\(^{26}\) 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”.

\(^{27}\) Resolution No. 4 of meeting 400 dated May 6, 2013, on the matter of “Annual Update for 2012-2013”
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, and 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 was determined by the Electricity Authority in its decision of March 7, 2011 on the subject of spreading the debt of the Electric Company in order to prevent shortage of electricity as described above. 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 congratulated the type of solution taken by the Company and 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 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.

See Note 3B.2)B) to the Financial Statements for further information.

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.

(d) 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 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 in accordance with that which has been described below:

(1) The financial leverage level

The leverage level recognized in the charge rate is one-third (⅓) equity capital and two-thirds (⅔) foreign capital.

(2) The return on equity capital rate (gross)

The return on equity capital in the generation segment is 7.65% after tax (10.2% before tax). The total recognized costs of financing are the product of the weighted recognized return rate (equity capital and foreign capital) multiplied by the aggregate of recognized assets, from which the reserve for deferred taxes will be deducted.

(3) Interest on foreign capital
(a) The recognized return on foreign capital is derived from three (3) components:

1. Shekel financing basket – represents loans that are raised in Israel in Israeli currency in an index linked channel. For this financing basket, an average real shekel interest rate will be recognized.

2. Hedged financing basket – represents raising of foreign capital overseas in foreign currency, which is protected by a hedging mechanism within the framework of which index basket differentials and interest differentials that accumulate to the debit / credit of consumers relative to the Company are calculated (which are supposed to be noted as a regulatory asset / liability in the balance sheet of the Company). See Section b below for details with respect to the hedging mechanism.

3. Increased interest shekel financing basket – represents the raising of capital in foreign currency, which is translated into shekel terms by recognition of additional costs that result from overseas raising, against which the Company is required to perform hedging transactions. For this basket, an average increased real shekel interest rate shall be recognized. The recognized return rates for index- and foreign-currency-based foreign capital were established at the baseline point based on the average return rates for 2008 and the marginal rate for 2009, using an update formula with respect to the following years, as is performed for each annual update. The average return rates for 2008 were derived from the Financial Statements for 2007.

Under the decision of the Electricity Authority of March 6, 2013, the interest rates for the foreign capital were set as follows:

The recognized interest rate for the foreign capital (NIS financing basket) for 2012: 4.86% and for 2013: 4.68%. The recognized interest rate for the foreign capital (increased interest financing basket) for 2012: 5.92% and for 2013: 5.83%. The hedged recognized interest rate (average foreign currency interest rate) for 2012: 6.82% and for 2013: 6.63%.

(b) 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 instruments for hedging of exchange rate risks, and therefore it has decided to cancel the hedging mechanism. Accordingly, according to the new charge rate base book for the generation segment, the previous hedging mechanism (as prescribed in the charge rate basis book for 2002-2005 dated July 1, 2002) has been cancelled, but a new hedging mechanism has been established, which was supposed to be gradually cancelled within three (3) years, until 2013. After cancellation of the hedging mechanism, the Company is supposed to perform its own hedging of the exposures to the foreign currency exchange rate that are currently hedged using the existing hedging mechanism.

In the decision of the Electricity Authority of September 16, 2013, it was determined that the outline of cancellation of the hedging mechanism that was determined in the decision of the Authority regarding the generation rate base is frozen, and therefore

28 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”.

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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.

The main points of the new 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) 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, it was noted in the charge rate basis book for the generation segment that in view of the expected structural changes, the Electricity Authority is freezing the incremental outline of the shekel financing basket until March 31, 2011 or until the kickoff date of the Structural Change, whichever is earlier. This freezing expired in March 2011, as mentioned, as a result of which the shekel financing percentage increased.

(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 current format will be spread over a period of five (5) years. See Note 3B.2 (D) to the Financial Statements for further information.

(c) The operational costs

The recognized operational costs for the test period are 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. A depreciation coefficient of 2% per year is applied to these recognized costs.

(d) 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 to the Financial Statements.

(E) 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.

(4) 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 7.7.6 for details with respect to recognition of costs of the Emergency Plan of the Company.

(5) The position of the Company with respect to the new generation charge rate basis

The Company has many reservations with respect to the new charge rate basis for the generation segment, which it believes may have a material effect over the Company, inter alia due to non-recognition of the full costs of construction and operation of the generation units of the Company; the mechanism of reduction of costs recognized in the charge rate in the case of the Company will not meet the normative operation dates that have been prescribed for the new generation units of the Company; the non-recognition of all capital costs for spare parts inventory; the non-recognition of extraordinary costs of the Haifa and Gezer combined cycle stations and the Alon Tavor steam addition; non-recognition of costs of building a potable water cooling unit at Alon Tavor, and so on. From time to time, the Company holds meetings with the Electricity Authority on these subjects. To the best of the Company’s knowledge, as part of its regular work, the professional team of the Electricity Authority examines the reservations of the Company with regard to certain components as stated.

7.1.4 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. See Sections 6.5 and 7.4 for details.

The installed generation capacity of the Company has increased from approximately 13,248 megawatts as of December 31, 2012 to approximately 13,483 as of December 31, 2013, expressing an annual increase of 1.8%. The increase results from the synchronization of a steam addition at combined cycle unit 9 at the Ramat Hovav site in July 2013 and from the synchronization of a steam addition at the Combined Cycle Unit 9 at the Hagit site, in August 2013.

A number of private electricity producers began operating in the field of electricity generation during 2013. For details of the production volume of the private electricity producers as of the date of the report see sections 7.4.3.4 and 7.4.3.5.

On March 14, 2013, the steam addition to the Eshkol Combined Cycle with an output of 134 megawatts was initially activated, and the unit was operated as a combined cycle unit.
On January 1, 2014, the Company received a letter from the Antitrust Authority, under 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. 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, and as of the date of the report a final decision of the General Director on the issue has not yet been received. For additional details see section 7.4.1.1. For details of the recommendations of the Steering Team with regard to the field of electricity generation see Note 1 e to the Financial Statements.

7.1.5 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 depends, \textit{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 possibility of the Company establishing and operating additional power stations. See Sections 7.4 and 7.7.6 for further information. See Section 7.7 for details on the Development Plans in the generation segment.

7.1.6 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 and diesel oil, which are used for the generation of electricity. See Section 7.10.9.2 for details with respect to the array of suppliers and raw materials, including the commencement of gas supply from the Tamar reserve.

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

7.1.7.1 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. Moreover, the uncertainty on the issue of the supply of natural gas may also constitute an entry barrier to the field relating to the generation of electricity based on natural gas.

7.1.7.2 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.

7.1.8 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 growing level of competition. The Company generates most of the electricity in Israel and its competitors are the private electricity producers.
At this time the installed production capacity of the private electricity producers is approximately 7.5% of the total installed production capacity in the State of Israel and is expected to reach approximately 17% during 2014. In 2013, the OPC Rotem Ltd. (“OPC”) power station was activated, with a maximal output of approximately 446 megawatts. The Dorad Energy Ltd. (“Dorad”) power station, with a maximum output of approximately 820 megawatts, is planned to be activated in the second quarter of 2014. The expected date of entry of Dalia Power Energies Ltd. is 2015.

In view of the Structural Changes that are required according to the provisions of the Electricity Sector Law, including the incorporation of generation units within the framework of separate subsidiaries, which in accordance with the Electricity Sector Law, cannot all be subsidiaries of the Company, and in view of the policy to encourage competition in the electricity market as a whole and in the generation segment in particular, through the entry of private electricity producers, the Company cannot estimate at this stage what the consequences might be for itself with regard to incorporation of the generation units within the framework of separate subsidiaries and the entry of such private electricity producers on the volume and terms of future competition. See Section 7.4.4 for a description of possible consequences for the Company following the entry of the private electricity producers. See Section 7.2 for further information.

7.1.9 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.

7.2 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. See Section 7.1 for further information on the electricity generating operation. See Sections 8 and 9 for further information on the other segments.

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 2013 (based on the assumptions stated in Note 38 to the Financial Statements) for sales of approximately 53,506 million kWh came to a total of approximately NIS 21,289 million, compared with approximately NIS 22,486 million, adjusted to New Israeli Shekels of December 2013, for sales of approximately 57,085 million kWh in 2012. This represents a decrease in revenues of approximately NIS 1,197 million; a decrease of approximately 5.33%. The change in revenues derives as a result of an increase of approximately NIS 212 million due to a real increase of the electricity rate, and in addition a decrease in consumption of approximately NIS 1,409 million.

7.3.2 Profit from ordinary operations – the generation segment

The profit from ordinary operations in the generation segment in 2013 amounted to approximately NIS 374 million, compared to approximately NIS 1,407 million, adjusted to New Israeli Shekels of December 2013, in 2012. This represents a decrease of approximately NIS 1,033 million; and a decrease of approximately 73.4%.
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 22.10 for further information on the declaration of the Company as a monopoly and the consequences of this declaration.

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.

In accordance with what has been 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 (today, the total installed generation capacity of private electricity producers stands at approximately 7.5% of the total installed generation capacity in the sector, and following the commencement of operation by three power plants, which are being built by private electricity producers (Dorad, Ashdod Energy and Ramat Negev Energy) in 2014, it is expected to stand at approximately 17% at the end of 2014. 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. 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.

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 essential service supplier.

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), which regulate, *inter alia*, the provision of infrastructure services by which private electricity producers may sell energy either to the system administrator or to 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

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29 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.
regulations). In addition, a private electricity producer can obtain a license to supply electricity and to sell electricity directly to end consumers.

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. The Company will be given an opportunity to present its position to the General Director of the Antitrust Authority before a decision is reached on the subject. On March 4, 2014, the Company delivered 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 the issue of an order as stated. On March 7, 2014, the Company underwent an oral hearing in this matter, and a final decision of the General Director in the matter has not yet been received as of the date of the report.

7.4.1.2 Pursuant to the arrangements mentioned above, the Company is required, as an essential service supplier and as a transmission license holder, 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 by legislative arrangement, that is, in the regulations and rules 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 suppliers 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 (which have not yet been determined by the Electricity Authority).

30 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 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.

31 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. 

32 “Supplier” – a holder of a license to sell electricity to consumers (supply license).
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 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 update\(^{33}\) to its resolution on the issue of the charge rate arrangements supporting financing for private electricity producers. The resolution was intended to provide a safety net 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) The responsibility for any act or default of an essential service supplier, the gas conduction company or a third party that impairs the generation ability of the private electricity producer will be assumed by the essential service supplier, that is, as of the time of this report, the Company.

(B) Upon the occurrence of a force majeure event (war and terrorism) that impairs the competency of the private electricity producer generation facility, the essential service supplier must pay the senior debt (the primary source of financing) for the private electricity producer in the period of the event. Upon the restoration of operation of the private electricity producer, it will be required to return to the Company only 40% of the amount that was paid by the Company for it, and the Electricity Authority will consider compensation for the Company for the remaining 60%. In the case of such an event that will cause the conclusion of the agreement with the private electricity producer, the Company will be responsible for the balance of the senior debt of the private electricity producer, while transferring the ownership of the generation facility of that private electricity producer to the Company. The Electricity Authority will consider recognition of the costs that the Company will sustain due to that which has been set forth above, based on criteria that have been established on this matter.

In its decision of June 3, 2013\(^ {34}\), 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 producers\(^ {35}\). 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.

Prior to the entry of private producers on a large scale, on February 4, 2013 the Electricity Authority reached a decision on May 13, 2014, regarding the establishment of a temporary rate for the system’s management services\(^ {36}\), 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

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\(^{33}\) Electricity Authority Resolution No. 1 of Meeting No. 268, which was held on July 31, 2009 on the matter of: “Charge rate arrangements that support financing for private electricity producers”.

\(^{34}\) 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”.

\(^{35}\) 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 315, 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”.

\(^{36}\) 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”
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. According to the recommendation of the external legal advisors of the Company, under which the determination of the temporary rate cannot be limited or conditioned by publication of the Notes as stated, the Company intends to continue debiting and collecting the temporary rate for system management services, and at the same time presented the Electricity Authority with a letter explaining this position of the Company. For additional details see Note 3 h to the Financial Statements.

7.4.2 Types of private electricity producers

7.4.2.1 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:

(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” transmission system.

(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.

(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.

(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.

7.4.2.2 **Conventional private producer**

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:

(A) **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

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37 The regulation applying to a private electricity producer OPC, 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.
determined by the Electricity Authority, and sell it electrical energy upon a demand on the part of the system administrator; or

(B) 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 (2) 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.

In November 2011, the Electricity Authority published a resolution proposal for hearing, for public comment to restrict the granting of conventional generation licenses insofar as the constant level of availability of all facilities that would be set up pursuant to these licenses would be up to 1,000 megawatts. The decision of the Authority on the subject has not yet been received.

7.4.2.3 Cogeneration

In accordance with the Electricity Sector Regulations (Cogeneration) - 2004 (hereafter: the “Cogeneration Regulations”), a cogeneration transaction will be conducted based on one of the following methods:

(A) Sale of energy – a transaction for purchase whereby an electric energy producer sells electricity to the system administrator in accordance with the terms of the Cogeneration Regulations and an appropriate generation plan, whose features will be determined by the Electricity Authority.

(B) Sale of available capacity and energy – as is the case for a conventional producer, this transaction requires the approval of the Electricity Authority, and in contracts for selling available capacity and energy exceeding 50 megawatts, the approval of the Manager of the Electricity Administration is also required.

In May 2008, the Electricity Authority published a resolution 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 system administrator. 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 administrator, while 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.

7.4.2.4 Pumped storage

The regulation of this technology within the framework of special provisions in the Electricity Sector Regulations (Conventional Private Electricity Producer), 2005. In November 2009, the Electricity Authority published a resolution with respect to a charge rate arrangement for generation of electricity using the pumped storage method and sale of constant available capacity to the system administrator, with all of the dynamic and planning benefits of the generation unit or within the framework of variable available capacity,
and criteria were established for the conduct of the private electricity producers, which are updated from
time to time.

7.4.2.5 **Renewable energies**

In the 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. This Resolution constitutes a continuation of a previous resolution on the subject dated
January 29, 2009, and is based on a policy document of the Ministry of Energy for combining renewable
energies in the electricity generation array in Israel.

In view of what was stated above, the Electricity Authority has established various charge rate arrangements
for each of the quotas as determined in the Government decisions.

The highlights of the charge rate arrangements that have been determined are as follows:

(A) **Medium sized solar facilities (that are to be connected to the distribution grid):** In December 2009, the
Electricity Authority published an arrangement for medium sized solar facilities (greater than 50
kilowatts) that were connected to the distribution grid.\(^{40}\)

(B) **Major solar facilities that are connected to the transmission grid:** There are two (2) types of facilities –
one is thermosolar facilities: solar energy is converted into thermal energy and then in a suitable process
into electrical energy. The other is solar or photovoltaic facilities in which solar energy is converted to
electrical energy. In January 2011 the Electricity Authority published a charge rate arrangement\(^{41}\) for
solar facilities that were connected to the transmission grid.\(^{42}\)

(C) **Wind facilities:** The additional arrangement relates to wind turbines of greater than 50 kilowatts, for
which different charge rates and quotas have been set.\(^{43}\)

(D) **Bio-gas:** In July 2011 the Electricity Authority published a charge rate arrangement for bio-gas electricity
generation facilities using anaerobic digestion facilities.\(^{44}\)

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 (not
including past debts and purchase of electricity from private electricity producers), which is approximately
33.32 agorot per kWh alone.

**Exceptions:**

There are facilities that generate electricity using renewable energies, for which some of the arrangements
are stated in the Rules of the Electricity Sector (Transactions with an Essential Service Supplier), 2000, do not
apply:

(A) **Photovoltaic and wind turbine facilities (these two (2) facility types are limited to a 50 kilowatt output per
facility):** the Electricity Authority has drafted special regulations\(^{45,46}\) with respect to electricity consumers

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\(^{40}\) Resolution No. 2 of Meeting No. 284 of the Electricity Authority that was held on December 28, 2009, on the matter of
“Arrangement for solar electricity production facilities larger than 50 kW”.

\(^{41}\) Resolution No. 2 of Meeting No. 325 of the Electricity Authority that was held on January 24, 2011, on the matter of “Update of the
arrangement for electricity production facilities with production licenses which are connected to the conduction grid by means of
solar technologies”.

\(^{42}\) Resolution No. 2 of Meeting No. 347 of the Electricity Authority that was held on January 24, 2011, on the matter of “Update of the
arrangement for electricity production facilities with production licenses which are connected to the conduction grid”

\(^{43}\) Resolution No. 1 of Meeting No. 349, dated October 10, 2011, on the matter of “setting of charge rate and regulation for a wind
farm of more than 50 KW output”

\(^{44}\) Resolution No. 2, adopted at Meeting No. 344 on July 25, 2011, on the matter of: “Rate determination and arrangement for
facilities which produce electricity from biogas in anaerobic digestion facilities”
that has allowed for the construction of electricity facilities of up to 50 kilowatts size per facility for internal consumption and transfer of energy surpluses to the grid. In accordance with this arrangement, the consumers have not been required to receive a generation license. A quota has been set for the total consumers that may be included in this arrangement. This number is changed by the Electricity Authority from time to time in accordance with the resolution of the Government.

(B) Net meter arrangement – a consumer arrangement in the volume of up to 400 megawatts that allows the integration of a renewable energy facility with an installed output of up to 5 megawatts. The owner of the facility may use the electricity that is generated by the facility for his own consumption. If the output of the facility exceeds the consumption of the owner of the facility, credit will be issued (hereinafter: “Credit”). The Credit may be maintained for up to two years or, alternatively, may be transferred to another consumer.

(C) Producers that set up facilities following the acquisition of a tender that the State published for the Ashalim site including two thermo-solar facilities of 121 megawatts output each of 136 megawatts that are the installed size of the unit, and a photovoltaic facility of 30 megawatts output, to which the provisions of the tender, some of which are not consistent with the provisions of the rules and the Criteria on the issue, shall apply.

(D) “Veteran” private electricity producers – renewable energy private energy producers, which started to work before the application of the arrangements for renewable energy generation, are not included in these arrangements and the payment to them is based on a charge rate that is calculated in accordance with the generation component of the Company, plus a premium for generation by renewable energy, subject to a resolution of the Electricity Authority of July 2004 within which the principles by which the premium is to be calculated were prescribed, among other things.

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 built and started to run the generation facility). 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 it. 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.

45 Resolution No. 1 of Meeting No. 216 of the Electricity Authority dated June 2, 2008 “Arrangement for decentralized production of electricity for in-house consumption and transfer of surplus to the grid, by means of small facilities using photovoltaic technology”.
46 Resolution No. 1 of Meeting No. 275 of the Electricity Authority dated September 7, 2009 “Arrangement for decentralized production of electricity for in-house consumption and transfer of surplus to the grid, by means of small wind turbines”.
47 Resolution No. 3 of Meeting No. 145 of the Electricity Authority dated July 13, 2004.
48 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.
49 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 the Electricity Sector Regulations (Conventional Private Electricity Generator), 2005, and the Electricity Sector Regulations (Cogeneration) 2004, have stated that a provisional generation license is a temporary licenses that is given by the Minister in accordance with the regulations determined, 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.
7.4.3.2 Entrepreneurs with provisional licenses (that do not yet generate electricity)

As of the date of the report, the total output of entrepreneurs with provisional generation 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 6,281 megawatts using various electricity generation technologies, divided as follows:

(A) Conventional producers – approximately 3,244 megawatts.

(B) The volume within the framework of provisional licenses of cogeneration producers – approximately 901 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 1,496 megawatts.

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

See Section 7.4.3.3 with respect to producers that have signed, as of the date of the report, an agreement with the Company for the sale of capacity availability.

In addition to this, in March 2008 a tender was published for the construction of up to three (3) solar power stations in the Negev, two (2) solar-thermal power stations of up to 121 megawatt output each of supply to the grid, and another 30 megawatts by photovoltaic energy. In accordance with the Government resolution dated March 2008, the power stations will be built in the Ashalim complex in the Negev covering an area of approximately 4 million square meters.

In accordance with that stated, in March 2012, Ashalim Sun PV Ltd. was awarded the tender for the construction of a photovoltaic power station with an output of 30 megawatts. In November 2012, Magalim Solar Power Ltd. was awarded the tender for the construction of a solar thermal power station with an output of 136 megawatts, of which up to 121 megawatts may be supplied to the grid.

7.4.3.3 Description of the private electricity producers with which the Company has executed agreements as of the reporting date:

(A) OPC won a public tender that the State published in 2001 for private electricity producers to build a combined cycle power station of 440 megawatts at Rotem Plain.

In November 2009, the Company executed an agreement with OPC, in which the latter warranted that the power station that it was constructing would be ready for commercial activity within 49-52 months of the date of the execution of the agreement (early 2013).

Accordingly, on July 6, 2013, OPC started its commercial activity, with a combined cycle maximum output of 448 megawatt (actual output 440 megawatts, maximum output 448 megawatts). As of the date of the report, the combined cycle can operate on natural gas and can also operate on diesel oil for 100 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.

(B) In August 2010, the Company executed an agreement with Dorad Energy Ltd. with regard to the purchase of available generation capacity and energy of approximately 850 megawatts and the provision of infrastructure services, which is due to end in the second quarter of 2014.

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50 Resolution No. 3338 dated March 27, 2008, on the matter of “tenders for the construction of solar power stations”.

C) In May 2012, the Company signed agreements with two co-generation producers – Ramat Negev Energy (124 megawatts output) and Ashdod Energy (52 megawatts energy). To the best of the Company’s knowledge, the expected operation time of these producers is 2014.

D) In May 2012, the Company executed an agreement with Dalia Power Energies Ltd. with regard to the purchase of available generation capacity and energy of approximately 870 megawatts and the provision of infrastructure services, which is due to end in 2015.

E) On June 6, 2013, the General Director of the Antitrust Authority applied to the Antitrust Tribunal, requesting a mandatory injunction against the Company that will order the Company to immediately connect the Dalia power station to the electricity grid and will order the New Federation of Labor and the Company employees’ union to refrain from any activity whose goal is to disrupt or prevent the connection of the Dalia power station to the electricity grid. Prior to the date of submission of the above application, the Company applied to the Haifa Labor Court, requesting an injunction against the sanctions of the employees with regard to the connection of the Dalia power station to the electricity grid.

F) On June 26, 2013, the National Labor Court reached a decision granting validity to the consent reached by the Company, the State of Israel and the employee union of the Company, regarding sanctions taken by the employee union with regard to the reception of EMS system (a command and control system with national supervision for managing the system) at Company sites, connecting the Dorad power station and connecting electricity to the Dalia power station construction site. On July 25, 2013, in accordance with this consent, a joint notification was submitted to the National Court of Labor regarding renewal of the negotiations between them. Pursuant to the decision of the National Court of Labor of October 8, 2013, on March 9, 2014, the parties reported to the Court of the state of their negotiations. For details of sanctions taken by the employees with regard to steps taken by the Company management, see section 1.3

G) In June 2012, the Company executed an agreement with Ashalim Sun P.V. Ltd. (which won the tender published by the State of Israel) with regard to the purchase of energy (30 megawatts output), which is due to end in 2015. Additionally, in November, 2013, the Company entered into an agreement with the two other winners of the Ashalim tender, Magalim Solar Power Ltd. And Negev Energy Ltd. (121 megawatts output each), and their completion is expected to end in 2016 and 2017, respectively.

H) In August, 2013, the Company entered into an agreement with P.S.P Investments Ltd. with respect to purchase of energy (300 megawatts output), and its completion is expected to end in 2018.

I) In addition, the Company signed contracts with a large number of producers that have intermediate photovoltaic facilities, which will be connected to the distribution grid (high or low voltage).

7.4.3.4 Producers with generation licenses

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 885 megawatts, constituting approximately 6.5% of the total installed generation capacity of the Company which, as set forth, is approximately 13,483 megawatts. The total volume of private producers operating as of the date of the report, including independent producers, constitutes approximately 7.5% of the installed generation capacity of the Company.

In the year ended on December 31, 2013, the Company purchased approximately 1,048 million kWh from private electricity producers, compared with approximately 376 million kWh purchased in the year ended December 31, 2012. The average price that the Company paid to owners of private production facilities in 2013 (including small photovoltaic facilities whose generation in 2013 came to a total of approximately 438

52 Meaning those that actually generate electricity.
million kWh) was 94 agorot per kWh compared with 119 agorot per kWh in 2012. 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 2013 constitutes approximately 1.9% of the electricity that the Company supplied in that year, as compared to 2012, in which the electricity purchased from private producers and from small photovoltaic facility owners amounted to approximately 1.27% of the electricity supplied by the Company.

The Company estimates that the production rate of the private electricity producers out of the total production in the sector, including with renewable energy, is expected to be as follows: approximately 17% in 2014 and approximately 22% in 2015. There is uncertainty as to the activation dates, acceptance tests, the infrastructure transactions of the private electricity producers, and the new suppliers (especially with regard to Dorad).

Accordingly, in 2013, approximately 40 big customers that purchase electricity from approximately 100 consumption locations transferred to private producers (mainly O.P.C), and the Company estimates that in 2014, approximately 50 additional customers, purchasing electricity from approximately 1,500 consumer locations, are expected to transfer to private producers (mainly to Dorad). The total production the Company is expected to lose after the transfer of all the customers as detailed above is between 6-8 a year, according to actual production of Dorad and Mash’av Entrepreneurship and Development Ltd in all the demand hours cluster according to hours in a whole day, days in a week and seasons.

Furthermore, 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, kilowatts and revenues it will lose.

As of the date of the report, the private electricity producers that sell electricity to the Company can be classified into five key categories:

(A) Private electricity producers that operate pursuant to the arrangements that have been prescribed by the Electricity Authority (wind, water, solar) and that win tenders that receive payment based on the generation component charge rate for the sale of energy plus a premium for renewable energy producers with which the Company has signed agreements for a total output of approximately 151 megawatts.

(B) Two diesel power stations, a fuel oil powered generator, both of which are owned by Shikun U’Binui Ltd. – “Etgal” in Ashdod, with an output of approximately 26 megawatts and Noga Paz in Acre, with an output of approximately 16 megawatts. The Electricity Authority has established the charge rate for these power stations based on their actual generation costs. As of the date of the report, the Company has an agreement with these producers for a period of twenty (20) years that ends in 2024, whereby these producers will sell to the Company available energies at the demand of the system administrator in accordance with the price to be determined by the Electricity Authority.

(C) Cogeneration producers – IPP Delek Ashkelon (with roughly 87 megawatt output) and Ashdod Refineries (with roughly 49 megawatt output and roughly 60 megawatts), which operate at high voltage and sell surplus generation to the Company.

(D) Conventional producer – O.P.C (approximately 448 megawatts maximum output), and to the best of the Company’s knowledge, its commercial outline is selling most of the electricity to end consumers and selling surplus electricity on the basis of competition.

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)
(E) A self-use electricity producer Mashav Enterprising and Development Ltd. (Nesher, Ramla, with a 48 megawatt output). In July 2010 an agreement was signed with it for the sale of surplus electricity to the Company for a one year period.

Consumers who own photovoltaic devices - as of the date of the report, the installed output\(^{54}\) of small photovoltaic systems at medium and low voltage, which run generation surpluses to the grid (up to 50 kilowatts per facility) is approximately 247 megawatts.

For details with respect to the recommendations of the Steering Team regarding the generation segment, including sale of stations to private producers, see Note 1 e to the Financial Statements.

7.4.4 **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, 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, there will be 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 to a potential loss of strategic consumers.

(B) Notwithstanding, following the decrease in the volume of production, a decrease mainly in the fuels expenses and marginally in the operation expenses that are variable is expected, so that the profitability with respect to these components is not expected to change materially as a result of the entry of private electricity producers. Additionally, revenues from capital services (depreciation, financing and yield) in the production rate for 2013 are not affected by a decrease in the volume of the kilowatts produced by the Company, and this is according to the decision of the Authority. In comparison, in the operation component, the Company's profitability is expected to be adversely affected in light of the decrease in Company production volumes and the expected revenues for covering the fixed operation costs in production (such as: maintenance of power stations) are expected to be adversely affected, and they constitute most of the operation costs. It should be noted that as of the date of the report, and due to the uncertainty involved in private electricity producer projects, whose completion is not under the control of the Company, the Company cannot predict how many projects will be completed or when.

(C) As to the transmission and distribution segments - because most private electricity producers use the transmission and/or distribution grid of the Company, and are therefore committed to infrastructure charge rates, the Company assesses that the revenues of the Company in the transmission and distribution segments are not expected to be adversely affected materially and may even increase. See Sections 8.3 and 9.3 for details. The increase in the generation capacity in the national economy, whether by private electricity producers or by the Company, requires enhancement of the distribution and transmission system.

(D) 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 decision of the Electricity Authority of May 6, 2013\(^{55}\), 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

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\(^{54}\) Installed and running systems, after passing facility tests and integration of the facility with the grid.

\(^{55}\) 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”.
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. As of the date of the report, the Company does not know if its position was fully or partially accepted by the Electricity Authority. The decision of the Electricity Authority in this matter is expected to be reached as part of the decision that will determine the backup rates. The Company estimates that in view of the significant entry of private electricity producers into the Electricity Sector, the Electricity Authority will update the electricity charge rates in a manner that will compensate the Company, partially at least, for costs that it will sustain in view of the need to maintain such generation capacity reserves. 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.

(E) 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 which has been set forth above, a time gap may form until the Company expenses are covered by the charge rate.

(F) 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. Because there is no certainty with respect to the structure of the Company after the Structural Change, if and to the extent implemented (in accordance with that which has been set forth in Section 1.3) and the length of time for which preferential (better or similar) conditions will be given, there is no certainty that the Company will be able to compete with the private electricity producers.

(G) For details of reducing costs with respect to non-compliance with normative operation dates (“Fines”) see Note 3b 2) to the Financial Statements

(H) 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.

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 2011 and in
2010, and in the first quarters of 2011 and 2012:

<table>
<thead>
<tr>
<th>For the year ended on December 31</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>Installed generation capacity</td>
</tr>
<tr>
<td>Peak demand throughout the sector</td>
</tr>
<tr>
<td>Of which: generation by the Company</td>
</tr>
<tr>
<td>Generation capacity available at peak demand times</td>
</tr>
</tbody>
</table>

(*) This peak demand was measured on December 15, 2013.
(**) This peak demand was measured on July 19, 2012.

As of December 31, 2013, the installed generation capacity of the Company increased by approximately 235
megawatts, compared with December 31, 2012. This difference arises from the synchronization of a steam
addition at the combined cycle unit 9 at the Ramat Hovav site with an output of 116 megawatts and from the
synchronization of a steam addition at the combined cycle unit 9 at the Hagit site with an output of 119
megawatts.

For additional details of the total installed production capacity in the electricity sector see section 7.4.3.4.

7.6 Fixed assets, land and facilities

7.6.1 General

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

7.6.1.1 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.

7.6.1.2 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).

7.6.1.3 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).

7.6.1.4 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.
7.6.1.5 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 and approximately 150 administrative logistic sites, and in total approximately 13,500 properties, 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 15.3 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:

<table>
<thead>
<tr>
<th>Name of site</th>
<th>Location</th>
<th>Type</th>
<th>Area of the site in m²</th>
<th>Land rights</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Rothenberg Power Station</td>
<td>Ashkelon</td>
<td>Power station</td>
<td>1,442,600</td>
<td>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</td>
</tr>
<tr>
<td>2 Reading Power Station</td>
<td>Tel Aviv</td>
<td>Power station</td>
<td>227,861</td>
<td>Most of the area is being leased from the State of Israel by an unsigned lease contract, for periods that have expired and for periods of concession extension, some by expropriations. 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.</td>
</tr>
<tr>
<td>3 Haifa Power Station</td>
<td>Shemen Beach, Haifa</td>
<td>Power station</td>
<td>355,964</td>
<td>Owned by the Company, except a certain plot being leased from ILA until 2016</td>
</tr>
<tr>
<td>**4 Hagit Power Station</td>
<td>Next to Elyakim Interchange</td>
<td>Power station</td>
<td>735,844</td>
<td>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)</td>
</tr>
<tr>
<td>5 Gezer Power Station</td>
<td>Next to Nesher plant in Ramla</td>
<td>Power station</td>
<td>451,200</td>
<td>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.</td>
</tr>
<tr>
<td>6 Eshkol Power Station</td>
<td>Ashdod</td>
<td>Power station</td>
<td>470,055</td>
<td>Owned by the Company</td>
</tr>
</tbody>
</table>

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56 Pylons for which the Company is required by law to pay municipal tax.
<table>
<thead>
<tr>
<th>Name of site</th>
<th>Location</th>
<th>Type</th>
<th>Area of the site in m²</th>
<th>Land rights</th>
</tr>
</thead>
<tbody>
<tr>
<td>Orot Rabin Power Station</td>
<td>Hadera</td>
<td>Power station</td>
<td>2,024,940</td>
<td>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 m² of land is used by H2DI Ltd. for seawater desalination purposes. See Section 23.1 for details.</td>
</tr>
<tr>
<td>Substation and gas turbine</td>
<td>Raanana Industrial Zone</td>
<td>Gas turbine</td>
<td>27,631</td>
<td>Owned by the Company</td>
</tr>
<tr>
<td>Ramat Hovav Gas Turbine</td>
<td>Ramat Hovav Industrial Zone</td>
<td>Gas turbine / switching</td>
<td>251,960</td>
<td>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 m² of the area until 2058 plus an option for 49 years more.</td>
</tr>
<tr>
<td>Atarot substation and gas turbine</td>
<td>Atarot Industrial Zone</td>
<td>Gas turbines</td>
<td>38,194</td>
<td>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.</td>
</tr>
<tr>
<td>Kinarot substation and gas turbine</td>
<td>North of Tiberias</td>
<td>Gas turbine</td>
<td>29,870</td>
<td>About half of the area is being leased from Mekorot. The rest is under authorization from Mekorot for the period of the concession of the Company, that is, until March 4, 1996, and the extension or renewal period of the concession of Israel Electric Corporation (ending as stated on March 4, 1996), with the effect of the Electricity Sector Law.</td>
</tr>
<tr>
<td>Hartov substation and gas turbine</td>
<td>Beit Shemesh Industrial Zone</td>
<td>Gas turbine</td>
<td>28,470</td>
<td>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).</td>
</tr>
<tr>
<td>Alon Tavor Gas Turbine</td>
<td>Alon Tavor</td>
<td>Gas turbine</td>
<td>142,660</td>
<td>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.</td>
</tr>
</tbody>
</table>

57 Substation.
58 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.
<table>
<thead>
<tr>
<th>Name of site</th>
<th>Location</th>
<th>Type</th>
<th>Area of the site in m²</th>
<th>Land rights</th>
</tr>
</thead>
<tbody>
<tr>
<td>* 14 Eitan substation and gas turbine</td>
<td>Moshav Eitan</td>
<td>Gas turbine</td>
<td>41,704</td>
<td>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.</td>
</tr>
<tr>
<td>* 15 Eilat substation and gas turbine</td>
<td>Eilat</td>
<td>Gas turbine</td>
<td>67,600</td>
<td>Leased from ILA until 2028 (there is an option for the Company to extend the lease by 49 years more). Lease rights registered</td>
</tr>
<tr>
<td>* 16 Tzafit substation and gas turbine</td>
<td>Tzafit</td>
<td>Gas turbine</td>
<td>232,970</td>
<td>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</td>
</tr>
<tr>
<td>* 17 Caesarea substation and gas turbine</td>
<td>Caesarea</td>
<td>Gas turbine</td>
<td>228,500</td>
<td>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.</td>
</tr>
</tbody>
</table>

**Total area:** 6,798,023

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

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, 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 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.

Such a demand is also included in the provisions of the generation licenses that have been given to the Company, whereby, among other things, the license holder, which is also an essential service supplier, will submit to the Minister once every five (5) years a Development Plan with respect to its operation in accordance with the License and a duty is prescribed in the Electricity Sector Regulations (Terms and Procedures for Granting Licenses and Obligations of the License Holder) - 1997. The Company is complying with this condition with respect to the submission of a development plan.
In accordance with what has been stated above, the supply of electricity is divided into three (3) 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. The Development Plans for the generation segment serve as a basis for the Minister’s decision making on 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 Development Plan for the generation segment is drafted by the Company with respect to the need of the entire Electricity Sector for the construction of additional generation units. The Company regularly warns the Minister of the expected shortage in the generation capacity and the possible impairment in the reliability of the supply and for recommending solution methods. 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.

Until the end of 2008, as is elaborated below, the Development Plans for the generation segment of the Electricity Sector include the construction of power stations, whether by the Company or by other parties (private producers). In accordance with a Government resolution of June 2008, as adopted in Section 60(D5) of the Electricity Sector Law, the Company has no approval to build additional power stations besides those which were approved for it by January 1, 2009.

### 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 all of the input data: 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.

### 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 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 forecasts.

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60 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.
The development of electricity consumption is affected by economic, climate and demographic factors. The correlation between electricity consumption and these varying factors is expressed in an econometric model that was developed by an external consultant in cooperation with the Company. 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 forecast demand, which is used for long term planning of the generation system, assumes a mean annual increase of approximately 3.8% in the peak demand in 2014 to 2020.

7.7.4 The forecast for gaps between peak demand and generation capacity for the years 2014-2018

A table that summarizes the predicted available capacity of the generation units of the Company, compared with peak demand forecast during the summer for the entire national economy for the years 2014-2018, in megawatts\(^1\) follows.

The data of the forecast of long term electricity demand (except 2014-2015, for which a short term forecast is being made) of installed generation ability, available capacity during the summer and the gap between the peak demand of the national economy and the generation ability of the Company during the summer in the system in 2014 to 2018 is as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Peak demand forecast in the national economy [MW]</th>
<th>Company capability during the summer [MW]</th>
<th>Available capacity taking into consideration downtime for implementing emission abatement products at existing coal power stations</th>
<th>Gap between available capacity taking into consideration downtime and peak national demand during the summer [MW]</th>
<th>Available capacity during the summer assuming a fault in the major unit [MW]</th>
<th>Gap between available capacity taking into consideration downtime and a fault in a major unit and peak national demand during the summer [MW]</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>12,712</td>
<td>13,617</td>
<td>12,877</td>
<td>165</td>
<td>12,302</td>
<td>(410)</td>
</tr>
<tr>
<td>2015</td>
<td>12,926</td>
<td>13,617</td>
<td>12,877</td>
<td>12,302</td>
<td>11,727</td>
<td>(1,199)</td>
</tr>
<tr>
<td>2016</td>
<td>13,801</td>
<td>13,617</td>
<td>12,877</td>
<td>12,302</td>
<td>11,727</td>
<td>(2,074)</td>
</tr>
<tr>
<td>2017</td>
<td>14,345</td>
<td>13,476</td>
<td>12,736</td>
<td>12,186</td>
<td>11,611</td>
<td>(2,734)</td>
</tr>
<tr>
<td>2018</td>
<td>14,848</td>
<td>13,335</td>
<td>12,595</td>
<td>12,595</td>
<td>12,020</td>
<td>(2,828)</td>
</tr>
</tbody>
</table>

The assumptions that have been used in preparing this table:

(A) The peak demand forecast is the scenario that assumes reasonable economic development and extreme weather during the summer and winter. The values relate to peak demand in the national economy\(^2\).

(B) The forecast for installed capacity of the Company has been based on the forecast for the initial operation of new generation units in accordance with the Development Plan of the Company, including the Emergency Plan. See Section 7.7.6 for further information on the Emergency Plans. The installed ability shown is at the time of occurrence of the peak demand during the summer.

(C) The available capacity during the summer period is obtained when the output that is subtracted for industrial gas turbines and combined cycle units as a result of the effect of high ambient temperature is deducted from the installed capacity.

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\(^1\) Negative numbers appear in parentheses.

\(^2\) Arrangements for the management of demand loads with large consumers.
(D) A fault in the major unit – a fault in the largest unit is a common way of examination of immediate risk to available capacity in this system, as such as fault is enough to reduce the generation capacity immediately. At present, the major unit in the generation system is a coal powered unit whose output is 575 megawatts, meaning that a fault in it may immediately reduce the available capacity by approximately 575 megawatts each year.

(E) The installed available capacity shown is of the Company only. This generation capacity is not sufficient to supply the economy’s demand for electricity in accordance with IEC’s forecast, but as extensively detailed in section 7.4 above, from 2013 onwards, private producers began to enter the electricity sector and are expected to continue to enter it in future at a volume that, in the Company’s estimation, will enable to meet the peak demands in the sector and will even create a situation of surplus capacity in the electricity sector.

(F) Due to uncertainty as to the construction date of the “Alon Tavor” combined cycle, which has been approved within the emergency plan (see section 7.7.6 below), the output of the gas turbine and steam turbine of this combined cycle were not taken into account as part of the generation system.

(G) The Company estimates that the exposure (costs reduction due to failure to meet the normative operating dates) it may have is in case it will be possible to ascribe the failure to meet the electricity demands to failure to construct the Alon Tavor power station, which was supposed to be constructed in July 2012 (with an output of approximately 250 megawatts on that date) or to failure to meet other liabilities it has under its licenses, development plan or provisions of the law.

For details regarding the recommendations of the Steering team pertaining to future development of additional generation capacity see Note 1e to the Financial Statements.

7.7.5 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 Minister of Energy and Water, the previous planning proceeding of Project D as a coal power station has been stopped, 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. The construction of the project is in a new planning proceeding at the National Planning and Construction Council, at the review preparation stage. 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 sectorial generation capacity in the electricity sector, see section 7.4.1.1.

For details with respect to the policy of the State of Israel regarding the increase of competition in the electricity sector and electricity consumption saving see section 6.5.

Following a non-binding memorandum of understandings which was signed on December 19, 2012 between the Company and Electricité De France S.A. (“EDF”), a company owned by the Government of France and one of the world’s largest companies in the field of energy, according to which the parties agreed on main terms of a memorandum of understandings within which the manner and areas of cooperation between them will be

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arranged (subject to provisions of the law that apply to the Company), an additional non-binding memorandum of understanding was signed on November 21, 2013 between the Company and EDF, within which the parties expressed their joint and non-binding intention to cooperate and conduct negotiations relating to Project D and the Alon Tavor power station, subject to receiving all the required approvals from all the relevant authorities and fulfilling all the relevant provisions of the law (the “Non-binding Principles”). According to the Non-binding principles, the parties agreed to immediately continue the discussions between them in order to examine, inter alia, the possibility of reaching consents in the subject of technical principles, joint development and investment of the Company and EDF in these projects, and the examination of their financing feasibility.

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

7.7.6 **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 endanger the reliability of the electricity supply in the upcoming years. The Emergency Plan stated that it would be performed in two (2) 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.

In recent years, the Company has been given a permit to build the following power stations: in November 2007, the Company was given an approval by the Minister to build two (2) industrial gas turbines at the Ramat Hovav site at an output of approximately 125 megawatts each. In August 2008 the Minister approved the construction of three (3) combined cycles (at Ramat Hovav, Eshkol and Hagit) at a total output of approximately 375 megawatts per combined cycle, in two (2) stages: at Stage A, a gas turbine of approximately 250 megawatts output and at Stage B, a steam addition of approximately 125 megawatts more.

In December 2008 the Minister gave an approval for the construction of an additional combined cycle at the Alon Tavor site with an output of approximately 375 megawatts, in accordance with the construction outline described above (at Stage A: a gas turbine with a 250 megawatt output for operation in July 2012 and at Stage B: a steam addition for operation in July 2013). For details of the postponement of the construction date of the Alon Tavor combined cycle see section 7.1.3.2 above for normative operation dates of the new generation units and their implications for the rate.

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, whose financing will be executed in accordance with the decision of the Electricity Authority, as detailed below, 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.

Within the decision of the Electricity Authority of March, 2011\(^{64}\), it was determined in that resolution that as an outline for the financing of Stage B of the Emergency Plan (the three steam additions described in the previous paragraph), the debt of the Company to consumers (as a result of excess collection from consumers within the electricity charge rate in accordance with what was mentioned above) in the amount of NIS 2 billion would be spread until the end of 2025 for the purpose of financing Stage B of the Emergency Plan, while the Electricity Authority...
Authority made the spread of the debt conditional, *inter alia*, on the presentation of an economization plan of the Company. In accordance with the decision of the Electricity Authority of May, 2013, (annual update of the rate of May 6, 2013), the period of the spread of the debt to consumers was shortened up to 2017.

Additionally, in March 2011, the Board of Directors of the Company adopted a resolution that confirms to the management of the Company to commence with execution of the construction of the three (3) steam additions that are included in Stage B of the Emergency Plan, whose financing shall be conducted in accordance with the resolution of the Electricity Authority, in accordance with what was stated above.

The estimated expense for Stage B of the Emergency Plan is approximately NIS 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 7.1.3.2b above); approximately NIS 1.1 billion is to be financed through specific loans for financing fixed assets or equipment (as detailed, *inter alia*, in section 7.7.7 below); and approximately NIS 0.24 billion from the Company’s own internal sources. The cumulative expenditure until the end of December 2013 with respect to Emergency Plan Stage B (steam additions at the Ramat Hovav, Hagit and Eshkol sites) amounts to approximately NIS 2.6 billion.

### 7.7.7 Financing of the Development Plan

The Development Plans require material capital investments and require both the investments in the power stations that are to be built by the Company in accordance with the Development Plan and the investments for the actions required for building power stations and facilities that derive from the environmental protection statutes applying to the Company, for the purpose of the implementation of the Development Plan. The Company is preparing short term capital investment plans (up to a year) and long term ones (up to five years). The Company is financing the Development Plans by revenues from its activity, through the charge rate. In the past, and the Company expects that this will be the case in the future, as well – the Development Plans were financed in part by the taking of loans from domestic and foreign financial institutions and from raising debts from public or private issues, in Israel or overseas.

Following the above mentioned, 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. The estimated period of the loan is approximately 14 years, and the estimated utilization period of the loan is for a year and a half and the repayment period is 12 years. During 2013, approximately USD 132 million and EUR 96 million were received within this financing.

### 7.7.8

The budget of the Company for the Development Plan in 2014 stands at NIS 5.1 billion in 2014 budget prices. The investment forecast of the Company for the Development Plans for 2015-2018 stands at a mean annual expenditure of approximately NIS 5.1 billion (December 2013 prices). For details of the recommendations of the Steering team with regard to the investments plan see Note 1 e to the Financial Statements.

### 7.7.9 The forecast investments that will be required in order to execute the Development Plan for the generation segment

The financial planning for 2014-2018 has not yet been approved by the Board of Directors. According to the planning, the proposed investment without interest capitalization in 2014-2018 in the generation system is approximately NIS 1.8 billion in December 2013 prices. In 2013, a sum of NIS 2.4 billion was invested in the generation segment in current prices including Project “D”, investment works in the active power stations and...
periodic renovations of the power stations. For details of the recommendations of the Steering team with regard to the investments plan see Note 1 e to the Financial Statements.

7.7.10 **Forward looking information**

The estimates that have been described above with respect to the Development Plan for the Electricity Sector – generation segment, 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 will 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 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: 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 C to the Financial Statements) and the ability of the Company to raise the financing required for the execution of the Development Plan.

7.8 **Intangible assets**

See Section 16 for details on intangible assets.

7.9 **Human capital**

The organizational structure of the generation segment:
As of December 31, 2013, the generating segment employs 2,383 permanent workers and 210 temporary workers, compared with 2,298 permanent workers and 121 temporary workers as of December 31, 2012. The increase in the number of employees derives from an intra-organizational change in the Company, within which starting from 2013, the Production and Energy Division is included in the generation segment instead of the transmission segment. 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 14.4 and 14.6 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.

7.10 Raw materials and suppliers

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

7.10.2 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 2013 and 2012:

<table>
<thead>
<tr>
<th></th>
<th>For the period</th>
<th>January – December</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013</td>
<td>2012</td>
</tr>
<tr>
<td>Coal</td>
<td>56.2%</td>
<td>63.4%</td>
</tr>
<tr>
<td>Fuel oil</td>
<td>0.6%</td>
<td>7.1%</td>
</tr>
<tr>
<td>Natural gas</td>
<td>40.6%</td>
<td>14.3%</td>
</tr>
<tr>
<td>Diesel</td>
<td>2.6%</td>
<td>15.2%</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Fuel expenses constitute the biggest operating expense of the Company and constituted approximately 63.7% of the operating expenses of the Company (following the transfer of fuels to regulatory assets) in 2013 compared with approximately 63.2% in 2012. The increase in the use of natural gas in 2013 and the decrease in the use of diesel oil resulted from the commencement of the supply of gas from the “Tamar” field.

7.10.3 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 2012 and 2011:

<table>
<thead>
<tr>
<th></th>
<th>Year ended on December 31, in NIS million (in shekels of December 2013)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013</td>
</tr>
<tr>
<td>Coal</td>
<td>4,814</td>
</tr>
<tr>
<td>Fuel oil</td>
<td>271</td>
</tr>
<tr>
<td>Natural gas</td>
<td>4,727</td>
</tr>
<tr>
<td>Diesel</td>
<td>1,304</td>
</tr>
<tr>
<td>Transfer of regulatory asset to fuels</td>
<td>4,333</td>
</tr>
<tr>
<td>Total</td>
<td>15,449</td>
</tr>
</tbody>
</table>

See the description below for each separate raw material on explanations on the differences in costs.
7.10.4 The following table shows the average costs of fuels used by the Company for 2013 and 2012:

<table>
<thead>
<tr>
<th>Power stations powered by:</th>
<th>Year ended on December 31 in agorot of December 2013 per kWh</th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coal</td>
<td></td>
<td>15.00</td>
<td>18.18</td>
</tr>
<tr>
<td>Fuel oil</td>
<td></td>
<td>81.33</td>
<td>72.18</td>
</tr>
<tr>
<td>Natural gas</td>
<td></td>
<td>20.37</td>
<td>18.08</td>
</tr>
<tr>
<td>Diesel</td>
<td></td>
<td>87.54</td>
<td>89.49</td>
</tr>
</tbody>
</table>

A table showing the reductions in prices in 2012 to 2013, follows, for primary raw materials that the Company uses:

<table>
<thead>
<tr>
<th>Power stations powered by:</th>
<th>Year ended on December 31 Average annual cost per ton in agorot of December 2013</th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coal</td>
<td></td>
<td>407</td>
<td>503</td>
</tr>
<tr>
<td>Fuel oil</td>
<td></td>
<td>3,221</td>
<td>3,143</td>
</tr>
<tr>
<td>Natural gas</td>
<td></td>
<td>1,340</td>
<td>1,220</td>
</tr>
<tr>
<td>Diesel</td>
<td></td>
<td>4,239</td>
<td>4,270</td>
</tr>
</tbody>
</table>

(*) Diesel: an order was signed in 2011, reducing the purchase tax on diesel imported from abroad, to 31% of the amount of the purchase tax formerly imposed on imported diesel, and this was for the period February through December 2011. In addition, with the approval of the Knesset Finance Committee, the excise tax on local diesel oil was reduced at an identical rate and for an identical period. In 2012 it was decided to extend the reduction of the purchase tax for diesel imported from abroad and the excise tax on local diesel and to set the reduction rate at 88% until April 2012 and down to 69% until December 2012. The validity of the approval of the exemption was extended until May 5, 2013, and since then has returned to its full rate.

(**) Although it is a material expense with a cash flow influence, in general the Company receives compensation for all expenses for fuels.
7.10.5 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 Yam Tethys Group and 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 at least a month and a half 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 7.11.

See Section 7.10.9.2 for details on the agreement with respect to the supply of gas from the Egyptian pipeline and disruptions and a cessation of supply. See Section 7.10.9.2 and Section 29.2.3 for details with respect to the supply of gas from Yam Tethys and the depletion of this source. See Section 7.10.9.2 for details on the agreement for purchasing Tamar natural gas.

See Section 17 for details on the procedure for the Company for work with suppliers outside of Israel.

7.10.6 **Coal**

In each of the twelve (12) month periods ended on December 31, 2013 and 2012, the Company consumed approximately 11.8 and approximately 14 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 the power stations. The Company has a right to cancel the agreement at any time by giving one (1) 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 Coal Corporation is responsible for the transport of the coal to the Company’s power stations and for covering it with appropriate insurances (to the benefit of the Company), in the case of any loss or damage to the coal, and is also responsible for carrying out all of the operations which are necessary for the release of the coal cargoes and the transfer of its ownership to the Company upon the removal thereof from the ship’s storerooms by means of the cranes on the jetty, including the payment of imposts, fees and taxes. In accordance with the agreement, the ownership of the inventory of coal passes to the Company by means of the the railroad, which unloads the coal in the unloading port, pursuant to the amendment dated January 2011. Prior to the amendment in question, the ownership of the coal was transferred to the Company in the port of origin, so that the Company’s balance of current debt to the Coal Corporation also included a charge for the amount of “the stock en route”.

The average adjusted cost per ton of coal in 2013 stood at approximately NIS 407 per ton, compared with approximately NIS 503 per ton in 2012. The decrease derives from a decrease in the coal prices in the world as well a decrease in the reta of exchange of the dollar (approximately 6% annual average).

The Coal Corporation purchases coal from a number of sources overseas, the main ones being Africa, Colombia, Russia, East Asia and Australia. The Coal Corporation enters into commitments with the coal suppliers based on contracts for a term of at least one (1) year. The representatives of the Company participate in the negotiations that the Coal Corporation conducts with its suppliers, particularly on issues of quality, availability and price.
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 FOB\textsuperscript{66} 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 basis\textsuperscript{67}, while the purchase price includes the costs involved in the sea transport of the coal. With respect to most of the quantity of coal, prices are negotiated every period (six months or a year), and with respect to the other part, the price is linked to international indices of coal prices. In accordance with the policy of the Coal Corporation, some of the purchase and sea transport agreements are at fixed prices and periods.

In addition, most of the coal purchase agreements include a standard force majeure clause, whereby the occurrence of defined events that are not under the control of the parties to the agreement may justify a delay in the supply of coal or in certain conditions cause the cancellation of the agreement.

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 7.13, 8.9 and 9.11 for additional details on the impact of the environmental protection laws with respect to the use of coal and additional fuels.

7.10.7 Fuel oil

Upon the commencement of the use of natural gas for the generation of electricity by the Company from early 2004, the scope of consumption of fuel oil was reduced from about two (2) million tons per year to the quantities described below. The Company uses fuel oil mainly as a backup fuel for operational purposes at the coal power stations. Following disruptions that have occurred in the natural gas supply, from the end of 2011, the Company has increased its use of diesel and fuel oil. During 2013, the use of fuel oil decreased following the supply of gas from the “Tamar” field.

In each of the twelve-month (12) periods that ended on December 31, 2013 and 2012, the Company consumed approximately 84 and approximately 996 thousand tons of fuel oil, respectively. The average adjusted cost per ton of fuel oil as of December 31, 2013 stood at approximately NIS 3,221, compared with approximately NIS 3,143 as of December 31, 2012.

In December 2010, the Ministry of Environmental Protection published personal orders to prevent hazards from the power stations of the Electric Company ("lateral personal order") pursuant to the Hazard Prevention Law - 1961. The order, applying to all of the generating units of the Company and among other things requiring it to generate electricity with coal and gas only, while the natural gas is defined as a primary fuel and diesel oil/fuel oil is only backup fuel. At the dual fuel generating units that are permanently operated with natural gas, in certain cases when the demand for electricity cannot be supplied through their operation by gas, the Company has to use a cleaner but also more expensive fuel mix, and its actual implication is: exhausting the operation of all the generating units with diesel oil before the transition to use of fuel oil.

\textsuperscript{66} 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.

\textsuperscript{67} 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.
Due to the continued shortage of natural gas during 2011-2012 and due to the numerous applications of the Company on the subject, in April 2012 the Director General of the Ministry of Environmental Protection formulated a current procedure for using backup fuel during a time of a fault or shortage in the supply of natural gas to the electricity system\(^\text{68}\), which was to replace all the instructions and directions given on the subject in the past. See Sections 7.13, 8.9 and 9.11 for additional details on the application of the environmental protection laws to the use of fuel oil and additional oils.

7.10.8 **Diesel oil**

In each of the periods of twelve (12) months that ended on December 31, 2013 and 2012, the Company consumed approximately 308 and approximately 1,951 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 uses diesel oil mainly as a backup fuel for operating needs at the sites of the coal power stations.

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 LAVERA 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 4,239 in 2013, compared with approximately NIS 4,270 in 2012.

The diesel oil is transported to the sites of the Company mainly by pumping through a national pipeline, which was built by and belongs to Oil and Energy Infrastructures Ltd. (a company fully owned by the State), or by road tankers of the various shippers to sites that are not connected to the distillate pumping system\(^\text{69}\).

In light of the crisis in the fuels supply in 2011 and 2012, the Minister of Finance signed a number of provisional orders in 2011 - 2012, within which the purchase tax for diesel was reduced at a rate of up to 88%. These provisional orders expired with the commencement of gas supply from the “Tamar” reserve, in May 2013.

7.10.9 **Natural gas**

7.10.9.1 **General**

In 2013, the Company consumed approximately 3,528 thousand tons of natural gas at an average adjusted cost of approximately NIS 1,340 per ton, compared with approximately 1,290 thousand tons of natural gas in 2012 at an average adjusted cost of approximately NIS 1,220 per ton. The increase in the gas consumption resulted from the beginning of supply of gas from the “Tamar” field, and the supply of gas through the import of liquid natural gas (LNG).

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

\(^\text{68}\) Government Resolution No. 4623: “Measures to cope with the anticipated shortage of electricity”, dated May 13, 2012.

\(^\text{69}\) A pipeline for the transfer of distillates operated by Petroleum and Energy Infrastructures Ltd.
Company has, the estimated quantity of gas in the Leviathan reservoir is double that of the Tamar field. 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 2013, approximately 64% of the natural gas that served the Company for the generation of electricity was supplied to the Company from the “Tamar” field. Approximately 26% of the natural gas that served the Company for production of electricity was supplied to the Company by the Yam Tethys Group (until the month of December, 2013, within the arrangement that was formulated between the parties as detailed below, and approximately 10% of the natural gas that served to produce electricity was supplied to the Company as liquid gas by the gasification ship that is attached to the marine buoy about 10.5 km. west of the Hadera coast.

For details of the recommendations of the Steering Team with respect to natural gas trading see Note 1 e to the Financial Statements.

7.10.9.2 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. The total financial scale of the agreement with Yam Tethys was approximately 1.8 billion U.S. dollars, as of the time of signing the agreement in 2002. In July 2009 the Company executed a binding memorandum of agreed principles with the Yam Tethys Group for the purchase of additional quantities of natural gas, to an annual volume of 1 billion cubic meters for five (5) years, until December 2014 and in total 5 billion cubic meters more. Following the depletion of the Yam Thetis reserve, as of December 2013, the supply of gas from the Yam Thetis reserve has ended. For additional details, including the compromise agreement between the Company and “Yam Thetis”, see Note 34a4) to the Financial Statements.

(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

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.

See the Immediate Report dated July 23, 2009 (Reference No.: 2009-01-177324).
BCM a year in the first five (5) 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 (2) 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 (8) 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 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 stated arbitration proceeding will be considered an international arbitration proceeding for purposes of the Israeli Law, the English Law, the laws of the U.S.A. and the New York Treaty of Recognition and Enforcement of Foreign Arbitration Awards.

The agreement is in effect until the end of fifteen (15) 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 (13) 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 (15) years, then the agreement will be extended until the earlier of two additional years beyond the period of fifteen (15) 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:

4.1.2 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.

4.1.3 The Company can extend the option until after December 19, 2019, by notice to the Tamar Partnership until April 15, 2015. The date on which the second option will expire is the date on which the Tamar Partnership expires.

4.1.4 The Company can increase the hourly quantity of gas supply at annual level beyond the quantity that was set by the Tamar Partnership, as long as such an increase is possible as far as the system through which the gas is supplied is concerned and in coordination with the system manager.
4.1.5 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.

4.1.6 The rest of the sections of the agreement have not been changed.

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.

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 to the extent that the option will not be exercised in practice.

4.2 On June 30, 2013, the “Tamar” Partnerships announced the end of the running-in period of the production and supply systems, according to the provisions of the agreement between the “Tamar” Partnerships and the Company. The gas quantities supplied from that date are according to the provisions of the stated agreement, whereas both the binding period with regard to take or pay and the fines that will be imposed on the “Tamar” Partnerships if they do not meet the contractual obligations with respect to the supply of the hourly quantities in accordance with the provisions of the agreement, began from the beginning of October, 2013.

4.3 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 July 5, 2012, the Company received from the Ministry of National Infrastructures, Energy and Water Resources a draft document on behalf of the Director of the Natural Gas Authority, prior to announcing it to the public, appealing to any factor interested in bringing its suggestion or opinion with respect to regulating use of capacity of the gas pipe from the "Tamar" rig and up to the exit of the gas from the reception station in Ashdod. This is in view of the fact that as of the date of conveying the natural gas from the “Tamar” reservoir at the second quarter of 2013, Tamar is the only supplier with capability of continuous supply of natural gas in the Israeli market. Capacity of the pipe from the "Tamar" rig until exit of the gas from the reception station in Ashdod is limited and is not able to satisfy all anticipated hourly demands of the natural gas consumers for the next few years.

The document deals, inter alia, with the following issues:

(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 pipe exceeds the maximum capacity that is estimated at approximately 40,000 MMBTU.

(2) At any given moment, when the aggregate hourly demand of all the consumers for conveying natural gas through the pipe is expected to surpass the maximum capacity ("Capacity Exhaustion Event"), distribution of pipe capacity to all consumers shall be carried out on the basis of a formula determined in the document, and which is based on a pro-rata principal with respect to the hourly contractual quantity specified in the agreement of a certain consumer, except for marketers and consumers whose requested hourly consumption does
not exceed certain quantities according to periods specified in the document ("Small Consumers"), with respect to which special provisions were set (including priority to receive their full requested capacity) with regard to quantities they shall receive upon occurrence of such Event.

(3) The excess demand for natural gas shall be supplied, in the event possible, through the Company, using liquid natural gas ("LNG"). The excess cost as result of purchasing LNG shall be imposed on the public of natural gas consumers according to a formula specified in the document, except for Small Consumers. Upon a Capacity Exhaustion Event, a consumer shall be entitled to reduce his consumption to a maximum quantity it is entitled to according to the pro-rata principal as stated in Section (2) above, and thereby waive the cost deriving from purchase of LNG.

On December 9, 2012, the company received the decision of the Natural Gas Authority, of November 29, 2012, from the Ministry of National Infrastructures, Energy and Water Resources\textsuperscript{72}, regarding the regulation of the use of the capacity of the natural gas pipeline from the Tamar rig up to the exit point of the natural gas from the reception station in Ashdod. This decision was reached due to the inability of the gas pipeline to supply the expected national hourly demand of natural gas in the coming years.

The Company presented its position on the subject to the Natural Gas Authority on February 14, 2013, and noted that in its opinion, 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 Electric Corporation 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 (following a preliminary analysis) totaling hundreds 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. In view of this, the Company requested that the Chairman of the Natural Gas Authority would reconsider the decision of the Natural Gas Authority in view of the reasons detailed above. However, on February 21, 2013, the Company received a letter from the Natural Gas Authority, according to which there is no intention to change the decision of the Natural Gas Authority in view of the fact that the decisions of the Natural gas Authority are reached in a reasonable manner with a view to promote the goals of the natural gas economy in Israel and with a broad view of its goals.

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 further details of the decision of the Government, see Note 34 a 1)b)to the Financial Statements of the Company.

\textsuperscript{72} See Immediate Report dated December 10, 2012 (reference no.: 2012-01-305616)
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 liquified 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 liquified 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 approximately 10 km 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 liquified 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 August 2012, the Company signed an agreement with the BP Gas Marketing Ltd. Company (“BP”), to purchase 10 LNG cargos in the period from December 2012 – April 2013. Furthermore, in September 2012 the Company signed an agreement with the BP Company to purchase another LNG cargo, the first cargo, whose loading was carried out at the end of October 2012. As a result of the delay that occurred in the construction of the marine buoy array by the Gas Lines company and as a result of the early beginning of supply of gas from the Tamar field, the Company had to sell five of the 10 LNG cargos of the BP company in the free market (two of them were sold at a comprehensive loss of approximately Dollar 24 million and the rest were sold without loss).

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.

During July 2013, the Electric Company signed an agreement with the Vitol S.A. Company for the supply of an LNG cargo in August 2013. An additional LNG cargo was supplied by BP in March 2014.

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 and at times of peak demands, when the quantities of gas supplied from “Tamar” are not enough to meet the electricity demands of the Company.

(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 (15) years, with an option for the Company for the extension of the agreement by five (5) more years under the same conditions.

The contractual gas flow started on July 1, 2008.

Upon the change of the regime in Egypt in early 2011 after the “Mubarak era”, 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, to the extent that in 2011 the quantity that was actually supplied amounted to approximately thirty percent (30%) of the contractual gas quantity. 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 April 2012, the supply of natural gas from Egypt was stopped completely, with a notice from the Egyptian government gas companies supplying natural gas to EMG announcing the cancellation of the agreement with it for the sale of natural gas. The agreement with EMG includes a penalty mechanism in respect of failure to supply the contractual gas quantities as well as a guarantee by EMG in the amount of $18 million, which will be valid until the end of the agreement. This monetary compensation, by virtue of the penalties defined in the contract and the exercise of the guarantee, is significantly lower than the expenses incurred by the Company as a result of the discontinued supply of Egyptian gas.

The Company's Board of Directors decided in September 2011, that the Company will enter an 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 until the gas supply from the “Tamar” reserve will begin. 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 (4) billion dollars with respect to damages incurred and that will be incurred by the Company. In February 2013 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. At the end of October 2012, the arbitrators notified that after studying the letters of claims 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. In February 2013, all the Company's affidavits regarding the arbitration process were submitted. The affidavits of the Egyptian gas companies and EMG were submitted in June and July 2013. In January, 2014, an evidentiary hearing took place in the presence of the arbitrators, with the presence of the witnesses and experts on behalf of the parties in accordance with the decision of the arbitrators.

The parties have to submit summaries in writing in the beginning of April, 2014, and following that a summarizing hearing will be held in Paris in the middle of May, 2014.
(E) Project for the construction of a natural gas transmission system (hereafter: the “Gas Transmission Project”)

In November 2001, the Company was requested by the Government of Israel to finance, manage and order the works required for the construction of part of the natural gas transmission system. For this purpose, in November 2004, an agreement was signed 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.

7.11 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:

7.11.1 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 (5) 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 7.10.6 for details.

7.11.2 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 7.10.7 for details.

7.11.3 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 7.10.8.

7.11.4 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.

7.11.5 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.

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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.

7.12 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 22.1.2 for details on the validity of the generation licenses of the Company and the manner of their extension. 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. The Company must fulfill the conditions of the licenses, permits and approvals that it has received, otherwise they will be cancelled or suspended and/or the Company will be exposed to civil and criminal sanctions for their violation. See Section 22.1.5.

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

7.13.1 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, 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.


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.

7.13.2 Air

7.13.2.1 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.

In January, 2014, an emission permit was received for units 1-4 at the Orot Rabin station, for the conversion of the units to natural gas. 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 Alon Tavor 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, according to the updated instructions that were published in September 2013 on the site of the Ministry for Environmental Protection. These requirements may impose costs on the Company that may even be material costs. In January, 2014, the Company delivered its remarks on this issue to the Ministry for Environmental Protection, within which it requested the approval of the Ministry for Environmental protection for alternative dates to deliver documents for an integrative environmental regulation. These requirements may impose costs on the Company, and they might even be material costs.

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, however, the Company does not have the ability to estimate, at this time, the extent of the stated effects and whether they will have a material implication for the Company.

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.

7.13.2.2 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 until the end of 2016, 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 Company has presented the Ministry for Environmental Protection with possible alternatives for dates of closing the units of the abovementioned emission reduction project, as detailed below in section 7.13.2.4. In February, 2014, the approval of the Ministry for Environmental Protection was received, subject to conditions, for postponing the termination dates of the project to June 30, 2018.

For details of the recommendations of the Steering team with regard to units 1-4 at the Orot Rabin site and completion of the scrubbers’ project at the Ruttenberg site see Note 1 e to the Financial Statements.

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

As of February 2004, the Company is gradually converting some of its facilities to operation by natural gas, which significantly reduces the emission of pollutants and greenhouse gases into the air. As of the time of this report, the Alon Tavor, Haifa, Hagit, Reading, Eshkol, Tzafit, Gezer and Ramat Hovav sites are connected to a natural gas supply system and are powered by it in accordance with the availability of the gas and the directives for order of operation in accordance with that which has been described below. In addition, units 1-4 at the Orot Rabin power station are expected to be converted to natural gas power gradually until June 2018 – the Company has initiated the promotion of a National Outline Plan that is required for the Orot Rabin site that would facilitate its 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 February, 2014, a letter was received from the Electricity Authority, according to which the Authority requests to wait for the decision in
the matter of units 1-4 of the Orot Rabin within the framework of the Steering Team before continuing the discussion on the subject of recognition of the conversion costs.

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 view of the regular supply, a document was received from the Ministry for Environmental Protection in October 2013, defining the manner of use of liquid fuel in the electricity generation arrays of the Electric Company, inter alia, during shortage in generation capability. An update to this document was received in December 2013, which was valid until January 31, 2014, and in March its validity was extended to the date of update of the document.

7.13.2.4 **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, under certain conditions, the 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 Company applied to the Ministry of Environmental Protection and the Ministry of National Infrastructures, Energy and Water several times with an update of the developments in the project for the reduction of emission values, in view of unexpected difficulties encountered with various contractors in the project that were not in the control of the Company. As part of its applications, the Company suggested an amended schedule for the implementation of the project, which takes into consideration the implications of the aforementioned events. In February, 2014, the approval of the Ministry for Environmental Protection was received, subject to conditions, for postponing the termination dates of the project to June 30, 2018.

For details of the recommendations of the Steering Team regarding the emissions reduction plan, see Note 1e to the Financial Statements.

7.13.2.5 **Airborne emissions of coal dust and fly ash**

In March 2012, the Ministry of Environmental Protection issued the Company 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. The conditions prescribe various instructions with respect to operational and maintenance actions that the Company must take in all of the activity segments of the coal and fly ash systems to reduce and prevent hazards deriving from dust emissions.

In May 2012, following the request of the Company, some of the conditions of the business license for the Station were amended. The Company is working to implement the conditions that have become effective.

In October 2013, a meeting was held at the Ministry for Environmental Protection on the subject of implementation of the conditions of the business license with respect to the coal dust and fly ash at the “Orot Rabin” power station. During the meeting, the Ministry for Environmental protection was updated about the status of the handling of the various issues.

7.13.2.6 **Prevention and reduction of air pollution from vehicle fleet**

In September 2013, the Company received a draft of instructions under the Clean Air Law for Prevention and Reduction of Air Pollution from Vehicle Fleet, in order to comment on it. The draft of instructions wishes to determine, inter alia, an average particle emission target for a vehicle fleet and instructions for a gradual increase of the percentage of vehicles that use alternate means of propulsion. The Company is studying the
draft of instructions and its expected implications and has delivered its comments on the matter to the Ministry for Environmental Protection.

7.13.2.7 **Energy saving**

The Company is subject in its generation activity, *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 of it and of new regulation initiatives in the field. The Company estimates that this regulation does not affect the generation activity of the Company materially.

7.13.3 **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.

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. As of the date of the report, the response of the Ministry for Environmental Protection to the arguments of the Company has not yet been received.

In March, 2014, after completion of a fuels balance at the Hagit site, it was found that a container with a capacity of 10,000 cubic meters of diesel oil was missing approximately 200 cubic meters of diesel oil. The examination was performed following a leakage of diesel oil that leaked to a trench of upper runoff water and from there some upper runoff water mixed with diesel oil reached the Hagit stream. Upon discovery of the leakage, the Company took steps to stop it and locate its source.

The Company estimates that very small quantities of upper runoff water mixed with diesel oil and the rest remained in the area of the sute.

The Company reported the results of the inspection to the Ministry for Environmental Protection, is in constant contact with the relevant authorities and is acting in accordance with their instructions in this matter.

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.*

The Company is required, at various sites, within the framework of various requirements in the conditions of business licenses and poison permits, 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

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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.*

7.13.4 **Legislative bill for Prevention of Soil Pollution and the Rehabilitation of Polluted Soil Law - 2011**

In August 2011, the first reading of a legislative bill for the Prevention of Soil Pollution and the Rehabilitation of Polluted Soil Law - 2011, was approved, which prescribes a general prohibition against causing soil pollution and which imposes duties on owners and possessors of land and possessors of hazardous materials to prevent soil pollution and to act to rehabilitate polluted soils. The legislative bill (included in its amended version that was published during 2012) was discussed in 2012 by the Knesset Interior and Environmental Protection Committee for the purpose of its preparation for the second and third readings. The Company has delivered its comments on the legislative bill. As far as it will be approved, the draft legislation may impose costs on the Company, which may even be material costs.

The estimates of the Company with regard to the possible costs of the legislative bill 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 version of the law that will be approved.

7.13.5 **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 7.13.2.1, if a combined (integrated) environmental regulation will be required for all the sites of the Company, it may involve costs that may also be significant as regards the effluents treatment facilities.

*This estimate is forward looking information as is defined in the Securities Law, which may not materialize or may materialize in a different manner that expected by the Company, and it is, inter alia, according to the decision of the Ministry for Environmental Protection, as stated in section 7.13.2.1.*

7.13.6 **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.

7.13.7 **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.

7.13.8 **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 for regulating, *inter alia*, the operations at the Reading site of the Company in Tel Aviv was submitted. The plan refers to the generation units that exist at the site and determines the date of termination of their operation. 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. Under the text of NOP 10/a/3, the Company will be required to relocate certain facilities and make environmental investments at the site. If the plan will be approved in its proposed version, its provisions will impose material costs on the Company.

As part of the examination of the future of the Reading site, public committees were appointed by the Minister of Energy and Water and the Minister of the Interior and they recommended that the site will continue to have a power station operating from it. In January, 2014, an order was received from National Council for Planning and Construction, to prepare a new National Outline Plan for new generation units at the site.

*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.*

**7.13.9 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 both for the prevention of the pollution of the sea with salt and for protecting its facilities from sea pollution from an external source.

In March 2012, the Ministry of Environmental Protection disseminated for the comments of the Government ministries the memorandum of the Preparedness and Response to Sea and Coastal Environment Oil Pollution Incidents Law - 2012. The purpose of this legal memorandum is to implement the OPRC instructions, *inter alia*, by requiring the various entities operating offshore or near the shore to prepare plans for coping and dealing with incidents of sea pollution by oil and their consequences. The Company delivered its remarks on the text of the memorandum.

In May 2013, the Company received a warning and a summons to a hearing from the Division of Sea and Coasts at the Ministry for Environmental Protection, following which a hearing was held for the Company by the Division of Sea and Coasts of the Ministry for Environmental Protection in June 2013. Within the hearing, it was claimed that the Company did not execute examinations and reports required under the Ports (Loading and Unloading Oils) Regulations, 1975 in the fuel piping that is in the marine connectors (the marine mooring site of fuel tankers) that is close to the Eshkol power station.

The Company is acting in accordance with the summary of the hearing and has, *inter alia*, prepared for treatment of sea oil pollution incidents, is taking the required steps with regard to the piping and is carrying out marine patrols when fuel is being unloaded in accordance with the instructions of the Ministry for Environmental Protection.
7.13.10 **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). 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, 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.

The supply of coal ash for the range of uses is continuing unhindered and as far as the Company knows, it has not been affected by the announcement of the Radiation Supervisor at the Ministry of Environmental Protection and by the publication of the standard, and is not likely to be harmed in the future.

*This assessment constitutes forward looking information, as per its definition in the Securities Law, as based on the situation as of the time of the report, considering that there will be no changes or tightening of requirements, it may be assumed that the situation will remain the same and the fly ash supply for the range of applications shall remain unhindered.*

7.13.11 **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 22.9 for further information on the Business Licensing Law and the state of licensing of the various licensable items at the Company.

7.13.12 **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. For further details see section 7.13.2.1 above.
7.13.13 **PCB**

The Company has removed all transformers and capacitors that isolated PCB (polychlorinated biphenyls, a liquid that has high insulation and flame retardant properties compared to mineral oil; a carcinogenic substance) from its power stations, substations and internal transformation stations to the waste site at Ramat Hovav.

7.13.14 **Register of Emissions into the Environment**

7.13.14.1 In April 2012, the Register of Emissions into the Environment Law was published, imposing a reporting duty with respect to emissions and transfers of pollutants and waste to the environment. This is, among other things, for creating an emission register, which will be administered by the Ministry of Environmental Protection and will be made available for public inspection. The Company has submitted an initial report in accordance with the requirements of the law.

7.13.15 **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.

7.13.16 **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.

7.13.17 **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, even in the absence of relevant laws and regulations; 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.
Environmental costs and investments of the Company in environmental protection

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

<table>
<thead>
<tr>
<th>NIS million, current prices</th>
<th>Twelve months ended on December 31 (adjusted to NIS of December 2013)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2011</td>
</tr>
<tr>
<td>Total investment in environmental protection facilities</td>
<td>Approx. 548</td>
</tr>
<tr>
<td>Current costs (without depreciation)</td>
<td>Approx. 87</td>
</tr>
</tbody>
</table>

(A) Investments during 2013

In 2013, the Company invested approximately NIS 751 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 2013 within the framework of costs of operation of the power stations and ancillary expenses to fuels, approximately NIS 81 million for compliance by the production system with environmental protection requirements (in addition, a total of NIS 2 million which are not attributed to the production system). The Company estimates that the environmental costs that the Company bore in 2013 were invested mostly in future prevention and reduction of environmental damage and the rest was invested in environmental repair and restoration.

(B) Budget for 2014

The Company is allocating in its budgets money for compliance with environmental conditions and laws. For 2014, the Company allocated within its current operation and development budgets a total of approximately NIS 1,523 million for compliance with environmental protection requirements (of which approximately NIS 93 million, in current shekels, was within the operation and fuel budgets), including – 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, the Company has allocated an amount of approximately NIS 5,601 million (in 2014 budget prices) (it should be noted that the above mentioned investment does not include the comprehensive investment of emission reduction in Orot Rabin 1-4, the natural gas supply project at Orot Rabin 1-4, and the project of water supply to the emission reduction installations) without interest at the time of construction, for the years 2011-16, *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).

In February 2011, the Company executed an agreement with Babcock Noel 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 financial figures are based on past experience of the Company and the forecast of the Company that is based on the degree of environmental impact caused by the current generation activity of the Company and instructions with respect to environmental protection in their current form.

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 and other events, including those that stem from the lateralization of risk factors of the Company.

7.14 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 and section 24.
8. **The transmission and transformation segment**

8.1 **General information on the transmission and transformation segment**

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, 2015.

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, 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) 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. After transformation to medium voltage (distribution), the energy is transferred to end users through the distribution network. See Section 9 for details on the distribution segment.

The Company has three (3) types of substations: (1) permanent; (2) temporary, and (3) mobile, which 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 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 lies with the Electric Company.

- Old substations that are owned by a consumer of high voltage.

See Section 22.1 for information with respect to the management of the system as described in the Electricity Sector Law.

8.1.1 **Structure of the field of activity of changes occurring in it**

In accordance with the above, the activity of the Company in this field of activity includes activity of transmission of electric energy that is generated at the various generation units of the Company and by private electricity producers to the switching stations and from there to the switching stations and substations deployed throughout Israel. As of the date of the report, the Company is responsible for transmission of electric energy, in addition to consumers in the State of Israel, to East Jerusalem, to the West Bank and to Gaza, as well. Some of the customers of the Company are high voltage customers, which include primarily major consumers, such as industrial plants, the Mekorot Water Company, desalination facilities and others (see Section 10). Operation, maintenance and handling malfunctions should also be included in the execution of activity of the segment of electric energy transmission.

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

The Company estimates that 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
8.1.3 The electricity charge rate in the transmission and distribution segments

8.1.3.1 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”\(^\text{74}\) (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.

(A) Manner of determining and updating the charge rate

For details on the manner of determining and updating the electricity charge rate, see Sections 7.1.3.2 and 8.1.3 and note 3C of the Financial Statements.

(B) 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 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 – see Section 8.1.3. 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 medium 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

\(^{74}\) 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”.
Company. See Section 7.1.3.2 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 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 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 inputs⁷⁵; 2.5% for the inputs of the medium voltage distribution segment⁷⁶; 3.7% for inputs in the low voltage distribution segment⁷⁷; and 2% for the inputs of consumer costs that are included in the transmission and distribution segments (at all voltage levels).

8.1.3.2 **The future electricity charge rates in the transmission and distribution segments**

8.1.3.2.1 Within the resolution of the Electricity Authority of December 2005⁷⁸ with respect to principles for setting new charge rate bases and combined cycle costs, the Electricity Authority stated that with respect to the setting of a new charge rate basis for the distribution segment, the outline of the recognized costs that it will establish will limit the permitted investment level per year for the Company in order to maintain the level of services for the consumer, including reliability of supply and connections to the grid. In the same resolution, the Electricity Authority stated that with respect to the transmission segment, it considered the correct, updated definition of the activity of the transmission segment prior to determination of its cost to be of supreme importance, in view of it being a unique segment that would provide essential services both to the Company and to private entities operating in the Electricity Sector. In view of this, the resolution further stated that the Electricity Authority considered it necessary for the Company to operate immediately for managerial organization that would provide for the activity of this segment as a distinct, consolidated segment within an essential service supplier licenses, that the costs involved in such preparations be included within the recognized costs for the segment, subject to execution of that organization. It was further stated in the resolution that the transmission segment would include, *inter alia*, the following activities: prediction of demand and consumption in the national economy, overarching planning, simulations of systemic stability on the generation and consumption side alike, integration and activity of monitoring and control over all electricity delivery in the system, including the manner of conduct of commerce. As of the date of the report, the prediction for demand at the Company level and the manner of managing commerce, which the Company does not yet have, has not been included in the transmission segment.

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⁷⁵ Not including high voltage consumer costs: fixed payment in the electricity bill and payment for expanded services that are collected from consumers.

⁷⁶ Not including high voltage consumer costs: fixed payment in the electricity bill and payment for expanded services that are collected from consumers.

⁷⁷ Not including high voltage consumer costs: fixed payment in the electricity bill and payment for expanded services that are collected from consumers.

⁷⁸ Resolution No. 4 of Meeting No. 128, dated December 18, 2005 on the matter of “Principles for setting new charge rate bases and costs of combined cycles”.
Within the framework of the planned raising of the charge rate 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 for 2012, contributing approximately 1.2% to the electricity charge rate. The addition is in the amount of approximately NIS 240 million in charge rate basis quantities (sold quantities of 2006) based on the following distribution:

NIS 60 million in the transmission segment, NIS 80 million in the distribution segment and NIS 100 million in the low voltage distribution segment, relative to the recognized cost in the last charge rate update.

The rate increase in 2013 includes an additional advance in the amount of approximately NIS 100 million a year as an addition to the recognized cost of the transmission and distribution rates. This advance is added to the advance of approximately NIS 300 million that was given in the decision of the Electricity Authority of March 2012 (NIS 240 million in terms of 2006 sold quantities), so that the advance included in the recognized cost in accordance with the decision is approximately NIS 400 million a year.

The addition 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.

8.1.3.2.2 In its decision of May 13, 2013, the Electricity Authority determined a temporary rate for the services of the electricity system administration, which will apply to all the electricity consumers of the sector as of June 1, 2013. For additional details see section 7.4.1.5. and Note 3h to the Financial Statements.

8.1.4 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 reserve 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

79 Resolution No. 1 of Meeting No. 367 of the Electricity Authority dated March 22, 2012.
80 This refers to the difference between generation ability and the demand for electricity at that time from consumers.
avoidance” policy, which is application of reasonable measures for reducing magnetic field levels where possible.

(D) The construction of a larger number of private 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 for 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 are conducted only by the staff of the Company.

(E) Changes in the Criteria for the level, standard and quality of service that an essential service supplier license holder provides, 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.

(H) Security requirements including physical, logistical requirements and information security for substations, switching stations and command centers.

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.

8.1.5 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 MVA\(^{81}\) instead of 50 MVA) transformers with current limiters at the substations within metropolises for increasing the transformation ability at new substation sites and replacement of transformers at existing substations.

(B) Deployment of new technologies in the transmission field, such as ACSS wires with thermal ability, 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 mm\(^2\) cross section.

8.1.6 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. See Sections 7.1.3.2 and 7.7.3.1 for further information.

\(^{81}\) MVA – megavolt ampere.
8.1.7 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 barriers in the field of activity are: costs of connection of the generation installation to the transmission system, the technical ability of accommodating a new high voltage customer in the system, and 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 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.

8.1.8 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.

8.1.9 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

In accordance with the above, the Company operates as a single combined and coordinated system for the supply of electricity to consumers, from the generation of electricity at generation sites, continuing to its transmission and transformation to the distribution system and high voltage customers (private electricity consumers and producers) to its distribution and supply to the end points of each of the consumers. See Section 10.

Services in the transmission field are given to high voltage customers (private producers and approximately 40 major consumers such as Dead Sea Works) 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 8.1.3).

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 2013 (according to the assumptions detailed in Note 38 to the Financial Statements) came to a total of approximately NIS 3,081 million, compared with approximately NIS 2,648 million in 2012 adjusted to the NIS of December 2013, representing an increase in revenues of approximately NIS 433 million. The change in the revenues arises from an increase of approximately NIS 591 million for a real increase in the electricity charge rate, and additionally a decrease in consumption of approximately NIS 158 million.

8.3.2 Loss from ordinary operations – the transmission and transformation segment

The profit from ordinary operations in the transmission and transformation segment in 2013 came to a total of approximately NIS 766 million, compared with a profit of approximately NIS 548 million in 2012, adjusted to the NIS of December 2013, representing a decrease of approximately NIS 218 million.
8.4 Generation capacity – the transmission and transformation segment

8.4.1 The transmission segment (power lines):

A breakdown the length of the transmission circuits\(^{82}\) of the Company follows:

<table>
<thead>
<tr>
<th>Date</th>
<th>400 kV lines km of circuit</th>
<th>161 kV overhead lines km of circuit</th>
<th>115 kV lines km of circuit</th>
<th>161 kV underground lines(^{83}) km of circuit</th>
</tr>
</thead>
<tbody>
<tr>
<td>December 31, 2013</td>
<td>741.2</td>
<td>4,441</td>
<td>114.5</td>
<td>109</td>
</tr>
<tr>
<td>December 31, 2012</td>
<td>737.2</td>
<td>4,382</td>
<td>114.5</td>
<td>104.2</td>
</tr>
</tbody>
</table>

On December 31, 2013, the installed output of 161/400 MVa connection transformers stood at 9,650 MVa. On December 31, 2012, the installed output of 161/400 MVa\(^{84}\) connection transformers\(^{85}\) stood at 10,150 MVa

8.4.2 The transformation system:

On December 31, 2013, the transformation system consisted of 193 substations (of which 42 substations were owned by high voltage consumers), compared to 191 substations that had transmission systems, it had on December 31, 2012 (of which 41 substations were owned by high voltage consumers).

On December 31, 2013, the installed transformation ability was approximately 19,700 MVa (including approximately 2,855 MVa across substations for high voltage consumers), compared with an installed transformation ability of approximately 19,452 MVa (including approximately 2,825 MVa across substations for high voltage consumers) as of December 31, 2012.

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, 2013 and 2012:

<table>
<thead>
<tr>
<th>Year</th>
<th>Substation type</th>
<th>Switching station</th>
<th>Substation</th>
<th>Private</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>December 31, 2013</td>
<td></td>
<td>10</td>
<td>141</td>
<td>42</td>
<td>193</td>
</tr>
<tr>
<td>December 31, 2012</td>
<td></td>
<td>10</td>
<td>140</td>
<td>41</td>
<td>191</td>
</tr>
</tbody>
</table>

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

\(^{82}\) In general, there is more than one transmission line between any two pylons, known as a “circuit “and measured in km

\(^{83}\) Underground.

\(^{84}\) A connection transformer changes voltage levels within the transmission system (from 400 kV to 161 kV).

\(^{85}\) 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 (an old system whose use is decreasing).

\(^{86}\) A voltage measurement unit.
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 15.3 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:

<table>
<thead>
<tr>
<th>Name of site</th>
<th>Location</th>
<th>Type</th>
<th>Site area in m²</th>
<th>Nature of the rights</th>
</tr>
</thead>
<tbody>
<tr>
<td>Caesarea **</td>
<td>Caesarea</td>
<td>Switching station</td>
<td>-</td>
<td>Sublease, Caesarea Development Company, until 2048</td>
</tr>
<tr>
<td>Tzafit *</td>
<td>Next to Kfar Menachem</td>
<td>Switching station</td>
<td>-</td>
<td>Lease till 2034</td>
</tr>
<tr>
<td>Petach Tikva *</td>
<td>Next to Morasha Junction</td>
<td>Switching station</td>
<td>65,073</td>
<td>Ownership</td>
</tr>
<tr>
<td>Zevulun *</td>
<td>Kfar Hassidim</td>
<td>Switching station</td>
<td>272,045</td>
<td>Development agreement with ILA till 2000 with a right to receive a lease</td>
</tr>
<tr>
<td>Gan Sorek *</td>
<td>Rishon le Zion</td>
<td>Switching station</td>
<td>210,136</td>
<td>Development agreement with ILA till 1998 with a right to receive a lease</td>
</tr>
<tr>
<td>Even Sapir *</td>
<td>Southwest of Moshav Even Sapir</td>
<td>Switching station</td>
<td>104,000</td>
<td>Lease till 2040</td>
</tr>
<tr>
<td>Gezer **</td>
<td>Next to Ramla</td>
<td>Switching station</td>
<td>-</td>
<td>Possession</td>
</tr>
<tr>
<td>Ramat Hovav **</td>
<td></td>
<td>Switching station</td>
<td>-</td>
<td>Lease contracts till 2028/2029</td>
</tr>
<tr>
<td>Hagit ***</td>
<td></td>
<td>Switching station</td>
<td>-</td>
<td>327,000 m² leased till 2051. The rest is owned.</td>
</tr>
<tr>
<td>Yavneh</td>
<td>Ashdod Junction</td>
<td>Major substation</td>
<td>100,117</td>
<td>17,600 m² leased until 2023. The rest is owned.</td>
</tr>
<tr>
<td>Kishon **</td>
<td>Nesher</td>
<td>Major substation</td>
<td>100,000</td>
<td>Lease till 2058</td>
</tr>
<tr>
<td>Alon Tavor **</td>
<td></td>
<td>Major substation</td>
<td>-</td>
<td>Lease till 2039</td>
</tr>
<tr>
<td>Yarkon *</td>
<td>Tel Aviv, Ramat Hahayal</td>
<td>Major substation</td>
<td>116,655</td>
<td>100,000 m² owned. The rest is possessed</td>
</tr>
<tr>
<td>Ayalon (Ganot)</td>
<td>Ganot Intersection</td>
<td>Switching stations</td>
<td>39,092</td>
<td>Lease until 2061 (transaction approved in ILA and IEC, site under construction, contract issued, signed in IEC and transferred to be signed by ILA)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Total area</td>
<td>1,007,118</td>
</tr>
</tbody>
</table>

* 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 22.1.3.2 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 once a year. The duration of the Development Plan as stated is for a period of five (5) 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 (10) 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 transmission and transformation system Development Plan of the Company for 2011-2015, which was submitted for the approval of the Minister in April 2010, which received his approval in December 2010, is estimated at approximately NIS 5.4 billion in December 2009 prices, for the stated period, and approximately NIS 1.1 billion per year on average. In effect, in recent years, in view of its financial situation, the Company has been acting to reduce the expenses for the development of the transmission system. The plan includes 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 The main projects in the field of transmission and transformation that ended in 2012 were:


(B) The addition of transformation at existing substations – Ofakim, Galia, Misgav, Yoqneam.

(C) Activation of 56 km of new overhead circuits.

(D) Hundreds of relatively small projects and advancement of multi-year projects whose utilization started in 2013.

8.6.3 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; (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.

See the Immediate Report of December 19, 2010 (Reference No.: 2010-01-722700).
8.6.4 The Development Plan fulfills the following needs:

(A) Securing optimum operation conditions of the generation system, while considering the expected geographic distribution of the loads, using assorted reasonable scripts with respect to the loading of the generation units;

(B) Securing the survivability of the system, which is an isolated system, therefore being exposed to unusual occurrences at a high likelihood;

(C) Securing the reliability of adequate supply to consumers in cases of faults in the generation units, in transmission circuits, at substations, at connection transformers and at substation transformers;

(D) Maintaining the quality of the supplied electrical energy;

(E) Consideration for the feasibility of the projects elaborated in the Development Plan following analysis of chances of materialization.

The transmission and transformation system Development Plan is a result of techno-economic optimization of various options that answer these needs, for the purpose of adapting the main parameters of the equipment to the Israeli system in the technical aspect and in scheduling of the order of equipment from the economic aspect.

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 2009\(^\text{88}\) 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 resolution of the Electricity Authority of July 2008.\(^\text{89}\) See Sections 7.4.4 and 22.1.3.2.

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 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.

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 (NNI) decided on an underground section inside the crater (Makhtesh). According to the decision of the NNI, the Company is operating to advance the project in the planning track and receive approvals.

\(^{88}\) Resolution No. 4450.

\(^{89}\) Resolution No. 1 of Meeting No. 222 dated July 9, 2008 on the matter of “proceeding for construction of private electricity generation facility”.
8.6.5 Development of the transmission system

In accordance with the Development Plan above, in 2014-2018, the Company is planning to add to the high voltage (400 kV) transmission system approximately 274 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 22.8 for details on the statutory proceedings.

In 2014-2018, the Company is planning to add approximately 720 km of upper circuitry to the high voltage (161 kV) transmission system. In addition, approximately 1,056 km of circuitry will be upgraded, rebuilt or relocated, and approximately 81.5 km of underground cable circuits are scheduled to be added.

8.6.6 Development of 400/161 kV transformation system

The Development Plan of the Company for 2014-2018 includes: the addition of connection transformers to an output of approximately 575 MVA at the Zevulun Switching Station (2014); termination of melioration of a cooling system of transformers in Caesarea (2013) and the transfer of a connection transformer from Tzafit to Petach Tikva, along with its upgrade to 650 MVA (2014) – contingent upon the conclusion of statutory proceedings for the approval of said sites; the construction of the Ayalon Switching Station with 3 connection transformers and a total output of approximately 1,950 MW (2015), the construction of the Atidim Switching Station with 2 connection transformers and a total output of approximately 1,950 MW (2017); At the end of 2017, the Company is due to have eleven (11) 400/161 kV switching stations with a total output of approximately 14,895 MVA.

8.6.7 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. Fixed substations are divided into two (2) types: open and closed substations. A temporary substation is usually built for a few years, where transformation is needed but it is difficult to get permits to build a permanent station within the time required. A portable substation is moved from site to site as necessary, as an interim solution, before the construction of a permanent substation. The Company prefers to build open substations over closed ones, because the cost of construction of a closed station is twice that of an open one. Closed substations are built due to the demand of the authorities or in the absence of sufficient area for building an open station.

In certain cases, the Company has difficulty in implementing all of the projects that are required for the purpose of adaptation of the transformation ability installed at the substations to the regional electricity demand in accordance with the planning criteria. Therefore, until the construction of a permanent substation in the region, alternative solutions are being run, such as the construction of a temporary substation or the deployment of a portable substation. A temporary substation is a temporary facility that is constructed in arrangement with the local authority. This substation is constructed at a standard that is lower than that of a permanent substation and is scheduled for dismantlement within approximately five (5) years of its date of construction, and is designed for the installation of only 1 to 2 transformers, compared with 2 to 6 transformers at a permanent station.

Portable substation – the Company has a number of portable substations that were purchased during the 1990s. A portable substation is a device that consists of two large trailers and has 161 kV high voltage equipment, a single 20 MW transformer, a medium voltage distribution regulator that has 3-4 outlets and an appropriate protection, command and control system. These facilities are installed in accordance with the needs of the system and are transported to a new location upon the completion of the permanent project of expansion of the transformation system.

Within the Development Plan of the Company, approximately 18 permanent substations with a total transformation ability of approximately 2,253 MVA are planned to be added in 2014-2018. At the end of 2017, there are expected to be approximately 53 substations with a total transformation ability of approximately
19,050 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.

8.6.8 **Forecast of the investments that will be required for executing the Development Plan of the transmission and transformation segment**

Based on the financial planning for 2014-2018, as not yet approved by the board of directors, the development budget of the transmission and transformation system for the years 2014-2018 is estimated at a minimum of NIS 0.9-1.5 billion per year.

In 2013 approximately NIS 721 million were invested compared with NIS 768 million in 2012.

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

The above mentioned with respect to the Development Plan of the Company and the investment plan that will be required for the execution of the Development Plan of the Company for the transmission and transformation segment is forward looking information, as per its definition in the Securities Law.

This information includes forecasts, subjective estimates and other plans of the Company as of the date of the report with respect to the working assumptions that it has used in the construction of the forecasts and the times of materialization of those assumptions. Such information 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); the Development Plan that the Minister prescribes, to the extent that he prescribes such a plan 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 **Intangible assets**

See Section 16 for details on intangible assets.

8.8 **Human capital**

The organizational structure in the transmission and transformation segment:
As of December 31, 2013, the transmission and transformation segment has 304 permanent employees and 46 temporary employees in the transmission and transformation section and the system administration unit, compared with 415 permanent employees and 59 temporary employees in the transmission and transformation section and the system administration unit as of December 31, 2012. (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 9.9). The decrease in the number of employees derives from an intra-organizational change in the Company, within which starting from 2013, the Generation and Energy Division is included in the generation segment instead of in the transmission segment.

See Section 14 for details with respect to benefits and the nature of the employment agreements and additional details.

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

8.9.1 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 7.13 and 9.11 for details on environmental risks and the regulation applicable to the Company in these fields.

8.9.2 Land

The Company is working to seal transformer enclosures in accordance with an internal environmental survey of transmission and transformation sites in which there are containment enclosures of transformers that are not sealed, which was performed for the purpose of prioritizing the lining of containment enclosures of transformers. An initial assessment by the Company concerning the financial implications shows that this activity is not expected to impose material expenses on it.

8.9.3 Hazardous materials

The transmission and transformation division has a poison permit that is renewed every three (3) years. See Section 7.13.6 for details on risks from hazardous materials.

8.9.4 Business licensing

See Section 22.9 for details on this subject.

8.9.5 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.

8.9.6 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.

See Section 9.11.2 with respect to proceedings related to non-ionizing radiation

8.9.7 The policy of the Company in environmental risk management

See Section 7.13 for details on this subject.

8.9.8 Environmental costs and investments of the Company in environmental protection
See Section 21.7 for details on this subject.

8.10 **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 Sections 1.3 and 22 for details on the regulation applying to the Company, including the transmission segment.

See Section 22.8 with respect to licensing proceedings in accordance with the Planning and Construction Law.

In October 2005, the Electricity Authority published updates to criteria for infrastructure utilities whereby producers could sell electricity to the Company and “supply” electricity to end consumers via the transmission grid of the Company and criteria for the purchase of electricity from private producers and license holders (hereafter: “Chapter E and Chapter F in the Book of Criteria”). See Sections 7.4.1 and 8 for details on the Book of Criteria.

In July 2009, the Electricity Authority published an update to Chapters E and F of the Book of Criteria that deal with private producers, infrastructure utilities, definition of the structure of the future Electricity Sector and the roles of the players that will be operating in it.

In December 2012, the Electricity Authority published a criterion and rates for high voltage and extra high voltage connection works for consumers and private producers.

See Section 7.4.2.5 for details on charge rate arrangements that the Electricity Authority has published for private producers that operate using conventional technologies, cogeneration, pumped storage and renewable energy at various voltages, with the goal of regulating the activity of these producers in the Electricity Sector.

8.11 **Legal proceedings**

See section 8.9.6

8.12 **Raw materials and suppliers**

The primary suppliers of the Company in the transmission and transformation field are Elco Van Rol and Siemens, that supply transformers. GE ALSTOM, AREVA, ABB, SIEMENS supply arrays, switching equipment (current interrupters and disconnectors), control systems and protection.

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91 Resolution No. 1 from meeting 388 dated December 3, 2012, with respect to criteria and rates for connecting works with high voltage. This decision was amended within resolution no. 16 of the Electricity Authority of October 20, 2013 from meeting 416.
9. The distribution segment

9.1 General information on the distribution segment

9.1.1 General

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 (5) 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 2.58 million.

9.1.2 Structure of the field of activity and changes occurring therein

In accordance with that which has been described above, the activity of the Company in this field is activity of electricity distribution from substations to consumers through medium voltage lines and low voltage lines, and the supply and sale of electricity to consumers. As of the date of the report, the Company distributes, supplies and sells most of the electricity in the State of Israel.

9.1.3 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 structural changes 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, 2015. 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 22 for details on these aspects of the activity of the Company and the various restrictions.

9.1.4 The electricity charge rate in the distribution segment

See Section 7.1.3.2 for details on the electricity charge rate in the distribution segment.

9.1.5 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. A significant entry of private electricity producers into the electricity generation field began in the second half of 2013. See additional details in section 7.4.3.4. The departure of consumers that stems from that is not expected to affect the revenues of the Company from the distribution segment that will continue to receive revenues with respect to infrastructure services (distribution) through the suppliers of the customers. For details of the

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recommendations of the Steering team with respect to the distribution and supply segment see Note 1 e to the Financial Statements.

9.1.6 **Developments in markets of the field of activity or changes in the characteristics of its customers**

As from 2011, and as of the date of the report, the Ministry of National Infrastructures, Energy and Water has been encouraging savings in the consumption of electricity by consumers, *inter alia*, through changes in the regulation of air conditioners, refrigerators, light bulbs, motors and transformers, by subsidizing the replacement of old equipment, which features high consumption, with new energy saving equipment, and by public information actions for increasing the awareness for energy savings among consumers. The Company is a partner in this effort, for which purpose it has contributed the activity of the marketing branches and districts. See Section 6.5 for details on the policy of the Government of Israel with respect to savings in electricity consumption.

9.1.7 **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 grid” fields (see Section 9.7.4.4 for details on the “smart grid”).

9.1.8 **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. In 2013 and until the date of publication of the report no change has occurred in these factors.

9.1.9 **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 East Asia for purposes of reducing costs. However, some of the increase in the cost of raw materials in the distribution segment is because the main raw materials of the segment are copper, aluminum and steel, whose prices have experienced a constant rise.

9.1.10 **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 a distribution and supply license. 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.

9.1.11 **Alternatives to the products of the field of activity and changes occurring therein**

See Section 7.1.9.

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 2013 (in accordance with the assumptions stated in Note 38 to the Financial Statements) came to a total of approximately NIS 2,906 million, compared with approximately NIS 2,879 million in 2012 adjusted to New Israeli Shekels of December 2013. This represents an increase in revenue of approximately NIS 27 million. The change in the revenues arises from an increase of approximately NIS 200 million, for a real increase in the electricity charge rate, and against a decrease in consumption of approximately NIS 173 million.

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

The profit from ordinary operations in the distribution segment in 2013 came to a total of approximately NIS 218 million, compared with a loss of approximately NIS 562 million in 2012, adjusted to New Israeli Shekels of December 2013. This represents an increase of approximately NIS 780 million.

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 Section 6.5 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 as stated, including all of the ancillary services that the Company supplies with respect to the supply of electricity, except billing services). Departure of consumers will not affect the revenues of the distribution segment. See section 7.4.4.

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 distributors 

93 to other entities that will be provided with a license to distribute and supply electricity (the “**Mechanism**” and “**Other Distributors**”). The Decision of the Electricity Authority of August 11, 2009

94 determined that if a Historical Distributor chooses not to join the outline of the Historical Distributors, or will not meet its terms, it will have to transfer the infrastructure it owns to an entity that holds a license for distribution and supply of electricity. 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. 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

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93 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”.

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

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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.

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 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 over the competition in this field of activity, over its activity, profitability and financial status. See Sections 1.3, 6.1 and 7.4 for details with respect to the sale of electricity by private electricity producers and the Structural Change required by the Electricity Sector Law, respectively.

For details of the recommendations of the Steering Team with respect to the distribution segment, including with regard to the operation of private entities as sub-distributors, see Note 1e to the Financial Statements.

9.5 Distribution capacity

On December 31, 2013, the distribution system consisted of approximately 26,631 km of medium-voltage grid lines (compared with approximately 26,194 km on December 31, 2012); approximately 47,474 distribution transformers with a total output of approximately 22,871 megavolt-amperes (compared with approximately 46,848 distribution transformers with a total output of approximately 22,492 megavolt-amperes as of December 31, 2012) and approximately 21,768 km of low-voltage grid lines (compared with approximately 21,478 km of low-voltage grid lines as of December 31, 2012).

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 15.3 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 22.1.3.2 for details on the duty of the Company to submit a Development Plan and comply with its prescribed conditions and schedules. For details of the recommendations of the Steering Team with regard to the distribution segment see Note 1 e to the Financial Statements.

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 is based on the following data and assumptions:

9.7.2.1 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.

9.7.2.2 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.

9.7.2.3 High voltage consumer data received from the ordering department of the Company.

9.7.2.4 Technical directives for planning of the distribution grid given by the national grid.

9.7.2.5 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.

9.7.2.6 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 customers division for 2013, which is submitted to the Board of Directors within the financial planning of the Company, each year.

9.7.3.1 Medium voltage

Within the Development Plan, 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. During 2013, approximately 598 km of overhead and underground medium voltage lines were added. These figures are based on the estimates of the Company, namely the construction of approximately 1,200 km on average per year (including grid renewal), and replacement of 190 km. Out of the estimated construction, 900 km on average will be underground voltage lines.

At the end of the aforesaid period, the total length of the medium voltage lines is expected to be approximately 33,035 km.
9.7.3.2 Low voltage

Within the Development Plan, in 2014-2018, approximately 8,299 km of overhead and underground voltage lines were added. In addition, approximately 703 km of grids will be replaced. During 2013, approximately 767 km of overhead and underground low voltage lines were expected to be added. These figures are based on the estimates of the Company of construction of approximately 1,500 km on average per year (including renewal of grid) and replacement of approximately 125 km.

At the end of the aforesaid period, the aggregate length of low voltage lines is expected to be approximately 30,067 km.

9.7.3.3 Distribution transformers

Within the Development Plan, during 2014-2018, approximately 6,775 new transformers are expected to be added. During these years, approximately 4,674 transformers are scheduled for replacement. During 2013, approximately 18 new transformers were added and approximately 541 transformers were replaced.

At the end of the aforesaid period, the Company is expected to have approximately 54,249 distribution transformers at its disposal.

9.7.4 Forecasts for investments that will be required for the execution of the Development Plan of the distribution segment

An average annual investment forecast for the distribution and supply segment for each of the years 2014 to 2018 is estimated at approximately NIS 3 billion per year. This plan has not yet been presented to the Board of Directors. The investment forecast described in section 9.7.3 above (before cutback) also includes an investment in the renewal of the grid and in special projects that are listed below:

(A) The privatization of kibbutzim and their switching from bulk supply to individual supply.

(B) Placing existing grids underground in populated areas: earlier investments in the wake of excavation opportunities in city centers.

(C) The shifting of pylons on roads.

(D) Addition of private electricity producers, which is expected to increase the electricity generation capacity, for which the Company may have to strengthen the existing grid and/or build an additional distribution grid.

For details of the recommendations of the Steering Team with regard to the 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 investments plan it will be required to execute constitutes forward looking information, as per its definition in the Securities Law. This information includes forecasts, subjective estimates and other plans of the Company as of the date of the report with respect to the working assumptions that it has used in building the forecast and the date of materialization of those assumptions. Such information 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), 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 **Consequences of the Non-Ionizing Radiation Law**

Since 2007, the Company has been operating in accordance with the Non-Ionizing Radiation Law and the class permits that have been received from the Ministry of Environmental Protection. Within this framework, the Company allocates approximately 2 million dollars per year for the purpose of reduction of the exposure of the public to magnetic fields, in accordance with the Criteria that have been formed and according to the plan that has been forwarded for the information of the Ministry of Environmental Protection as required by the Non-Ionizing Radiation Law. For additional detailing of the non-ionizing radiation see section 9.11.2.

9.7.4.2 **The electric automobile project**

The Electricity Sector Regulations\(^5\), as amended in March 2012, regulate the manners in which a customer may transact with a supplier for recharging of an electric vehicle.

The Company as an essential service supplier is committed to building recharging posts in public grounds (roads and pavements), using which any customer, casual or regular, can recharge his automobile.

As far as the Company is concerned, a condition for the fulfillment of the project is securing coverage of costs of an essential service supplier for the construction and maintenance of the recharging array in general, including in public grounds.

In accordance with the policy principles of the Ministry of National Infrastructures, Energy and Water (the Ministry of National Infrastructures, as it was then) of July 2011, the Company is responsible for providing a recharging connection to customers who will choose to connect without a recharging provider. For the purpose of management of the recharging stations in public grounds, and management of recharging stations for direct customers without a supplier and control of all of the recharging arrays of vehicles during congestion, the Company has the burden of establishing and regularly maintaining an IT array. At this stage, and following the collapse of the Better Place Company, the project has been halted.

\(^5\) The Electricity Sector Regulations (Conditions and Procedures for Issue of a License and Duties of a License Holder) - 1997.
9.7.4.3 **Pylon protection project**

The pylon protection project that the Company executed in cooperation, *inter alia*, with the Ministry of national Infrastructures, Energy and Water ended in early 2011.

Within the framework of the project, approximately 140,000 pylons were protected against electric shock, mostly in populated areas.

There is a joint initiative of the Ministry of National Infrastructures, Energy and Water and the Company for the approval of regulations for protection and signage medium voltage and low voltage truss pylons\(^{96}\) that will vest the protection project in the form that has been carried out by the Company. These regulations have not yet been approved and their approval will require the Company to complete the pylon protection and signage project in open grounds located up to 1,000 meters from built up areas, within a schedule that will be defined, according to the estimate of the Company, during a consensual transition period. An initial estimate of the Company is that the project completion will cost (as this has been defined in the regulations) approximately NIS 57 million (in current shekels).

Additionally, the Company will be required to complete the protection of high voltage pylons (about 1,000 pylons). The budget estimate is about 15 million NIS.

*What has been described above with respect to the estimate of the cost of execution of the project 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 time of the report and includes its estimates and forecasts for this time. This information may not materialize, in part or in full, or may materialize in a manner differing from the forecast of the Company, inter alia, as a result of the wording of the Regulations that will be approved, insofar as will be approved, an update in the number of pylons to be actually protected, the results of the tenders for the materials for the project and changes in the estimated schedule.*

**Smart grid project**

The smart grid 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.

Currently, a new approach for executing a pilot of the subject is being examined, and it will enable to reduce costs and shorten schedules for the starting up of the proceeding.

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

9.8 **Intangible assets**

See Section 16 for details on intangible assets.

9.9 **Human capital**

The organizational structure of the distribution segment:

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Field of Activity – Distribution Segment

Customers & Business Entrepreneurship

Roster of employees (positions): 4,470

Business Entrepreneurship

Marketing
  - Tiberias
  - Zefat
  - Afula
  - Hadera
  - Naharia
  - Karmiel

Northern District

Southern District
  - Beer Sheva Region
  - Netanya
  - Petah Tikva

Jerusalem District
  - Bet Shemesh
  - Ariel
  - Raanana
  - Rehovot
  - Rishon Lezion
  - Ramla

Dan District

Haifa District
  - Krayot
As of December 31, 2013, the distribution segment employs 3,483 permanent employees and 987 temporary employees in the marketing segment and in the districts (compared with 3,464 permanent employees and 947 temporary employees in the marketing segment and in the districts as of December 31, 2012 (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 8.8). See Section 14 for details with respect to the employment agreements and additional details.

9.10 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, except for one material supplier (Synergy Cables Ltd.), which supplies the Company with medium voltage and low voltage cables at a cost of approximately NIS 120 million per year (this supplier supplies the Company with approximately 80% of the medium and low voltage cables that are purchased by it and about a third of the cost of the suppliers of the distribution segment).

9.11 Environmental risks and their manner of management – distribution segment

9.11.1 Environmental risks and environmental regulation – general

See Section 7.13 for details on this subject.

9.11.2 Non-ionizing radiation

9.11.2.1 The Non-Ionizing Radiation Law: 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 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 or is conducting negotiations in order to arrive at understandings with the Ministry of Environmental Protection with respect to them. In June, 2012, the Company was apprized of the Non-ionizing Radiation Law Memorandum (Monetary Sanctions) - 2012, which concerns stricter administrative and criminal means of enforcement by virtue of the Non-Ionizing Radiation Law. The Company is studying the provisions of the Memorandum and its implications for the Company.

9.11.2.2 Over the course of the past 30 years, many studies have been conducted in the world for the purpose of the examination of the relationship between prolonged exposure to magnetic fields from domestic electric appliances and excessive frequency of other diseases, and some of the health surveys that have been conducted have revealed findings that indicate a statistic relationship between magnetic fields and leukemia in children. The findings of these surveys have been attacked by various researchers, who argue that they are based solely on estimates and that the statistical correlation that was found was very weak and does not substantiate causality while other health surveys and laboratory tests have found no findings indicative of any relationship. In November 2010, updated directives were issued by the International Commission for Non-Ionizing Radiation Protection (ICNIRP), in accordance with which the maximum value of exposure to a

magnetic field from the electricity grid for the general population is 2,000 milligauss, relating to the known health effects that result from the induction of a magnetic field in the body. 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 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.

9.11.2.3 The 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 Non-Ionizing Radiation law, in regulations that were supposed to be promulgated by January 1, 2007. The Non-Ionizing Radiation Law further states that if no such regulations have been promulgated on matters pertaining to the Electricity Sector until that day, the resolutions of the Supervisor 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 report of the Experts Committee with respect to magnetic fields from the electric grid published on the website of the Ministry of Environmental Protection (hereinafter: the “Expert Committee”). However, such a resolution on matters that have an impact on costs for the Electricity Sector, requires the approval of the Minister for Environmental Protection, the Minister of Energy and Water and the Ministry of Finance. The Expert Committee determined a threshold value for exposure of 1,000 milligauss in relation to short term effects, while at the same time operating the principle of preventive measures 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.

In March 2011, a draft interim report of a public expert committee that was appointed in 2007 following the recommendations of the Expert Committee in 2005 was forwarded for the comments of the Company, within the framework of which, inter alia, target values of a few milligauss were recommended for exposure to magnetic fields from the electricity grid, along with a recommendation to require all electricity facilities to have a construction permit. During the course of 2011, the Company forwarded its initial comments on the draft interim report to the relevant parties.

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. Within this framework, meetings of a team whose members included representatives of the Company and representatives of the Government ministries are held, with the goal of examining the meaning of establishing a threshold value of exposure from a magnetic field from the electricity grid of 4 milligauss on average for the busiest day.

It was noted in correspondence between the Directors General of the Ministry of Health and the Ministry of Environmental Protection 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

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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, the Minister of Energy and Water and of the Minister of Finance.

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.

In the assessment of the Company, according to tests that it has conducted, most of the electricity facilities that it owns comply with the directions of the International Commission for Non-Ionizing Radiation Protection (ICNIRP). The Company is acting to design new facilities in order to avoid exceeding the threshold value above. 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 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.

9.11.2.4 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 2 milligauss is a possible carcinogen and that the recommended average level of 24 hour continuous exposure is to be 2 milligauss, for 12 hour continuous exposure – 3 milligauss, and for 8 hour continuous exposure an average level of 4 milligauss. These values were also cited in various correspondences between the Ministry and the Company and raise contentions and claims 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 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.

9.11.3 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.

9.11.4 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 transmission segment unless specified above.

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

See Section 7.13 for details.

9.11.6 Environmental costs and investments of the Company in environmental protection

In 2013, the expenses of the Company relating to non-ionizing radiation came at approximately NIS 4.9 million out of approximately NIS 6 million which were allocated for the reduction of public exposure to magnetic fields as set forth in Section 9.7.4.1. For additional details, see Section 21.7.
9.12 Restrictions to and regulation of the operations of the Company in the distribution and supply segment

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

In accordance with the Electricity Sector Law, one of the functions of the Electricity Authority is: “the establishment of criteria for the level, standard and quality of the service that is provided by the holder of a license for the provision of essential services.” In the Book of Criteria that was first determined by the Electricity Authority in 2002, and which is updated from time to time, both the rules for transactions between consumers and the Company and the binding charge rates for the various services that the Company provides to its consumers are determined.

See Sections 8.1.2 and 22.1.3.1 for further information on the Book of Criteria.

In addition, the Electricity Authority has determined 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 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, with the exception of that which has been stated above and below with respect to the determination of the reliability of the level of supply. With regard to the determination of the level of reliability in accordance with that which has been stated above, 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 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, not within the framework of the plan to achieve the goal which will be confirmed by it, 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.

The measured downtime per consumer in 2013 was 234 minutes (including the storm of December 2013), and the variance between the areas was 369 minutes (including downtime minutes of the December 2013 storm events). 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 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 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.

99 Resolution No. 6 of meeting 109 dated June 26, 2002 in the matter of “[The] level of reliability in charge rate bases”.
9.13 **Legal proceedings**

See Section 24 to the Financial Statements with respect to details of legal proceedings that pertain to this sphere of activity.
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, 2013, the number of customers of the Company stood at 2,594 thousand, in comparison with 2,557 thousand customers on December 31, 2012, representing an increase of 37.0 thousand customers. The electricity consumption in 2013 was 53,506 million kWh, which constitutes a decrease of 3,579 million kWh in comparison with 2012.

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 for the years ended December 31, 2013 and December 31, 2012. See Note 28 to the Financial Statements for details on the revenues of the Company by customer types.

In the twelve-month (12) period that ended on December 31, 2012, and 2013 (in millions of kWh, and in percentages)

<table>
<thead>
<tr>
<th></th>
<th>Total electricity consumption in percent</th>
<th>2013</th>
<th>Total electricity consumption in percent</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic</td>
<td>29.3</td>
<td>15,662</td>
<td>30.2</td>
<td>17,245</td>
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<tr>
<td>Industrial</td>
<td>19.4</td>
<td>10,372</td>
<td>20.8</td>
<td>11,849</td>
</tr>
<tr>
<td>Public and commercial</td>
<td>33.2</td>
<td>17,752</td>
<td>32.3</td>
<td>18,433</td>
</tr>
<tr>
<td>Water pumping</td>
<td>5.8</td>
<td>3,108</td>
<td>5.6</td>
<td>3,175</td>
</tr>
<tr>
<td>Agriculture</td>
<td>3.6</td>
<td>1,935</td>
<td>3.2</td>
<td>1,836</td>
</tr>
<tr>
<td>East Jerusalem Electricity Company</td>
<td>3.5</td>
<td>1,898</td>
<td>3.2</td>
<td>1,852</td>
</tr>
<tr>
<td>Palestinian Authority</td>
<td>5.2</td>
<td>2,779</td>
<td>4.7</td>
<td>2,695</td>
</tr>
<tr>
<td>Total</td>
<td><strong>100</strong></td>
<td><strong>53,506</strong></td>
<td><strong>100</strong></td>
<td><strong>57,085</strong></td>
</tr>
</tbody>
</table>

10.2.1 The domestic sector – as of December 31, 2013, 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, 2012.

In the year that ended on December 31, 2013, the domestic consumption decreased by approximately 9.2%, relative to the corresponding period during the preceding year. The revenue from the gross sale of electricity in this sector decreased by approximately 4.2% in 2013 relative to the corresponding period during the year that preceded it, because of an increase in charge rates and a decrease 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, 2013 by approximately 3.7% relative to the corresponding period during the preceding year. The revenues from the gross sale of electricity in this sector increased in 2013 by approximately 0.9% relative to the corresponding period during the year that preceded it because of a decrease in consumption and an increase in charge rates. 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** - electricity consumption of the industrial sector decreased by approximately 12.5% in the year that ended on December 31, 2013 relative to the corresponding period during the preceding year. In 2013, the revenues from the gross sale of electricity decreased in this sector by approximately 8.7% relative to the corresponding period during the year that preceded it, because of a decrease in consumption and an increase in charge rates.

10.2.4 **Water pumping** 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 2.1% for the year that ended on December 31, 2013, relative to the corresponding period during the preceding year. In 2013, the revenues from the gross sale of electricity in this sector increased by approximately 3.2% relative to the corresponding period during the year that preceded it because of a decrease in consumption and an increase in charge rates.

10.2.5 **The agricultural sector** – in the year that ended on December 31, 2013, the consumption of the agricultural sector increased by approximately 5.5% relative to the corresponding period during the preceding year. In 2012 revenue from the gross sale of electricity increased by approximately 11.7% relative to the corresponding period during the preceding year because of an increase in consumption and charge rates.

10.2.6 **The East Jerusalem Electricity Company** – in the year that ended on December 31, 2013, the consumption of the sector increased by approximately 2.5% relative to the corresponding period during the preceding year. In 2013 revenue from the gross sale of electricity increased by approximately 6.2% relative to the corresponding period during the preceding year because of an increase in consumption and charge rates.

10.2.7 **The Palestinian Authority** – in the year that ended on December 31, 2013, the consumption of the sector increased by approximately 3.1% relative to the corresponding period during the preceding year. In 2013 revenue from the gross sale of electricity increased by approximately 10.8% relative to the corresponding period during the preceding year because of an increase in consumption and charge rates.

For details of the debt balance of the East Jerusalem Electricity Company see Note 6b 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 (4) 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

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100 Mainly Mekorot, water desalination, local authorities, etc.
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 rates were first instituted in Israel in 1982, and on the date of the report they 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, 2013, the total number of consumers who use the load and time charge rate is approximately 77,836, in comparison with 66,086 consumers as of December 31, 2012. In other words, approximately 3% of the total number of consumers consumes approximately 60% of the total annual electricity consumption.

As of December 31, 2013, the total number of consumers using the “domestic” charge rate is approximately 2.27 million, in comparison with approximately 2.24 million for December 31, 2012. In other words, approximately 88% of the total number of consumers consumes approximately 29.6% of the total annual electricity consumption.
11. **Marketing and distribution**

From time to time, the Company initiates and executes advertising and marketing projects, including with regard to the consumption of electricity, safety, a concept of sustainability and environmental commitment.

The Company’s advertising costs in 2013 amounted to approximately NIS 12.7 million, not including publications required by law, such as: tenders, building and planning, job offers, etc., that amounted to approximately an additional NIS 1.75 million in 2013.

12. **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 60% of the electricity consumption (in accordance with the data for 2012), 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.

See Section 7.7.4 for details on forecast of peak demand for electricity.

<table>
<thead>
<tr>
<th>Breakdown of Revenues, net, for 2013, 2012 and 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>(adjusted to the NIS of December 2013)</td>
</tr>
<tr>
<td>In NIS million</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Q1</th>
<th>Q2</th>
<th>Q3</th>
<th>Q4</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>6,320</td>
<td>6,199</td>
<td>8,398</td>
<td>6,359</td>
<td>27,276</td>
</tr>
<tr>
<td>2012</td>
<td>6,653</td>
<td>6,345</td>
<td>8,455</td>
<td>6,560</td>
<td>28,013</td>
</tr>
<tr>
<td>2011</td>
<td>5,309</td>
<td>5,225</td>
<td>8,301</td>
<td>6,283</td>
<td>25,118</td>
</tr>
</tbody>
</table>
13. **Research and development**

13.1 **General**

The purpose of the expenditures for research and development activity is the development of tools for the maximal utilization and the optimal implementation of modern technologies, for contending with the growing strictness of the environmental requirements (in all of the spheres of operation of the Company) and for the achievement of the reliability of supply objectives, while striving toward the minimization of costs. For this purpose, various research projects are examined and conducted by the Company, including for improvement of the reliability of the supply of electricity and its quality, new technologies to improve efficiency and diversification of the sources of energy and renewable energy, optimal use of soil reserves and other company resources, and conducting research and developing models of environmental aspects that are related to the operation of the Company and improving and streamlining procedures.

In 2013, the Company invested in research and development projects approximately NIS 3.8 million (not including the technology incubator, as stated below), in comparison to approximately NIS 2.5 million in 2012, and in 2014 the Company is expected to spend approximately NIS 4.2 million for these goals (not including the technological incubator as detailed below).

13.1.1 **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 (3) 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 (15) companies (except for two companies whose activity was not successful), within the framework of which the Company has extended a total of NIS thirty (30) 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 (1) 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 6.6 million was included in the budget for 2014. This is required for providing loans to several companies within the framework of the innovative technological ideas, as well as for its regular operations. In 2013, the Company spent an amount of approximately NIS 10.2 million for projects of innovative technological ideas and in 2012 the Company spent NIS 9.3 million.

14. **Human capital**

14.1 **Organizational structure of the Company**

At the start of 2013, the Company underwent organizational changes: a new division was established by the name of “Broadband Communications”, the generation and transmission division was transferred to the customers division and the business development unit, which was part of the engineering project division, was transferred to the customer division.
Field of Activity – Engineering Projects Segment

Roster of employees (positions): 2,191

- Engineering Projects
  - PMO
    - Economic Planning
  - Office
    - Construction
    - Engineering
As of December 31, 2013, 1,105 permanent employees and 1,086 temporary employees (of which 997 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 1,111 permanent employees and 1,068 temporary employees (of which 958 are project - temporary under an arrangement of an “emergent plant” in the performance wing) as of December 31, 2012.

A material change in the volume of manpower employed in the segment did not occur in this period.

These employees are mainly employed in construction and renovation of power stations, and construction of sub-stations and switching stations.
14.2 Employee roster by areas of operation

The personnel roster (number of positions) as of December 31, 2013 is as follows: 12,968 employee positions, in comparison with 12,830 employee positions as of December 31, 2012. As of December 31, 2013, 13,188 employees worked at the Company, compared with 13,067 employees as of December 31, 2012. 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:

<table>
<thead>
<tr>
<th>Field</th>
<th>Employee roster (positions)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>As of December 31, 2013</td>
</tr>
<tr>
<td>1. Generation</td>
<td>2,593****</td>
</tr>
<tr>
<td>2. Transmission and transformation</td>
<td>350</td>
</tr>
<tr>
<td>3. Distribution (marketing and districts)</td>
<td>4,470 *</td>
</tr>
<tr>
<td>4. Headquarters (strategic resources, finances and economics, general administration)</td>
<td>1,569</td>
</tr>
<tr>
<td>5. Service (logistics, security and emergency economy, supply and storage organizations)</td>
<td>1,795</td>
</tr>
<tr>
<td>6. Engineering projects (planning and execution)</td>
<td>2,191 **</td>
</tr>
<tr>
<td><strong>Total</strong>:</td>
<td>12,968</td>
</tr>
</tbody>
</table>

* 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.
*** The increase and decrease, respectively, in the number of employees in the generation field and in the distribution and transformation field derives from an intra-organizational change in the Company, within which, beginning from 2013, the generation and energy division was included in the generation segment instead of the transmission segment.
**** In 2012, the system administration unit was included in the transmission and transformation. In 2013, it is included in the generation and is called generation and energy division.

14.3 Changes in the personnel roster

The personnel roster in 2012 remained without a material change compared to 2011.

14.4 Training and instruction at the Company

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

School of Generation and Transmission Vocations, School of Marketing and Grid Skills, School of Engineering Projects, and the School of Management and Leadership.

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.


14.4.2 **Expenses for training and instruction at the Company:**

The expenses for training and instruction at the Company for 2013 were approximately NIS 55 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.

14.5 **Employee compensation plans, benefits and employment agreements:**

14.5.1 **Employment agreements**

The labor relations in the Company are regulated by the labor legislation and 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.

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 9,850 permanent employees of the Company and 5,380 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 conditions 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 (2) groups: administrative grade staff and professional grade staff (which includes 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 14.5.6 – 14.5.10.

On July 18, 2013, a new collective agreement (salary agreement) was signed between the Electric Company and the Employee Union and the New National Labor Federation. The salary agreement in the Company 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 new salary agreement, the employees are entitled to a salary increment at a rate of approximately 1% (completion to

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101 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.
from July 1, 2013, but the entitlement to receive this salary increment will be postponed and will apply only from January 1, 2015. According to this salary agreement, the actuarial liability has increased by approximately 0.5% with respect to 2012, in comparison to the liability as it appeared in the financial statements as of December 31, 2012. This change increased the liability for pension by approximately NIS 52 million and was recorded in the second quarter against other comprehensive profit and fixed assets. It was further determined in this agreement that beginning from July 1, 2015, the rates of provision by the Company and the deduction from employees for pension fund will be increased by 0.5%.

The 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 determined on this subject until December 31, 2014.

According to the stated 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 that will be determined by the Minister of Finance (up to this date execution instructions as stated have not yet been received). This sum is estimated at approximately NIS 30 million per year. A suitable provision has been included in the statements.

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 an annual salary raise expected in a future salary agreement, which will also be valid for 2013, at a rate of approximately 1% per year. Therefore, it is an expected salary raise for all of 2013 at a rate of 1%. This assessment is determined on the basis of past experience. This accounting assumption constitutes the best assessment for an expected salary raise in a future agreement.

For details 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, see Note 1 e to the Financial Statements.

The above mentioned regarding the expected salary rise in the future salary agreement constitutes forward looking information as it is defined in the Securities Law, and is based on an accounting estimate and evaluation in accordance with past experience and information the Company has as of the date of the report. These estimates may not materialize or may materialize in a different manner and/or in another way, and this is, inter alia, in accordance with the agreements reached by the parties.

14.5.2 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.

Section 185 of the Employment Rules establishes that as a result of the needs of the Company, the management of the Company is allowed to transfer an employee to another position or venue of work, on a temporary or a permanent basis, subject to an agreement with the labor union, without worsening his or her terms of employment or reducing his or her salary.

The issue of the conclusion of the employment of employees of the Company to which the Employment Rules apply is regulated in Sections 200-201 of the Employment Rules. In accordance with what is contained in these sections, the Company may dismiss an employee, inter alia, due to the reorganization of the units of the Company or for any other satisfactory reason, and in any case of dismissal, with the exception of a temporary
employee, the management of the Company will first confer with the labor union and the employee will be
dismissed in accordance with the agreement with the labor union.

In the absence of an agreement with the labor union in the region to which the employee belongs on the matter
of dismissal of an employee at the Company, the differences of opinion will be brought before the labor union
and the management, to the extent that no agreements are achieved at this level, in accordance with the
provisions of Section 223 of the Employment Rules, the issue will be brought forth for negotiation between the
CEO of the Company and the Israel General Labor Federation. The Employment Rules do not include a
mechanism for dispute settlement if no agreement is achieved between the CEO of the Company and the Israel
General Labor Federation.

The provisions of the Employment Rules that have described indicate that the management of the Company is
limited 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 employees with the labor union,
it is possible, in accordance with what is specified, 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 consent
to these measures having been given. See Section 14.8 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.

14.5.3 As a government company, the Company is subject to Section 29 of the Budget Foundations Law - 1985
(hereafter: 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 and Employment Agreements at the Ministry of Finance (hereafter: the “Commissioner
of Wages”) on these matters.

During the years 2001-2012, the Company received a number of letters from the Commissioner of Wages,
including attention to the wage terms of the employees of the Company, pensioners of the Company and next
of kin who are entitled to pension payments, whereby, in the Commissioner’s opinion, a number of wage
components were paid to employees and to pensioners / next of kin of employees of the Company in violation
of the Budget Foundations Law, as a result of which the Commissioner of Wages decided to cancel and/or
change them, and ordered the Company to demand that the employees, pensioners and next of kin of employees of the Company refund them.

At the same time, a dialog was held on the subject between the Company and the labor union and the
Commissioner of Wages. In January 2011, a wage agreement was signed, including, inter alia, the regulation of
wage overruns in the Company, against a reduction of 0.5% out of the total parallel pay rises that were
established in the wage agreement in the public sector, and a further reduction of 0.3% from the previous wage
agreement that was signed in the Company in 2008 was vested. See Note 12 to the Financial Statements
regarding this matter.

In February and March 2012, the Commissioner of Wages and Labor Agreements at the Ministry of Finance
(hereinafter: the “Commissioner of Wages”) approached the Company by power of his authority under section
29 to the Budget Foundations Law, 1985 (that requires his approval for every change in employee salary and
benefits), with regard to 5 issues which for him constitute alleged salary irregularities: increased compensation
for employees in a special agreement, global pension overtime for members of management, overtime payment
not in accordance with actual execution, board and lodging payments and command supplement. In April and
May 2012, the Company delivered its response to these issues to the Commissioner of Wages, detailing its
position according to which these are not salary irregularities but salary components paid according to the law.

Approximately a year and a half after the delivery of the Company’s response, on October 10, 2013, the
Company received a letter from the Commissioner of Wages, including decisions about salary irregularities on
the following subjects:
1) Paying overtime not according to actual execution - the Commissioner of Wages instructs the Company to place external employees according to the work needs of the Company, and not to act in accordance with a memorandum from the Management of the Company of 1990 under which a work day of external employees is 10 hours long. Payment for overtime will be paid only subject to reporting of actual execution and subject to the existence of an arrangement that will enable tighter supervision of the work hours of external employees. He intends to bring his decision to the attention of the board of directors so that it will supervise the manner of execution and allocation of the overtime of external employees.

2) Board and lodging payments - The Commissioner of Wages determines that the Company payments with respect to board and lodging deviate from that which is acceptable in the civil service and are in contradiction to section 29 to the Budget Foundations law and are therefore void. The Commissioner of Wages instructed the Company to adjust these payments to that which is acceptable in the civil service. The Commissioner of Wages intends to demand a return of payments paid in excess to employees starting from October 1, 2010, subject to right to a hearing for the employees within 60 days.

3) Command supplement - the command supplement is paid to various groups of entitled employees of command ranks at various rates. According to the letter of the Commissioner of Wages, command supplement should only be paid in accordance with a collective agreement from 1994, that is - at lower rates than those which some of the employees of various command ranks receive at present. Additionally, in accordance with the letter of the Commissioner of Wages, command supplement should not be paid to managers of deputy division/district manager rank and above. The Commissioner of Wages intends to consider demanding return of payments that were paid to employees in excess from October 1, 2010 and to pensioners from October 1, 2011, subject to right to a hearing for employees and pensioners within 60 days.

4) Global pension overtime - members of the management of the Company (at a rank of division and district managers, and above) receive salary composed as a “comprehensive salary”, composed of a rank value and global overtime value, and are not entitled to a separate payment for overtime. The Commissioner of Wages instructs not to include the global overtime in the pension salary of members of the management of the Company that were appointed after 1996. The Commissioner of Wages intends to consider demanding return of payments that were paid in excess to active management members from October 1, 2010 and to members of management who are pensioners from October 1, 2011, subject to right to a hearing for employees and pensioners within 60 days.

5) Increased compensation for employees in a special agreement - after examining the issue, the Commissioner of Wages decided not to interfere with this payment.

In response to the decision of the Commissioner of Wages, the Labor Union announced a labor dispute and the employee union announced it will take organizational steps. On October 14, 2013, the Company applied to the Haifa Regional Court of Labor with an urgent application, and on October 22, 2013, the Court gave the agreements of the parties the validity of a decision, under which the decision of the Commissioner of Wages will not enter into effect until a decision is reached in the main case that will be submitted in this matter. Additionally, it was agreed that the employee union will refrain from taking organizational steps in regard to the decision of the Commissioner.

On March 10, 2014, the Haifa Regional Court of Labor decided, inter alia, that the consents of the parties of October 22, 2013, under which the decision of the Commissioner of Wages will enter into effect on the one hand, and the employee representatives will not take organizational steps on the other hand, will remain in effect until the fate of the application itself in this action will be decided.

103 See Immediate Report of October 14, 2013 (Reference no.: 2013-01-165468)
14.5.4 Central pension provident fund - as of 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.

14.5.5 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 (hereafter: the "Trust Agreement"). For additional details see Note 3 to the Financial Statements

14.5.6 Permanent employees – As of December 31, 2013, the Company has 9,850 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.

14.5.7 Special agreement employees – As of December 31, 2013, the Company has 981 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 (5) 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 (10) work years.

14.5.8 Temporary employees – As of December 31, 2013, the Company has 1,139 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.

14.5.9 Special agreement temporary employees – As of December 31, 2013, the Company has 1,248 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.

14.5.10 Personal agreement employees – As of December 31, 2013, the Company has 24 personal contract employees, of which 7 with a personal employment agreement approved by the Government Companies Authority – 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 78 trainees and apprentices and 20 scholarship recipients who are working within the “Enlightened Future”105 project (as of the salary data of December 2013) and 23 employees in a training course for the execution division.

14.5.11 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. For example, the Company is bound by restrictions in the employment of relatives and rules with respect to the manner of electing senior officers and the appointment of special functionaries.

14.5.12 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.

14.6 Employee compensation

In general, the Company has no compensation plans for employees who are not senior officers, except the following:

14.6.1 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 Authority106 (in this section – the "circular"), which state, inter alia, that the distribution of a bonus to 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 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 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.

14.6.2 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.

105 "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.

14.7 Compensation policy regarding senior officers at the Company:

14.7.1 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”).

14.7.2 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.

14.8 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”), which was based, inter alia, on the retirement of approximately 2,000 - 2,500 employees and of Corporation staff layoffs that was supposed to be spread out over a period of approximately three (3) 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. 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.

The labor union announced, after presentation of the plan, that it objected to the implementation of the plan and prohibited employees from cooperating on the issue. Later, a few consultation meetings were held, which 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 with respect to organizational changes and economization in the Company.

In December 2011, within the framework of the approval of the budget of the Company for 2012, the Board of Directors of the Company decided to cut 400 permanent posts in the second half of 2012, and stated that a multi-year plan for organizational change and streamlining, “Tnufat Or”, would be started, to be advanced, at top priority, within the realization of the program for the overall reform in the electricity sector. This program was based upon the main aspects of the Matzpen Program and it included structural and organizational changes in the Company, including the retirement of approximately 2,000 employees. This program has not yet been implemented.

Following this decision, sanctions have been initiated in the Company, which ceased, once understandings had been achieved between the CEO of the Company and the labor union, on January 25, 2012, which dealt primarily with: issues of tenure for 2012; the manner of execution of the overtime budget; advancing the implementation of the understanding on trust account sums; and shifts of temporary employee authorizations in the Company.

The decision of the Board of Directors of December 2011, to reduce 400 permanent posts in the second half of 2012, was not executed. In addition, in December 2012, the Board of Directors of the Company reached a decision to reduce 200 permanent posts in 2013, but this move too was not executed, in light of the renewed negotiation process of the reform in the electricity sector, including discussions of an overall efficiency plan.

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, 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.
During the discussions of the Steering Committee, within the efficiency plan, the Company submitted an updated retirement program that will replace, if and as far as it will be approved, the outline of understandings and decisions of the Board of Directors described above. As of the date of the report, this retirement plan of the Company has not yet been agreed upon by the other entities involved in the Steering team and there is no certainty that it will be approved or implemented, and/or if any other plan or understandings will be agreed upon and/or approved or implemented, and what implications this will have for the Company employees. For additional details see section 1.3 and Note 1e to the Financial Statements.

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 multi-year plan for organizational change and economization, with respect to which the Board of Directors decided that it would be performed in any case, may be material.

For details of the recommendations of the Steering Team with regard to the efficiency plan and organizational change see Note 1 e to the Financial Statements.

14.9 Labor disputes
For details regarding labor disputes see Note 34(c) of the Financial Statements.

14.10 The Increase of Enforcement of Labor Statutes Law

On June 19, 2012, the Increase of Enforcement of Labor Statutes Law - 2011 (in this Section: “the Law”) took effect. The Law addresses, inter alia, two main subjects:

One. is the institution of administrative proceedings for the issue of a warning regarding the imposition of a financial sanction on an employer with respect to the violation of provisions of existing labor laws;

The other is imposition of civil and criminal liability on an employer and a party ordering service with respect to the violation of various labor laws in entering commitments for the receipt of services using employees, in the guarding and security, cleaning and dining trades (alongside the establishment of various safeguards that will be available to the party ordering the service in this context).

The Company, which has various agreements with contractors in those trades, has adjusted its existing agreements to the provisions of the Law. Additionally, the Company has retained the services of an accounting firm to perform on its behalf periodic audits of the wages of contractor employees in the aforementioned trades. Such an audit report is one of the defenses that are recognized in the Law for a party ordering a service. The Company has also established an effective mechanism for the investigation of complaints by contractor employees, as required under the Law.

14.11 Additional Provisions Regarding Rights of Contractor Employees in the Field of Guarding and Cleaning

On December 4, 2012, a special collective agreement (the "Public Sector Agreement") was signed between the State of Israel and the new National Labor federation, with respect to the improvement of employment conditions of employees employed by service contractors in the field of cleaning and security. On August 6, 2013, the Employment of Workers by Service Contractors in the Fields of Guarding and Cleaning in Public Bodies Law, 2013, entered into effect, adopting a major part of the determinations in the Public Sector Agreement and implementing them, inter alia, on the Electric Company as of November 1, 2013 (with regard to existing contracts). On July 11, 2013, a collective agreement was signed between the Organization of Cleaning Companies in Israel and the New national federation of Labor, bestowing preferential terms on the contractor workers in the field of cleaning. The validity of a major part of the provisions of the agreement, that adopted some of the principles of the Public Sector Agreement, were stipulated by publication of an expansion order. On February 5, 2014, an expansion order in the cleaning field was signed, expanding the provisions of the agreement of July 2013. The expansion order became effective on March 1, 2013.
15. Fixed assets, land and facilities

15.1 General

The Company owns the assets that it uses (subject to the statements in Section 15.3 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 15.3.

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 (10) 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 2012 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 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 (49) years.
The Company has two head offices in Haifa and in Tel Aviv, as follows:

<table>
<thead>
<tr>
<th>Name and location of the site</th>
<th>Nature and registration of the right</th>
<th>Land area in m²</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Head management offices – Haifa</td>
<td>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.</td>
<td>80,000</td>
<td>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.</td>
</tr>
<tr>
<td>2. Head management offices – HaChashmal St., Tel Aviv</td>
<td>Ownership of the Company is registered at the Land Registration Bureau.</td>
<td>14,540</td>
<td>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.</td>
</tr>
</tbody>
</table>

The Company has eight (8) logistics sites that are located on land used as storage areas, as follows:

<table>
<thead>
<tr>
<th>Name of the site</th>
<th>Location</th>
<th>Type of site</th>
<th>Site area in m²</th>
<th>Nature of the rights</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Giborei Israel warehouse</td>
<td>Tel Aviv</td>
<td>Logistic</td>
<td>8,508</td>
<td>Lease from Tel Aviv Municipal Council</td>
</tr>
<tr>
<td>2. Kiryat Shemona warehouse</td>
<td>Kiryat Shemona</td>
<td>Logistic</td>
<td>3,000</td>
<td>Lease from ILA</td>
</tr>
<tr>
<td>3. Kiryat Gat compound *</td>
<td>Kiryat Gat</td>
<td>Empty compound</td>
<td>3,600</td>
<td>Lease from ILA</td>
</tr>
<tr>
<td>4. North Akko logistic center **</td>
<td>Akko</td>
<td>Logistic</td>
<td>121,572</td>
<td>Lease from ILA</td>
</tr>
<tr>
<td>5. Area for storing equipment trolleys, Jerusalem</td>
<td>Jerusalem</td>
<td>Logistic</td>
<td>775</td>
<td>Rental / authorization from Jerusalem Municipal Council</td>
</tr>
<tr>
<td>7. Leyland logistic center, Ashdod</td>
<td>Ashdod</td>
<td>Logistic</td>
<td>106,000</td>
<td>Ownership</td>
</tr>
<tr>
<td>8. Orot Rabin logistic center</td>
<td>Hadera</td>
<td>Logistic</td>
<td>270,000</td>
<td>Sub-lease from the Caesarea Development Company</td>
</tr>
</tbody>
</table>

** As of the date of this report, the property is in the process of being sold. ** Under construction.

### 15.2 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.

15.3 **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 (hereinafter: “Section 46 of the Concession”).

For additional details see Note 1.f to the Financial Statements. For details of the recommendations of the Steering Team with regard to this subject see Note 1.e 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 respect 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, and it has no certainty that the implementation of the arrangement of the assets, insofar as will be implemented, and the manner and method in which it will be implemented, 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.
16. **Intangible assets**

16.1 **Software**

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.

16.2 **Patents**

As of the date of the report, the Company has one patent, which is in the registration stage in Europe and in Israel, with respect to chemical indicators for identification of hot spots in transformers.

16.3 **Concessions**

The Company owns a license for the use of 20 VHF frequencies, which are intended for use in the DMS project.
17. Suppliers

17.1 General

Suppliers in Israel:

In general, the terms of payment to suppliers, except for advance payments, will be 60-90 days from the date the Company receives a payment request or from the date the Company receives the goods or the service, according to the latest of the two. The fuel suppliers have shorter times according to the type of fuel. According to the instruction of the Head of the Finances and Economics Division (in this section; the “Instruction”), commencing from August 18, 2013, the terms of payment for most of the suppliers (not including fuel suppliers) in new contractual engagements are end of month + 90 days.

Suppliers from Overseas

As aforesaid, in accordance with the instruction, as of August 18, 2013, the terms of payment for most of the suppliers in new contractual engagements are end of month + 90 days.

The Company has a procedure for overseas suppliers, which defines the terms of payment and determines that in general, the payment will be transferred at least 60 days after the determining date according to the source of the payment (equipment, services, advances and liens. Nevertheless, terms of payment of less than 60 days can be determined in accordance with the instructions published by the Finances Division or with a written approval of the Head of the Finances Division, and with signatory authorizations according to the sum of the transaction.

Gas Suppliers

The terms of payment that were set with the “Tamar” Partnerships, the major gas supplier of the Company, are that the payment for receiving gas will be executed within 15 days from the date of the pro-forma invoice.

17.2 Agreements with Material Suppliers

The following table shows the material suppliers of the Company, rates of purchase that in 2012 exceeded 5% of the rate of purchases of the Company from suppliers throughout 2012:

<table>
<thead>
<tr>
<th>Name of the supplier</th>
<th>Raw material</th>
<th>Acquisition rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>The National Coal Supply Corporation Ltd.</td>
<td>Coal</td>
<td>24.71%</td>
</tr>
<tr>
<td>The Tamar Partnership</td>
<td>Gas</td>
<td>17.20%</td>
</tr>
<tr>
<td>VITOL</td>
<td>Diesel oil</td>
<td>7.21%</td>
</tr>
<tr>
<td>BP Gas marketing Limited</td>
<td>Gas</td>
<td>6.14%</td>
</tr>
</tbody>
</table>

See Section 7.10 for details on the Company’s contracts with these suppliers.
18. **Working capital**

18.1 **Credit policy**

18.1.1 **Customer credit:**

The average days of credit for customers in the year that ended on December 31, 2013, is approximately 58.6 days, compared with 55 days in the previous year. The average balance of credit to customers in the year that ended on December 31, 2013, came to a total of approximately NIS 4,622 million, compared with approximately NIS 4,405 million, adjusted to the NIS of December 2013, in the previous year.

18.1.2 **Credit from suppliers:**

The average days of credit from suppliers in the year that ended on December 31, 2013, is approximately 41 days, compared with approximately 32 days in the previous year. The average balance of the credit from suppliers in the year that ended on December 31, 2013, came to a total of approximately NIS 1,651 million, compared with approximately NIS 2,531 million, adjusted to the NIS of December 2013 in the previous year.

19. **Financing**

19.1 **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 (except the return on capital less dividend that was required in accordance with the directive of the Companies Authority) 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 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. For example, the Electricity Authority approved, in its decision of August 8, 2007, a recognized cost addition at a rate of 5% (in relation to the correct recognized cost for July 16, 2007) as of September 9, 2007, for a year or up to the determination of the new charge rate basis for the generation segment, whichever is earlier, which constitutes earlier recognition of the cost of investment. In addition, in the resolution of the Electricity Authority of October 30, 2008, the Electricity Authority recognized the costs for the purposes of the financing of Stage A of the development of the Emergency Plan at a cumulative amount of approximately NIS 2 billion. See Section 7.7.6 for details on the financing of the Emergency Plan, *inter alia*, by recognition of the investment costs in the charge rate.

The recognition was spread over a period of two years from January 2009 to January, 2011. In addition, 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). See Note 9 i to the Annual Financial Statements for further information.

In July 2010, the Board of Directors of the Company resolved to reduce the Company’s debt-to-balance ratio (hereafter: the “Financial Leverage”) to 60% over a period of six years (a reduction of debt which comes to a total of approximately NIS 9 billion up to 2016). However, the gas crisis began during the target period for the reduction, following which the Company had to raise, in 2012, an amount of NIS 8.9 billion with State guarantee for financing the extra fuels cost, which changed the trend of debt reduction under the target determined by the

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107 See the Immediate Report dated August 9, 2007 (Reference No.: 2007-1-352966)
Board of Directors of the Company. As at present, one of the financial objectives of the Company is that the total debt to total balance ratio will gradually decrease to 65%.

It is noted that as of the date of the report, the implementation of the actual structural change has not yet been commenced, in any outline, and there is uncertainty as to the final format of the structural change, the date of its implementation or its implications on the Company, its business and results. The Company management is examining the approval and execution of alternative or additional steps to the steps and decisions that will be included within the outline of the structural change (if and insofar as will be implemented), in order to improve the financial strength of the Company, whether as part of the structural change or whether as separately from it or parallel to it.

The reform process being formulated by the Yogev Committee is discussing, inter alia, the financial strength of the Company and the outline of reducing its debt.

For details see section 1.3 and 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.

19.2 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, 2013, 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.

<table>
<thead>
<tr>
<th>Details</th>
<th>Average interest rate (%) for long term credit</th>
<th>Average interest rate (%) for short term credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank credit sources</td>
<td>2.14</td>
<td>3.06</td>
</tr>
<tr>
<td>Non-bank credit sources</td>
<td>6.02</td>
<td>-</td>
</tr>
</tbody>
</table>

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, 2013.

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.

19.3 Restrictions applying to the Company at the time of receipt of credit

To finance the Development Plan of the Company, the Company will be 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 Company estimates that the provident funds 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. It is further noted that the possible restriction on the publication of a prospectus by the Company, for the issuance of public bonds that are not backed by State guarantee could impact the ability of mutual funds to provide financing to the Company, since most of their assets are required to be invested in marketable securities. For additional details see section 29.2.2.

19.4 Credit that has been obtained from the date of the statements until the date of signing this Report

After December 31, 2013 and until the date of publication of the report, the Company withdrew approximately USD 7 million and approximately EUR 9 million (approximately NIS 69 million) from loans that were received from banks abroad for financing stage B of the emergency project and the emission reduction project.
19.5 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 19.9 below.

19.6 Credit facilities for December 31, 2012

As of December 31, 2012, the Company has no credit facilities that are available for utilization, except for credit lines in negligible amounts.

19.7 Variable interest credit

As of December 31, 2013, the Company has variable credit interest coming to a total of approximately NIS 5,580 million. A breakdown of the variable interest credit that the Company has received follows:

<table>
<thead>
<tr>
<th>Currency</th>
<th>Interest rate range</th>
<th>Interest range in 2012 (in %)</th>
<th>Balance for December 31, 2012 (in millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>High</td>
<td>Low</td>
<td>Original currency</td>
</tr>
<tr>
<td>U.S. dollars</td>
<td>Libor 6m + 2.5</td>
<td>Libor 6m + 0.1875</td>
<td>2.92</td>
</tr>
<tr>
<td>Euro</td>
<td>Libor 6m + 2.5</td>
<td>Libor 6m + 0.325</td>
<td>2.83</td>
</tr>
<tr>
<td>CPI linked NIS</td>
<td>Government bond yield + 0.25</td>
<td>Government bond yield + 0.25</td>
<td>0.45</td>
</tr>
<tr>
<td>Unlinked Shekel</td>
<td>Telbor 6m + 1.15</td>
<td>Telbor 6m + 1.15</td>
<td>3.25</td>
</tr>
<tr>
<td>Unlinked shekel</td>
<td>Bank Israel + 0.51</td>
<td>Bank Israel + 0.49</td>
<td>1.76</td>
</tr>
</tbody>
</table>

Note: Does not include loan for financing the gas transmission project that is not designated for a unique use by the Company.

19.8 Credit rating

The total ability of the Company to fulfill its financial liabilities 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.

19.9 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 follows108.

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108 It should be noted that after the Company examined all of its liabilities for December 31, 2013 (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.
<table>
<thead>
<tr>
<th>Loan / bond contract</th>
<th>Characteristics of the lender</th>
<th>Revalued principal balance as of date of Report</th>
<th>Amortization schedule</th>
<th>Contractual interest and effective interest</th>
<th>Linkage mechanisms</th>
<th>Sureties extended to the lender</th>
<th>Restrictions applying to the Company with respect to the loan</th>
<th>Cross default or cross acceleration clause</th>
<th>Negative charge undertaking</th>
<th>Comments on material conditions to receipt of credit (*)</th>
<th>Material changes that occurred in the loan agreements / credit extension agreement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issue in the USA 05/2008 (GMTN)</td>
<td>Non-negotiable overseas bond</td>
<td>Revalued par value balance NIS 3,471.0 million</td>
<td>Principal will be repaid in one installment on January 15, 2019</td>
<td>Contractual interest 7.25% and effective interest 7.41%</td>
<td>U.S. dollars</td>
<td>Floating charge on all assets of the Company</td>
<td>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</td>
<td>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.</td>
<td>****</td>
<td>****</td>
<td></td>
</tr>
</tbody>
</table>

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 endorser 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
<table>
<thead>
<tr>
<th>Loan / bond contract</th>
<th>Lender characteristics</th>
<th>Revalued principal balance as of date of report</th>
<th>Amortization schedule</th>
<th>Contractual interest and effective interest</th>
<th>Linkage mechanisms</th>
<th>Sureties extended to the lender</th>
<th>Cross default or cross acceleration clause</th>
<th>Restrictions applying to the Company with respect to the loan</th>
<th>Negative charge undertaking</th>
<th>Comments on material conditions to receipt of credit (*)</th>
<th>Material changes that occurred in the loan agreements / credit extension agreement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electricity 2022</td>
<td>Non-negotiable bond in Israel</td>
<td>Revalued par value balance of NIS 3,835.6 million</td>
<td>The principal will be repaid in six equal semiannual installments from July 18, 2020 to January 18, 2023</td>
<td>Contractual interest 6% and effective interest 4.57%</td>
<td>Linked shekel loan (principal and interest) linked to the Consumer Price Index</td>
<td>Floating charge over the assets of the Company</td>
<td>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</td>
<td>Negative charge undertaking, except: (A) floating charges of equal degree (pari passu) or inferior than that of the floating charge given to secure the bond; (B) permitted charges as per its definition in the terms of the bonds</td>
<td>----</td>
<td>----</td>
<td></td>
</tr>
</tbody>
</table>

**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.
20. **Taxation**

On this matter, see Note 22 to the Financial Statements.

21. **Environmental risks and environmental regulation – general**

21.1 For details of the aspects of quality of the environment and environmental risks in each of the operational segments of the Company, see sections 7.13, 8.9 and 9.11 above.

21.2 **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.

21.3 **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 22.9. For details of the integrative licensing procedure see section 7.13.12.

21.4 **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.

21.5 **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.

21.6 **The policy of the Company in environmental risk management**

See Section 7.13 for details on this issue.

21.7 **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 (3) recent years, is as follows. The figures do not include the generation segment for which separate information has been provided in Section 7.13.17, and includes the transmission and transformation segment and the distribution segment and general expenses that may not be attributed to a particular segment.

<table>
<thead>
<tr>
<th>NIS millions (December 2013 prices)</th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total investment in environmental protection facilities, misc. purchases and investments</td>
<td>Approx. 5</td>
<td>Approx. 6</td>
<td>Approx. 8</td>
</tr>
<tr>
<td>Current costs (without depreciation) (fuels, research and development and more)</td>
<td>Approx. 2</td>
<td>Approx. 5</td>
<td>Approx. 9</td>
</tr>
</tbody>
</table>
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 connection with the Electricity Authority, which have no certainty of materialization, in part or in full.

22. Restrictions and control over the operations of the Company

22.1 Provisions of the Electricity Sector Law, relevant regulations, licenses issued accordingly and resolutions of the Electricity Authority

22.1.1 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, and a holder of a generation license for which the Minister has determined 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.

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 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.

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 Section 1.3 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 and the preparations of the Company to implement them.

### 22.1.2 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 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.

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 7.1.3.1 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 (as stated above, see Section 22.1.4 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. It is further stated that as of the date of the report, the Company has not received a notice that it is not complying with any of the terms of its licenses.
22.1.3 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

22.1.3.1 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 –

(1) 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.

(2) 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;

(3) 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;

(4) 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 and the dates of sale. 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. 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 within the electricity demand 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 of 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 August 2011, 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 provides\(^{109}\), 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.

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 2013, 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 900 thousand.

### 22.1.3.2 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 a Development Plan, complete or in parts, for the purpose of its activities in accordance with the provisions of the Licenses, and 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, respectively, 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.

### 22.1.3.3 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 are determined, in most of the cases, in the appendix to the License. In some of the licenses, certain ancillary actions require the approval of the Manager of the Electricity Administration. An action that is not included in

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\(^{109}\) 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
the appendix requires the approval of the ministers, in accordance with the provisions of the Electricity Sector Law.

Therefore, when the Company is going to engage in related activity 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.

22.1.3.4 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 or 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 15.3 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. In a private issue of the bonds (Series 2022) that the Company performed in January 2011, the approval for a floating charge on the assets of the Company, including restrictive conditions. During 2013, the Minister of Energy and Water gave an approval for a floating charge to be placed over the assets of the Company as part of the issuance of debentures abroad under the GMTN plan of the Company, and an approval for a fixed charge over a number of assets of the Company for securing loans that will be provided by a number of banks abroad under a master agreement that was signed with them (the “Minister’s Approvals in 2013”). The conditions that were included in the approvals of the Minister from January, 2011, as stated above, include, inter alia, the following:

- 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 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. Within the approvals of the Minister in 2013, a clarification was added, under which a response from the Minister within 30 days from the date of submission of the application to appoint a receiver will be deemed as the approval of the Minister to the identity of the receiver.

- 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 approval of the Minister to the amendment to the charge that the Company formed to the benefit of a banking corporation, within a credit agreement that it executed in December 2011, included additional restrictive conditions (in addition to the conditions stated above), including:

- 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 banking corporation must inform the Minister in writing of its intent to realize the charge and/or appoint the Receiver and state the identity of the intended Receiver;

- The approval for the realization of the charge, if given, shall be contingent to continued fulfillment of the duties prescribed in the licenses of the Company, including the continued regular operation of the activities in accordance with the Electricity Sector Law, using the assets and facilities of the Company.

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.

Similar terms to the aforesaid have also been included in the Minister’s approvals of the pledging of the Company’s assets by the Company during 2013. For details with respect to debt raisings by the Company during 2013 see Note 20 c to the Financial Statements.

22.1.3.5 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.

22.1.3.6 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 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 to the Company reflecting in the possibility of steps or proceedings being taken against the Company for failure to fulfill the said provisions in its licenses.

The Company estimates that this issue should be regulated within the structural change that will be agreed upon. For additional details see section 1.3.

For details of the recommendations of the Steering Team with regard to reporting under profit center see Note 1.e to the Financial Statements.

22.1.3.7 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.

22.1.4 Cancellation, suspension and change of the terms of the licenses

22.1.4.1 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 of deliberation 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 Law\(^{110}\) 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.

22.1.4.2 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.*

22.1.4.3 In accordance with the Conditions and Procedures for Granting Licenses Regulations, the authority has been vested in the Minister\(^{111}\) 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.

22.1.5 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.

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\(^{110}\) Dated April 11, 2005, which was made within the Economic Policy for the 2005 Fiscal Year Law (Legislation Amendments), 2005.

\(^{111}\) 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.
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 Electricity Authority), 34 (dealing with accounting entry as determined by the Electricity Authority) or 35 (dealing with requiring an essential service supplier license holder to submit to the Electricity Authority reports and any information in accordance with its demands), 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, purchase of electricity from a private producer and provision of infrastructure and Backup Services to a private producer, provision of Backup Services to a self-generation license holder 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.

### 22.1.6 Provisions of the electricity 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 7.1.3.2, 8.1.3 and 9.1.4 for details on the principles for setting the charge rate and the manner of setting the electricity charge rate in each of the segments.

### 22.2 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 issues under dispute between the Company and the Electricity Authority see sub-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.
22.3 Resolutions of the Government

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 22.5). Since 1995 (before the end of the validity of the Concessions) and in the year thereafter, the Government and the Socio-Economic Cabinet adopted various resolutions with respect to the Electricity Sector, including on the issue of the Structural Change in the Electricity Sector. Some of the resolutions were vested in amendments to the Electricity Sector Law, but some were not implemented at all 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. See Section 1.3 for details on the Government resolutions pertaining to the Structural Change in the Company; see Sections 6.5 and 7.4 for details on government resolutions pertaining to the promotion of competition in the Electricity Sector.

22.4 Formation of a team of regulators to increase efficiency and coordinate the regulation of the Company

On May, 2009, pursuant to a Government resolution\textsuperscript{112}, 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 (“the Regulator Team”) for increasing the coordination and efficiency of the regulation of the Company, the 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.

The Ministers have to report once a quarter to the Ministerial Committee for Social and Economic Affairs the progress of the work of the team.

In November 2010, a Government resolution\textsuperscript{113} was adopted to appoint the head of the Regulator Team that was established in accordance with what has been stated, the Director General of the Companies Authority and to attach to the team, in addition to all of the elements detailed in that Government resolution, the Superintendent of the Capital Market or his representative, and the Assistant Attorney General (Economic-Fiscal) or his representative.

It was further decided to order the Regulator Team to act so that a check would be made on its behalf of the following matters:

22.4.1 Recovery of surplus money, to the extent that there is any, that has been transferred by the Company to third parties (the Central Pension Fund, or other accounts that are included in the Financial Statements of the Company, with respect to pension and pension and non-pension components).

22.4.2 The manner of dealing with differences between the assessment of the liability of the Company towards the insured in the statements of the Company and the assessment of the liability in the central pension fund.

22.4.3 Management of the risks and sharing of the responsibility between the Company and the central pension fund in all matters relating to the management of investments of the money of the fund.

22.4.4 Examination of the factors that led to errors in the pension clauses, in the Financial Statements of the Company for previous periods that were corrected in the Financial Statements for June 30, 2009.

\textsuperscript{112} Resolution No. 129: Increase of Competition in the Electricity Sector, dated May 12, 2009.

\textsuperscript{113} Government Resolution No. 2442, dated November 18, 2010.
22.4.5 The factors for the tardiness in the publication of the quarterly and annual Financial Statements of the Company.

22.4.6 Examination of the aspects related to the reserve money of the Company deposited in a trust account for the purpose of payment of various undertakings of the Company for wage components that are not included in the central pension provident fund.

22.4.7 On the matters mentioned above, particularly in Sections 22.4.4 – 22.4.6, the Regulator Team shall operate to the extent that the team decides that coordination is required between the regulators and the Company, via the Companies Authority, inter alia, for coordination between the work that will be conducted by the Regulator Team and additional checks and the lesson-learning process that will be conducted by the Board of Directors and the committees of the Company for identifying the factors accounting for these issues. The team will submit an interim report to the Ministers within ninety (90) days. The interim report will state a date for submission of the final report.

On March 9, 2011, a draft interim agreement was forwarded for the comments of the Company, whose main points are as follows:

(A) Unique arrangements for supervising the decision making with respect to actuarial assumptions that are included in the Financial Statements of the Company must be examined.

(B) Explanations must be received from the Company with respect to accounting rules, accounting options and making out the calculations with respect to the creation of the accounting provision for non-pension elements to an amount of approximately NIS 2.2 billion in the statements of the Company (for December 31, 2009), and it is necessary to examine whether it is possible and correct to transfer the sums that were deposited for these elements to an amount of approximately NIS 1.7 billion (for December 31, 2009) from the trust account to the Company and whether there is a restriction in the transfer to the Company.

(C) Explanations must be received from the Company with respect to the involvement of the Board of Directors of the Company and its representatives in the Board of Directors of the Fund.

(D) The interface between the Board of Directors and the Management, the flow of information and the overarching checks on all matters relating to decision making with respect to the Fund must be examined.

(E) The decisions at the Company and the tools available to it with respect to changes in the articles of the Fund, which affect, inter alia, the deposits into the Fund, compared to the global standard, must be examined while considering the charge rate and cash flow coverage ability of the Company.

(F) The comparison between the rights in the articles of the Fund of 2004 and the rights included in the calculation of the undertaking for pension in the Financial Statements of the Company, compared to the rights that were included in the pension regulations of 1958 and elements that were duly approved after 1958, including the rights included in the pension agreements of 1975 and 1996 and the rights included in the employment and wage agreements in the Company must be completed.

(G) The taxation arrangements related to depositing in the Fund must be examined.

(H) It is advisable to reexamine the meanings of the Property Settlement, in accordance with Section 62 of the Electricity Sector Law - 1996, including, in view of the existing legal and economic expert opinions on the subject and its consequences when implementing the restructuring.

(I) It is proposed that the team establish rules by which each regulator will update the team with respect to the material information before it from the Company and with respect to events or decisions in its fields of responsibility that relate to the Company, which may materially affect its conduct and in particular, insofar as these pertain to the responsibilities of other regulators.

Also, it was written within the draft interim report that it is advisable to determine that the interim report was to be submitted to the Ministers by April 1, 2011, and the summary report be submitted to the Ministers by October 1, 2011.
The Company forwarded its comments to the draft, but as of the date of the report, no summary report with respect to all of the matters described had been received at the Company.

Regarding the recommendation of the Regulator Team concerning the issue of a trust account of non-budgetary pension components, see Section 14.5.5 and note 13 of the Financial Statements.

22.5 **Provisions of the Government Companies Law and status of the Company as a government company**

22.5.1 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.

22.5.2 According to the Government Companies Law\(^{114}\), 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.

22.5.3 The Government Companies Law includes another 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, elaborating the material weaknesses, if any, and including signed declarations of each officer signing the reports, and a report of the independent auditor of the Company that will include his

\(^{114}\) Section 10 of the Government Companies Law.
expert opinion on the effectiveness of the internal control of financial reporting in the Company and material weaknesses that he has identified.

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. 5 b) 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, and not according to the Securities Regulations (Annual Financial Statements) – 2010, although it is 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, commencing on January 1, 2015, the Company will fully implement the International Financial Reporting Standards (“IFRS”). For details with respect to the expected transition by the Company to reporting under the IFRS principles, see Notes 2a and 3e to the Financial Statements. For details of the recommendations of the Steering Team with regard to the transition to IFRS see Note 1 e to the Financial Statements.

The Financial Reporting Regulations determine 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 2a1) 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; it is also 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. 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 to act in accordance with the aforementioned provisions. 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 act in accordance with the provisions of sections 33A and 33B.

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 Companies\(^\text{115}\), 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 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 Government Companies Authority.

(g) Provisions with respect to settlement of disputes between Government Companies regarding infrastructures.

22.5.4 In accordance with Section 55 of the Government Companies Law, the Companies Authority is allowed, 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.

22.5.5 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 this section 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.

22.5.6 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.

22.6 Laws, regulations and other orders applying to the Company as a government company

22.6.1 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

\(^{115}\) Sections 51 – 56 of the Government Companies Law.
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 2013:**

In the reporting year, the State Comptroller published one audit report that indirectly dealt with an audit of the activity of the Company. The State Comptroller Report No. 64 A of October 2013, on the subject of readiness and preparedness for environmental effects of gas and crude oil drilling at sea - the report examines the activity of the Ministry for Environmental protection and the Ministry of Infrastructures, Energy and Water Resources to minimize the environmental risks involved in the activity of prospecting for and producing gas and crude oil in the Mediterranean Sea. The report examines the activity of owners of fuel conveying infrastructures, including the Electric Company with regard to the purchase of the equipment required for their readiness to prevent and treat events of sea pollution. Following the report, the Company purchased the required equipment pertaining to prevention and treatment of sea pollution and the team members were trained in how to operate the equipment.

**(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. In 2013, the Company received 17,552 customer complaints and objections, most of which were on the issue of demands of customers for pecuniary compensation, charges in their accounts and executing works and location of the Company installations, of which 0.8% arrived from the State Comptroller’s Office, and about thirty nine percent were found to be justified.

22.6.2 **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.3 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 the addition of Chapter F1 to the Government Companies Law relating to adequate representation of government company employees.
In addition, the directives of the Attorney General of the Government apply to the Company, including the directives of the Attorney General of the Government with respect to settlement of disputes between the Company and the State.\(^{116}\)

### 22.7 Quality control and quality assurance

22.7.1 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 starting from the stage of preparation of quality requirements in the product specifications that are attached to the purchase requirements during the manufacturing of the product until its receipt at the Company; participation in dealing with non-conformances that are discovered in products that are manufactured for the Company; participation in the processing of products in which a non-conformance is found during the warranty period.

22.7.2 Quality assurance - All of 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 units for the ISO 14001 standard and the OHSAS 18001 standard.

All of the activities of 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.

### 22.8 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.

If it is found that the Company has any construction works, which require such a permit, have not been performed 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 recent years, the Company has not performed construction works without a permit or authorization and its material activity is performed with a permit. These regulations are done for construction works that have been conducted in the past, for which the Company cannot quantity the total works requiring arrangements. However, the Company regulates from time to time items, buildings and facilities that have been erected and/or deployed without a past permit.

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

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\(^{116}\) 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.
the procedural processes for their approval, are carried out in accordance with the provisions of the Planning and Construction Law.

Following a change in the policy of the Ministry of the Interior and the amendment of the outline plan of the Southern District (within amendment 64A to the Local Outline Plan 14/4), from 2004, Electric Company was required to construct all the high voltage lines in a detailed plan and not by an authorization procedure which was customary until this change. The Electric Company petitioned to the High Court of Justice against this change of policy and against the amendment of the Local Outline Plan. Following the suggestion of the High Court of Justice, that the parties attempt to reach a compromise with respect to the appropriate planning outline for constructing 161 kV lines, the parties held contacts resulting in a compromise proposal allowing the formation in the interim period of a number of specific lines through an authorization proceeding, and also enabling the execution of change and maintenance works through an authorization proceeding, subject to certain conditions. Following the achievement of the compromise, a consensual motion was filed to revoke the petition (a resolution for revoking the petition was handed down on May 16, 2012). Following this, an amendment to the outline plan of the Southern District, that will enable the implementation of the compromise in this District, is promoted. In addition, the construction of high voltage lines has been declared as a national infrastructure by the Minister of the Interior, the Minister of Finance and the Prime Minister.

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 7.13.8 and Note 34.b.8 to the Financial Statements.
22.9 Business licensing

22.9.1 In accordance with the Business Licensing Law, the Company is required to receive a business license for about 275 licensable items out of those stipulated in the Business Licensing Order, including, *inter alia*, power stations, fuel stations, dining rooms and other, additional activities. 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.

22.9.2 As of the date of the report, the Company has a license for about 52% of these items only and applications have been prepared or submitted for about 48% of the total items. 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, which activity integrates with the current activity in the execution of adjustments and modifications within the fulfillment of requirements of competent agencies. 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 may reach approximately NIS forty (40) 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 indictments have 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.

22.9.3 The Company has recently received a draft of overarching conditions for the granting of a business license for gas turbine power stations, which was made out by the Ministry of Environmental Protection. This draft has been partly updated pursuant to some of the comments that were made by the Company. According to the updated conditions document, specific conditions are being issued for the new generation units with changes and adjustments regarding each and every site.

See Sections 7.13, 8.9 and 9.11 with respect to environmental conditions within business licenses.

For additional details with respect to business licensing see sections 7.13.11, 7.13.12 and 21.3.

22.10 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 declaration of the Antitrust Commissioner is only declarative and constitutes only prima facie evidence in any legal proceeding. The declaration itself does not serve to change the status of the Company as a monopoly.

22.10.1 The statutory tools prescribed in the Antitrust Law grant the Commissioner, *inter alia*, the power to demand that uniform contracts that the Company executes with customers and suppliers be submitted for approval in accordance with Chapter C of the Uniform Contracts Law 1982, the right 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 administrative penalties in a maximum amount of NIS 24 million with respect to competition inhibiting activities, such as abuse of a monopoly status. 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.
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. 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, including the incorporation of generation units within separate subsidiaries to the extent that these are applied (see Section 1.3), and in light of the notification of the Commissioner with regard to the hearing (see section 7.4.1.1), 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

(C) Consequences of the declaration for the Company as a monopoly over the purchase of electricity from private electricity producers- In the old agreements of the Company with electricity producers, clauses preventing a private electricity producer from selling electricity to others were omitted (following an arrangement with the Antitrust Commissioner dated February 2001), and in new agreements these clauses were not added.

For details of a letter received by the Company from the Antitrust Authority, under which the General Director of the Antitrust Authority in considering whether to order the Company to refrain from a future increase of its electricity generation capability, see section 7.4.1.1.

(D) 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.

### 22.11 Law for Promoting Competition and Reducing Centralization

On December 9, 2013, the Knesset approved the law of centralization. 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.

In accordance with the provisions of the law of centralization, every entity that desires to allocate, renew or extend the licenses of the Company has to consider considerations of centralization of the whole economy and
hold consultations with the committee for reducing centralization. Furthermore, under the law of centralization, if the Company desires to execute an engagement with a third party, to perform the activity that is a field from the fields of essential infrastructure\textsuperscript{117}, the tender committee of the Company will have to consider centralization considerations of the whole economy as part of the approval of the engagement.

In general, the law of centralization is expected to enter into force on December 11, 2014. However, the provisions that relate to the allocation of a new license (including the allocation of a license to the Electric Company) are expected to enter into force on December 11, 2015, and the provisions relating to extension of the validity or license renewal (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 on the Company, and is preparing to act in the matter.

\textsuperscript{117} According to the law of centralization, “a field of essential infrastructure” includes activities in which an essential infrastructure or public resource is being used or within which an essential service is provided to the public. According to the law, the field of activity which requires a transmission, distribution, generation license or management of the system is “field of essential infrastructure.”
23. **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.

23.1 **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 26.3.**

23.2 **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 to the Financial Statements.

23.3 **State guarantee for debentures Series 24 and Series 25 and for loan agreements of the Company**

On May 29, 2012, the Company’s Audit Committee and Board of Directors approved the signing of a guarantee agreement by the Company, pursuant to which the State of Israel provided three (3) letters of guarantee to the holders of the debentures (Series 23)\(^{118}\), (Series 24) and (Series 25) for the payment of the secured liabilities under the aforesaid debentures, which had been issued to the public under a prospectus with an aggregate principal amount of approximately NIS 2.9 billion. Following the approval by the Company’s Audit Committee and Board of Directors on August 23, 2012, the guarantee agreement was amended to the effect that it includes within its scope additional debentures that were issued by the Company in September 2012 by way of expansion of Series 23 and 24 by an additional NIS 1.5 billion. Additionally, with the approval by the Company’s Audit Committee and Board of Directors on November 6, 2012, the guarantee agreement was amended to include within its scope additional debentures that were issued by the Company in November 2012 by way of expansion of Series 24 and 25 by an additional NIS 1 billion (the guarantee agreement, as amended with the approvals of the Company’s Audit Committee and Board of Directors from August 23, 2012 and November 6, 2012, shall be hereafter referred to as: “the First Guarantee Agreement”). The State guarantees provided to the Company under the First Guarantee Agreement aggregate NIS 5.4 billion.

Additionally, on December 24, 2012, the Company’s Audit Committee and Board of Directors approved the signing of a guarantee agreement by the Company, pursuant to which the State of Israel provided four (4) letters of guarantee to four Israeli banks for the repayment of the unpaid balance of the secured liabilities of the Company under loan agreements that have been signed between the Company and the four banks, this in an aggregate amount of NIS 2 billion (“the Second Guarantee Agreement”).

Furthermore, on June 18, 2013, the Company’s Audit Committee and Board of Directors approved the signing of a guarantee agreement by the Company, pursuant to which the State of Israel provided four (4) letters of guarantee to four Israeli banks for the repayment of the unpaid balance of the secured liabilities of the Company under loan agreements that were signed between the Company and the four banks, this in an aggregate amount of NIS 2.4 billion (“the Third Guarantee Agreement”).

The approvals of the Company’s Audit Committee and Board of Directors, as mentioned above, were issued 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 First Guarantee Agreement, the Second Guarantee Agreement and the Third Guarantee Agreement (collectively: “the 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.

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\(^{118}\) It should be noted that as of the date of the report, the debentures (series 23) have been repaid in full.
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 with the Companies Registrar, in respect of each of the Guarantee Agreements, a floating charge in favor of the State on all of the Company’s assets, including the fixed assets and the current 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.
24. **Legal proceedings**

A breakdown of material legal proceedings\(^{119}\) that the Company is a party to, as of the time of the report:

24.1 **Pending actions**

24.1.1 **Class actions**

See Note 34 B-1 to the Financial Statements for information on class actions.

24.1.2 **Derived actions**

See Note 34 B-4 to the Financial Statements for information on derived actions.

24.1.3 **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).

\(^{119}\) 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 as of today, the pretrial hearing is scheduled for May 4, 2014.

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.

(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.

See Section 33(B) of the notes to the Financial Statements for further information on this matter, 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.

(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 (Public Works Department, 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 PWD 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, PWD, 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 February 23, 2011, the Company received a best judgment municipal tax assessment for the Rothenberg Power Station in Ashkelon, with respect to the years 2004-2011, in the total of NIS 566,370,018, after the municipal council had increased the assessment from NIS 43,239,136 to NIS 90,279,624 per year. In addition, the Company was charged retroactive municipal tax payment for the years 2004-2010 for a total of NIS 519,329,530, including a charge for interest and linkage differentials for a total of NIS 215,050,601.

Therefore, on November 15, 2011, the Company filed an administrative petition to the District Court in Be’er Sheva, convening as a court for administrative affairs (Administrative Petition (Be’er Sheva Administrative 28176-11-11) and a filing before the Municipal Tax Administration, within which it contended, inter alia, that the retroactive assessment contravened the law, was without authority and was void. It was contended that the assessment contravened a compromise agreement of 2002 and that the contentions of the municipal council with respect to the significant construction additions in the property were unfounded.

On December 18, 2011, a preliminary discussion was held in which the agreements of the parties were given the validity of a decision, whereby: (A) The municipal tax and petition would be cancelled; (B) the Company would pay NIS 4.5 million (constituting an adjunct to the annual assessment payment prior to the issue of the best judgment assessment) and the attachments imposed by the municipal council would be cancelled. (C) The parties will start negotiations to settle the disputes. If and to the extent that the negotiations fail, the municipal council will be entitled to issue new assessments, and the Company shall be allowed to take legal proceedings.

On April 15, 2012, during negotiations that were conducted between the parties, the municipal council issued amended assessments in an aggregate amount of NIS 496,960,061, which includes a retroactive charge from January 1, 2004 to December 31, 2011 as well as a charge for linkage differentials and interest in the amount of NIS 210,762,585.

On September 8, 2013, a compromise agreement was signed between the Municipal Council and the Electric Company, within which the Company paid NIS 43 million in return for closing all the disputes up to December 31, 2013, both for the Rutenberg power station and for the disputes over the municipal taxes relating to the Ofer substation. It was also agreed on an annual assessment supplement of NIS 6.5 a
year as of 2014 for the Rutenberg power station and on leaving the assessment of the Ofer substation unchanged.

See Note 24 to the Annual Financial Statements for further information on the matter of pending proceedings.

(E) 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.

For further information regarding ongoing procedures against the Company see note 34 to the Financial Statements.
25. Insurance

25.1 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. 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, its employees and other third parties may sustain. It must be noted that the insurance policies usually make an exclusion for damages that originate from acts of terrorism and war. Some of the damages are supposed to be 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.

To the best of the Company’s knowledge, the Minister of Finance appointed a team that was requested, *inter alia*, to reexamine the eligibility of private entities, including government companies, to compensation for damage from war and acts of terrorism, and the team may recommend legislative amendments on this subject.

25.1.1 The principal insured risks

The principal insured risks 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) An all risks insurance 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. In this context, insurance for construction of power stations, construction of a Palestinian substation and other projects may be mentioned.

(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.
26. **Objectives and business strategy**

26.1 **Vision**

26.1.1 **General:**

The Company is aiming at continuing to be the leading business 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 while 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.

26.1.2 **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, and sensitivity to the community and environmental protection.

26.1.3 **Key goals:**

(A) Achievement of a high 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 increasing competitiveness, raising productivity and profitability, introducing technological improvements and identifying additional markets.

26.1.4 **The goals will be achieved through:**

26.1.4.1 **Development**

(A) Increase in 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 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 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.

26.1.4.2 Operation

(A) Adoption of an environmental operation and development policy.

(B) Optimal operation of generation assets, while maintaining economic logic 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.

26.1.4.3 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.

26.1.4.4 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, raising of capital raising for financing of the needs of the Company and increasing the rating of the Company.

(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.

26.2 Company objectives for 2014

(A) Reform – agreement with regard to the structural and organizational.
(B) Electricity supply – continued supply of reliable, available and high-quality electricity, with leading services and environmental responsibility.

(C) Financial strength – reinforcing the Company’s financial position, with an emphasis on its cash flow, increasing liquidity, changing the debt structure and reducing it.

(D) Preparation for competition – continued preparations for the deregulation of the electricity sector, among others by reducing costs in the different segments on the one hand and recognizing the Company costs in the various segments on the other hand.

(E) Broadband communications - commencing access network deployment, connecting first customers and internet service providers and content suppliers.

(F) Business development – taking more business development initiatives in Israel and overseas while creating additional sources of revenue for the Company.

(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 (including units 1-4 at the Orot Rabin power station)

(H) Cyber - protecting critical networks and creating revenues for the Company from the information security field.

(I) Human resources planning and development – continued preparation and 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. Diversified employment: promote hiring of handicapped people and minorities.

(J) Regulation and the image of the Company - improving the interface and the cooperation with the Electricity Authority and the various government offices. Improving the image of the Company.

(K) Sustainability and quality of the environment - entering the age of sustainability while establishing a sustainability plan based on balancing between economic, environmental and social aspects. Continued positioning of the Electric Company as a green company and advancing community involvement and environmental responsibility.

(L) Promoting technological innovation projects, such as: continued promotion of the smart grid project, cloud computing - creating a computerized working environment that is supplied as a service independent of location or physical hardware.

(M) Availability – significant improvement in availability. Reducing overload shedding.

26.3 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. Most of the business development activity is currently directed overseas, mainly to the countries of the former Soviet Union, Russia and Eastern Europe, Africa, India and others.

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 – the sales forecast for 2014 amounts to approximately NIS 185 million (in current shekels).

(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. The sales forecast for 2014 amounts to approximately NIS 32 million (in current shekels).

(D) Effective utilization and renting of the infrastructures of the Company – the sales forecast for 2014 amounts to approximately NIS 45 million (in current shekels).

(E) Other services that are offered by the Company – the sales forecast for 2014 amounts to approximately NIS 44 million (in current shekels).

The total sales forecast in the area of other business ventures for 2014 is estimated at approximately NIS 306 million (in current shekels).

What has been stated above with respect to the sales forecast for 2014 constitutes forward viewing information, as per its definition in the Securities Law, and is based on information that is in the possession of the Company as of the date of the report, as well as forecasts that are based inter alia on past performance and reasonable estimates with respect to the magnitude of the sales and the transactions that are anticipated for 2014, the materialization of which is contingent upon the fulfillment of many conditions, some of which the Company has no control over. Examples of this would include resolutions by the government and/or the regulatory authorities that would prevent the Company from carrying out the execution of various projects in Israel and primarily overseas (including the sale of consulting and engineering services in Israel and abroad), and as a result of this, the Company cannot be certain that its estimates will materialize in full or alternatively will grow as a result of the initiation of new projects, mainly overseas.

For details of the 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 resolutions of the Government of Israel from 2010-2012 regarding the entry of the Company into activity in the field of communications through the establishment of a communication company that will be permitted to use the electricity grid for deploying a stationary infrastructure of optical fibers ("the Communications Company"), a selection committee (composed of state and Company representatives) ("Selection Committee") conducted a process in order to select a private investor that will be the controlling shareholder in the Communications Company ("the Selection Process")

Following the Government resolutions detailed above, 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.
On June 16, 2013, the committee announced the selection of a winning offerer in the Selection Process. According to the results of the Selection Process, the winning offerer, who will be the controlling shareholder of the Communications Company and will hold 60% of its total shares, 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 Communications 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 Company.

The Company and the employee union reached consents pertaining to arrangement of the employee rights with regard to the communications enterprise. Receiving approvals from the required relevant entities is a condition for the parties to sign the agreement. The Electric Company will act to obtain approvals as stated. As at present, the required approvals have not yet been received 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 13.1.1.

(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

120 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).
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. The Authority’s response to said application has yet to be received.

(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.5) to the Financial Statements.

(J) Solar energy project in India

On March 4, 2014, the Company signed a document of understandings with the Hindustan Salts Ltd., a company owned by the Government of India, and with the Sambhar Salts Ltd., which is a subsidiary of Hindustan Salts Ltd. (together: “HSL”), under which the Electric Company will share with HSL its expertise in development and execution of a solar energy project in India at a volume of up to 8000 megawatts. According to this document of understandings, the companies will act, inter alia, to execute feasibility studies for the stated project, and according to the results, the Company will consider signing a final agreement whose terms will be agreed upon by the parties. all subject to the approvals required in the Company and outside the Company.
27. **Financial information with respect to geographic areas**

The Company does not report in accordance with geographic areas.

28. **Event or matter outside of the ordinary business affairs of the Company**

28.1 In September, 2012, a gap was discovered between the forecasted cash flow of the Company that was attached to the Report of the Board of Directors of the Company for the second quarter of 2012, and the internal cash flow that was prepared by the Company during September, 2012. Following the stated gap, and a series of actions taken by the Company in this context as of that time, the Company signed an administrative enforcement arrangement with the Securities Authority on September 30, 2013 (in this section: the “Arrangement”), which does not include an admission of breach of the securities laws by the Company, but includes the Company’s agreement to facts described within the Arrangement, and a commitment by the Company to take upon itself the following enforcement measures: (1) appointing an external supervisor who will be authorized to ensure completion of the formulation and effective implementation of the enforcement plan and the enforcement procedures that were adopted during the process (in this section: the “External Supervisor”); (2) completion of the formulation and adoption of the internal enforcement plan that the Company is formulating, including the adoption of an information flow and update procedure with regard to the financial statements in general and the forecasted cash flow in particular, within nine months from the date of approval of the arrangement (in this matter: completing the writing and approval of the enforcement outline and the enforcement procedures will be regarded as completion of the formulation and adoption of the enforcement plan); (3) a monetary fine in the amount of NIS 5 million will be imposed on the Company, as well as a conditional monetary fine of NIS 5 million. Conversely, the Securities Authority undertook to refrain from taking enforcement procedures with regard to the facts that are the basis of the Arrangement, and this without the Company having admitted that these facts create any negligent acts or breaches, and while maintaining all the rights and arguments of the Company with relation to these facts. On November 28, 2013, the Arrangement was approved by the administrative enforcement committee panel\(^{121}\). The Company is vigorously working to fulfill its commitments in accordance with the enforcement arrangement and effective implementation of the enforcement plan, within which the NIS 5 million fine was paid, the writing and approval of the enforcement outline and enforcement procedures has been completed, and extensive instructions have been conducted with respect to them, as part of assimilating the enforcement plan in the Company. Additionally, the Company appointed an External Supervisor and he has began working.

For details of a letter of demand before submitting a derivative claim, which was received by the Company in relation to the arrangement described above, see Note 34b4) to the Financial Statements.

28.2 For details of the Draft recommendations of the Steering Team that was published on March 23, 2014, see Note 1e to the Financial Statements.

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29. **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:

- Appointment of a Board of Directors’ committee in charge of risk management in the Company: “Budget, Financial Management and Risk Management Committee”.
- Appointment of a management committee for risk management, headed by the Company’s VP Finance and Economics, 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.
- Approval of an organizational risk management structure.
- Drawing up of a master policy for risk management in the Company.
- The Company is currently in the process of formulating detailed policy portfolios for handling the risks that have been mapped in the Company.
- Specification and integration of a risk management IT system.

As of the date of this report, the Company, with the assistance of a risk management consultant, is continuing Stage C of the risk management program, which deals with the development of infrastructures and the implementation of the risk management program policy at the Company level, including, inter alia, the definition and specification of the appetite for risks at the Company level and on the level of the units in the Company, development of risk metrics, review of control processes that are designated to minimize risks, comprehensive risk management at the Company level and on the level of the units and the integration of a risk management IT system. Additionally, the Company executed a new comprehensive risk management survey that was approved by the CEO of the Company and the Board of Directors. The survey will serve as the basis for the mapping of principal processes and the rating of risks as part of the preparation of a multiannual work plan for the internal audit.

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:

<table>
<thead>
<tr>
<th>Classification of the risk factor in accordance with the Government Companies Authority circular of June 11, 2009</th>
<th>Significant effect on the Company</th>
<th>Medium effect on the Company</th>
<th>Low effect on the Company</th>
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<td>Macro risks</td>
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<td>(1) Regulation, corporate governance and compliance</td>
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<td>(2) Security, geopolitical and economic situation in Israel and its surroundings</td>
<td>X</td>
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<td>Strategic risks</td>
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<td>(3) Natural disasters</td>
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<td>(4) Fires</td>
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<td>(5) Market risks</td>
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<td>Financial risks</td>
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<td>(6) Teleprocessing and Cyber Systems and information security</td>
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<td>Operational risks</td>
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<td>(1) Setting of the electricity charge rate</td>
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<td>Compliance and regulation risks</td>
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<td>(2) Debt raising</td>
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<td>(3) Fuels</td>
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<td>(4) The Electricity Sector Law and licenses of the Corporation</td>
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<td>(5) Environmental protection</td>
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<td>(6) Human capital</td>
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<td>(7) Technical failures</td>
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<td>(8) Suppliers and contractual engagements (without fuels)</td>
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<td>Operational risks</td>
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<td>(9) Safety</td>
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<td>(10) Project risks</td>
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<td>(11) Strategic planning</td>
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<td>(2) Causes for calling for immediate repayment and cross violation clauses in existing financing contracts of the Company</td>
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<td>(3) Transition to reporting in accordance with the IFRS rules</td>
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<td>(4) Submission of audited Financial Statements to profit centers</td>
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<td>(5) Competition</td>
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<td>Classification of the risk factor in accordance with the Government Companies Authority circular of June 11, 2009</td>
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<td>High</td>
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<td>Significant effect on the Company</td>
<td>Moderate effect on the Company</td>
<td>Slight effect on the Company</td>
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(6) Planning of Development and advancing the development program in the generation and transmission segments

(7) Structural change

(8) Asset arrangement

(9) Legal

(10) Customers

(11) Labor relations

(12) Liabilities for pension fund

(13) Generation array management

(14) Planning and implementation of the development program in the distribution segments

(15) Image

(16) Organization and quality

(17) Embezzlements and fraud

29.1 Macroeconomic risks

29.1.1 Regulation, Corporate Governance 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 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 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, the relevant regulations published and the circulars of the Securities Authority (pursuant to it being a reporting entity) and regulations related to business licensing, planning and construction and environmental protection (see Sections 7.13, 8.9, 9.11 and 21). See Section 22 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 22.10.2(b).

Regarding the internal enforcement plan executed by the Company on the subject of securities laws see section C.4 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.

29.1.2 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 threats made by various entities to carry out terror acts that may lead to security tension in the area, and the ongoing tension with Iran.

Security events, such as the deliberate explosions at the gas pipe in Egypt which led to disruptions in gas supply and a complete cessation of the gas supply from this source, may impair the activity of the Company in each of its segments, including in 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 7.10.5). 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. These damages are supposed to be covered by a special fund that the State of Israel extends for compensation due to terrorist and wartime damages and that was established pursuant to the Property Tax and Compensation Fund Law. However, there is a dispute between the Company and the property tax authorities with respect to payment of war damages, and the issue is under adjudication. To the extent that 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 or that it expects to receive, this may have an adverse effect over the outcomes of the Company.

29.1.3 Natural disasters

The Company and its facilities are exposed to natural hazards such as floods, tsunamis, storm, strong winds, snow, earthquakes (that may cause the materialization of other disasters such as explosion, fire and additional safety and security risks) and other natural disasters that may affect its facilities and harm the Company 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 sector subcommittees operate, which deal in the planning and execution of the preparations of the Company for these events. The steering committee has established a multiannual work plan for coping with natural disasters, including execution of seismic studies at some of the sites of the Company, within which weak points were identified and recommendations for executing reinforcements and anchoring and reduction of damages were delivered, and following them work plans for executing the recommendations were prepared, and their implementation exists at various stages in the Company installations.

Within the preparations of the Company for winter ((natural disasters, snowstorms, strong winds), the following actions were executed: preparations for peak demand in the division units, maintenance of substation units, transmission and distribution lines according to the work plan, refreshing division procedure about activating operation headquarters of the division in a stress crisis situation. Examinations were carried out for preparedness to operate situation rooms in the division units, and an exercise of preparedness for winter including the examination of supporting information systems was performed.

In the winter of 2013, an irregularly powerful storm hit the country, causing a lot of damage to the electricity grid and leading to disruptions in the electricity supply across the country. While drawing conclusions, the Company decided to take extensive steps to improve the preparedness of the Company in dealing with natural disasters, such as: advance preparation of plans to receive employees from other districts and units for reinforcing teams that handle the damage from the disaster, promoting plans to renew old grids, increased pruning inspection, expanding the installation of network automation means (DMS), examining procedures of network planning and updating them if required, etc.

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, which the Company may be charged with in accordance with the insurance policy of the Company.
29.1.4 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.

It should be noted that 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.

In August 2011, an instruction of the chief fire commissioner was received for the power stations that included fire safety requirements that the firefighting city unions in various areas around the country would demand of the power stations. There are parallel instructions for substations and fuel sites.

29.1.5 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.

29.1.6 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: establishing 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.
29.2 Industry level risks

29.2.1 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 7.1.3.2 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 of the Company; 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.

The Company has no ability to assess the time of setting the new charge rate bases for these segments or the volumes of the property and costs that will be recognized for it, once recognized. These facts have a material adverse effect over the financial status of the Company. See Note 3a to the financial statements for details on the resolutions of the Electricity Authority dated March 2012 and May 2013 with respect to recognition in addition to the recognized cost of the transmission and distribution segments for 2012 and 2013.

See Section 7.1.3.2 for details on the applications of the Company to the Electricity Authority with respect to various issues that are related to the electricity charge rate.

29.2.2 Raising of capital and financing

The Company has needs of financing and debt raising to significant magnitudes, inter alia for financing the development plans and due to the need to recycle existing financial liabilities.

Debt raising by the Company is carried out through loans from Israeli and foreign financial institutions (including loans secured by export credit agencies and secured by the State of Israel), 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 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 credit rating of the Company, the business success of 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), the economic, security, legal and political terms, the geopolitical situation in Israel, the privatization policy of the Government and the support the Government gives the Company. In addition, insofar as the credit rating of the Company will be damaged, it may have a material negative impact on the value of the Company debentures and 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.

In addition, it should be noted that according to the announcement of the staff of the Securities Authority to the Company, as long as the Company intends to issue debentures that are not fully secured by guarantee of the State of Israel, as long as the uncertainty, with respect to the effect of the asset arrangement and the structural change of the Company, exists, the Company will be required to describe with further detail the financial exposure with respect to the repercussions of these subjects on the Company, in a manner that will satisfy the staff of the Securities Authority with regard to the format of the discovery. Therefore, as of the date of the
report, there is uncertainty as to the ability of the Company to publish a prospectus for issue of public debentures in Israel that are not backed by State guarantee.

29.2.3 Fuels

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 7.10.5.

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 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 7.10.9.2 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.

29.2.4 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 22.1.2. 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, including the terms 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 22.1.3.6, the Company is materially complying with the conditions of the licenses that have been given to it and the Company has not received any notice that it is not complying with any of the terms of its licenses.
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 22.1.2, the licenses of the Company will remain in effect through to January 1, 2015. This is in view of Amendment No. 12 to the Electricity Sector Law. An additional extension of the licenses until January 1, 2016 will require an order to be issued by the Ministers after consultation with the Electricity Authority and the Companies Authority and with the approval of the Economic Affairs Committee of the Knesset. This authority of the ministers to extend the licenses by order is limited to one period that will not exceed one year. According to the wording of the Electricity Sector Law, the extension of the licenses of the Company to a date later than January 1, 2016 will require a legislation amendment.

Based on past experience, the Company estimates that its licenses will be extended for additional periods, but in view of the uncertainty with regard to the implementation of the structural change, there is no certainty if, for what length of periods and under what conditions its licenses 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 implemented.

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.

29.2.5 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 7.13, 8.9, 9.11 and 21 for details on environmental protection instructions that apply to the Company and their consequences for it.

29.2.6 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 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.
29.2.7 Technical failures

A risk of technical failure is a risk of malfunction of equipment belonging to the electricity chain segments in a sudden manner and not as a result of expected erosion or amortization.

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, 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 and adjusting to competition. This policy may have some adverse effect on the reliability of the equipment.

29.2.8 Suppliers and Contractual Engagements (without fuels)

See Section 7.10.5 for details on the risk that derives from the fact that most of the fuel that is purchased by the Company is imported from abroad and acquired via agreements of limited validity, particularly in wartime and during other disruptions.

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.

29.2.9 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. However, 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.

29.2.10 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 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, harm to the financial position of the Company.

29.2.1 Strategic planning

The risk of strategic planning, including structural changes, competition, etc., relates to the inability of the Company, due to internal or external factors, to formulate and execute a strategic plan that suits the Company’s duties and assignments, the business environment of the Company and the expected changes in it, mainly due to uncertainty involved in these issues.

Within the Company's handling of this risk, a formulation of a strategic plan has begun, through consultants, as part of an adaption to changes that are occurring in the business environment.
29.3 Risks that are unique to the Company

29.3.1 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, inter alia, disruptions in the supply of natural gas which may cause the Company to operate the generation system with alternative, more expensive fuels. The expected financial damage from the occurrence of such events may be significantly higher than the fuels costs that are recognized for the Company at the rate basis, in accordance with the time gap between the date on which the monetary damage as stated was caused to the Company and the date on which the Company will be compensated with respect to these expenses within the framework of the rate.

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 order to enable the financing of the electricity sector development programs and recycling the debt, while maintaining a current cash reserve (safety cushion) in accordance with the decision of the Board of Directors.

In addition, 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.

According to the decision of the Board of Directors, the Company has an adequate cash reserve of approximately NIS 2.2 billion, as well as surplus inventory of diesel oil and fuel with a value of up to NIS 800 million in order to deal properly with risks that may adversely affect the liquidity of the Company.

29.3.2 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, 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. The volume of the financing agreements that include a MAC Stipulation comes to a total of approximately NIS 21,556 million as of December 31, 2013.

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). These financing contracts of the Company, that include a cross default condition, total approximately NIS 21,165 million as of December 31, 2013.

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). These financial contracts of the Company that include a cross acceleration condition total approximately NIS 4,618 million as of December 31, 2013. It is clarified that notwithstanding that some of the financing contracts that have a cross default condition also include a cross acceleration condition, the cross default sections in any case tacitly also include cross acceleration sections, and therefore while counting the extent of the financial contracts that include cross acceleration sections, only financing contracts that include cross acceleration sections, and not cross default sections, were taken into account.
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 Section 19.5 and Note 20d) to the Financial Statements for details.

**29.3.3 Transition to reporting in accordance with the international financial reporting standards (IFRS)**

As described in Notes 2.A.5) and 3.E 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 commencing on January 1, 2015, the Company will begin to fully report under the IFRS standards, and the transition date will be beginning from 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.

The Company approached the relevant authorities for the execution of an adjustment to the rate so that it will be adjusted to the transition of the Company to nominal reporting under the full international standardization. In addition, the Company is of the opinion that the transition to complete implementation under the IFRS should be accompanied by an appropriate rate or accounting solution.

It is noted that although the full transition to reporting in accordance with the international standards may cause a very 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 received in the electricity charge rate.

**29.3.4 Submission of audited Financial Statements to profit centers**

The Company as an essential service supplier is required, in accordance with the Electricity Sector Law and the relevant regulations to submit Financial Statements in a form as prescribed by the Ministers. In addition, the licenses of the Company state, *inter alia*, that it must 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. The Company manages its activities as separate profit centers but does not submit audited Financial Statements to profit centers as required in most of its licenses and does not submit audited annual Financial Statements separately for each area, for each activity, for each generation unit or power station.

Within the discussions with respect to the Structural Changes in the Electricity Sector, a possible outline has been formed between the representatives of the Ministry of Finance and the Ministry of National Infrastructures, Energy and Water, the Labor Federation, the labor union and the management whereby 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. In addition, a steering team was appointed on July 22, 2013, to execute a reform in the electricity sector and the Electric Company. For details of the work of the Steering team and its recommendations’ draft see section 1.3 and Note 1 e to the Financial Statements.

Therefore, the Company estimates that this issue is supposed to be regulated as part of the Structural Change. However, as set forth in Section 1.3, there is no certainty as to whether the Structural Change will be applied in accordance with the Outline of Understandings or with another outline. However, 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 revolved, there is exposure in the form of steps or proceedings that may be taken against the Company for failure to fulfill the provisions stipulated in its licenses.
29.3.5 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 whose aim is to increase 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 in the sector involves financial risks to the Company, as it 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 the generation capacity 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. Upon the entry of private producers in significant volumes, the Electricity Authority established principles for the recognition of costs for an essential service supplier for agreements for purchasing electricity, but there is no full certainty that the charge rates will be updated in accordance with the estimate of the Company, and to the extent that they are not updated as above, this may lead to an adverse effect on the outcomes of the Company.

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 recommendations of the Steering Committee see Note 1 e to the Financial Statements.

29.3.6 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 of Energy and Water Resources 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 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 and the entry of private energy producers to the Electricity Sector. 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.

The execution of the Development Plan requires material capital investments, as stipulated in Sections 7.7.7 and 7.7.9. 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. Accordingly, to the extent that the Company is unable to raise debt from external sources for the purpose of executing the Development Plan, there is no certainty with respect to its ability to execute the Development Plan.

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 recommendations of the Steering Team with regard to the investments plan see Note 1 e to the Financial Statements.

29.3.7 Structural Change

As described in Section 1.3.1, the purpose of the Electricity Sector Law is to regulate the activity in the Electricity Sector to the benefit of the public, while forming conditions for competition in the Electricity Sector in Israel.

Section 1.3 above shows an outline for structural change in the Electricity Sector, which is reflected by the provisions of the Electricity Sector Law, Government resolutions with respect to the implementation of the reform in the Electricity Sector were presented, and an Outline of Understandings that was formed in 2010 with respect to a structural change in the Company was presented. As has been elaborated in Section 1.3, this outline has not yet been examined or approved by the competent government agencies and does not correspond with the provisions of the Electricity Sector Law. On July 22, 2013, the Finance Minister and the Minister of Energy and Water Resources appointed a steering team, to perform a reform in the electricity sector and the Electric Company, whose assignments are, inter alia, to examine the optimal structure for the electricity sector and the Electric Company, and to suggest a comprehensive reform in the Company and the electricity sector. For details of the work of the Steering Team see Note 1 e to the Financial Statements.

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 market share of the Company in that activity.

If the provisions of the Electricity Sector Law are not changed (including the need to implement the Outline of Understandings or the recommendations of the steering team) and/or the agreements required for the implementation of the Outline of Understandings or the recommendations of the steering team 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.

As of the date of the report, there is 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. For additional details also see Note 1 e to the Financial Statements.
29.3.8  Asset arrangement

As described in Section 15.3, 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 (which were attached to his letter to the Company) with respect to the asset arrangement. The opinion by the State further stated that part of the assets were in the possession of the State on the date on which the Electricity Sector Law took effect, with all of the resulting implications. 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.

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 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. To the best of the Company's knowledge, as of the date of the report, the Ministers have not yet formulated any decisions whatsoever on the subject of the assets. 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 raised the subject of the assets arrangement with the steering team as a subject that requires regulation and it expects that the subject will be discussed and arranged within the discussions of the structural change. It is the understanding of the Company that the State entities are formulating their position on the subject and checking various possibilities to handle the subject within the handling of the financial strength of the Company. See Section 15.3 and Section 1f to the Financial Statements for details on the Asset Arrangement. See Section 1.3 and Note 1e to the Financial Statements for details on the Structural Change, the work of the Steering team and the draft of its recommendations.

29.3.9 Legal

As of the time of this report, 10 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 9 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 24 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.
29.3.10- 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. The Company is acting on the issue of collection enforcement using “red light” information\(^{123}\) with respect to deterioration in the business status of its strategic customers\(^ {124}\), which is received on a regular basis from the business information companies and is transferred to the districts of the Company.

29.3.11 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).

On October 10, 2013, the Company received a letter from the Commissioner of Wages, including decisions with respect to salary irregularities in 4 issues: overtime payment not in accordance with actual execution, board and lodging payments, command supplement and global pension overtime. The Labor Court determined that the stated decision by the Commissioner of Wages will not enter into effect until a decision is reached in the main case to be submitted in this matter. A hearing of the main case with regard to the decision by the Commissioner of Wages was scheduled for March 10, 2014. At the same time, the Labor Court determined that the employee representatives should refrain from taking organizational steps in all that concerns the decision of the Commissioner of Wages.

On March 10, 2014, the Haifa District Court of Labor\(^{125}\) decided, inter alia, that the consents of the parties of October 22, 2013, under which the decision of the Commissioner of Wages will not enter into effect and the employee representatives will not take organizational steps, will remain in effect until the fate of the application of this case will be decided.

The decision of the Commissioner of Wages may have a material effect on the labor relations array in the Company as well as on the cooperation between the employee organization and the steering team for executing a reform in the electricity sector and the Electric Company.

For additional details of the examinations of the Commissioner of Wages see Note 12 g to the Financial Statements.

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

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\(^{123}\) 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).

\(^{124}\) 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.

\(^{125}\) See Immediate Report of March 10, 2014 (Reference no.: 2014-01-010059)
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.

In view of the fact that subjects remained open and the consents of the parties have not yet been received with regard to them, and the draft of recommendations of the Steering Team dealing with the reform in the Electric Company and the electricity sector was published on March 23, 2014, without reaching conclusions on these issues, as a result of the team halting the discussions and publishing its draft of recommendations without consents and in advance preparation for a situation in which there will not be an agreed reform, the Company decided to take a number of administrative steps regarding various salary issues.

(For additional details of the notice of the Company CEO of halting the automatic rank grant and cancelling the advanced studies of the Human Resources Division, and the notice of the employee union about taking a series of sanctions (without disrupting the electricity supply) aimed at disrupting and interfering with the proper work process of the Company, see Note 34c.11).

29.3.12 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.

29.3.13 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.

29.3.14 Planning and Implementation of the Development Plan in the Distribution and Transmission Segments

Natural disasters, fires near lines, security events, human errors, disruptions and breaches in information systems and loss of measures of remote command and control may obstruct the transmission, transformation and distribution array of the Company. Failures in the transmission, transformation and distribution system may
sometimes cause chain reactions that will incapacitate power stations from regular operation and develop into blackout events, which could cause the Company material losses and harm its image.

29.3.15 Image

The image surveys that have been conducted over the years indicate that the image of the Company in the public mind is perceived as medium to low. The low image may intensify, according to the estimate of the Company, in special circumstances, mainly in circumstances of a crisis in the national economy or protest against the cost of living in the State of Israel, of the kind that has occurred since the summer of 2011 and that was directed against the increase in the fuel and electricity prices in Israel. To help consumers, the Electricity Authority updated in its resolution dated March 2012 the electricity charge rate by a three year mechanism for 2012-2014, spreading the cost of the fuels in a mechanism that would allow for checking of the increase in the charge rate for the public. The raising of the charge rate has relieved the cash flow burden sustained by the Company, to a certain extent, because of the need to purchase alternative and more expensive fuels due to the lack of Egyptian gas and the significant reduction in the natural gas supply from the Yam Tethys partnership, but has not prevented the cash flow difficulty of the Company. The continued implementation of the spreading mechanism of the fuels cost as detailed above, including the raising of charge rates in 2013-2014 could intensify the low image of the Company in the eyes of the public.

29.3.16 Organization and Quality

Flaws in information flow between various factors in the Company and inter organizational bureaucracy make it difficult for information transfer and flow as well decision making.

- Company procedures include clear procedures for inter organizational reporting of the events in the Company, and reporting them to external entities.
- The above mentioned including “Information Flow in the Company” procedure as an arrangement for an immediate report of an exceptional event and the information flow with respect to special events (such as operating a new generation / transformation facility).
- The Company obtains every year, for all of its units, the ISO 9001 quality standard, after a thorough examination by the Institute of Standards.
- The Company continuously examines the work processes while proposing improvements, the organizational structures, manpower permanent posts, and the permanent standards for the required physical resources (vehicles, mobile mechanical equipment, communications, etc.).

29.3.17 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.

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 the Company estimates that it will be completed during 2014. In addition, the CEO of the
Company has given his approval to the program outline.
30. **Forecast of investments required for the execution of development plans for acquisitions and investments (which are not associated with a specific segment)**

In line with the draft of the financial planning for 2014-2018, which has not yet been approved by the board of directors, the average investment in the years 2014-2018 is NIS 0.6 billion, at December 2013 price. As of December 31, 2013, a total of NIS 0.6 billion, in current prices, was invested.

31. **Additional details in accordance with circular 2011-5-1 of the Government Companies Authority**

31.1 **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.

31.2 **Disclosure with respect to investee corporations**

Details with respect to held corporations follow:
Name of the
Company

Country and Rights of the Company in the
place of
Company (including means and
incorporation 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 2013
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

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Adv. Dudu Yahav, the legal adviser
and secretary of the Company,
serves as the legal adviser and
secretary of the held corporation.
He receives no additional
127
compensation for this service .

None.

No general meetings were held
during 2013.

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Adv. Dudu Yahav, the legal adviser
and secretary of the Company,
serves as the legal adviser and
secretary of the held corporation.
He receives no additional
compensation for this service as
129
stated .

There is no material agreement for No general meetings were held
the Company. Migrashei
during 2013.
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.

Jordan
Israel
Properties
Company Ltd.

Fully owned (99.98%) subsidiary .
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.

Migrashei
Hakablanim
Ltd.

A fully owned (100%) subsidiary .
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.

Israel

126

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.
As of the date of the report, the Company is working on obtaining approval to appoint directors on the part of the held company.
128
630 deferred shares are held by officers in trust for the Company.
129
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.
127

203


<table>
<thead>
<tr>
<th>Name of the Company</th>
<th>Country and place of incorporation</th>
<th>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)</th>
<th>Names of the officers and other representatives who are serving or have served on behalf of the Company in the Company in 2013 and the compensation from the held corporation for this service</th>
<th>Material agreements between the Company and the held corporation, including guarantees to third parties for securing the liabilities of the Company</th>
<th>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</th>
</tr>
</thead>
<tbody>
<tr>
<td>The National Coal Supply Company Ltd.</td>
<td>Israel</td>
<td>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. Out of the nine members of the Board of Directors, six are representatives of the Company and three of the State.</td>
<td>Yaakov Hain, the Assistant CEO and Deputy Customers, serves as the chairman of the Board of Directors of the held company. 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. Furthermore, 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 this service. In addition, from January 2012, Adv. Shai Almalh, an employee of the Company, has been serving as a legal adviser of the held company. Did not receive and does not receive additional compensation for this service.</td>
<td>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 7.10.6 for details on the agreement.</td>
<td>2013 – ordinary general annual meeting – approval of the Financial Statements as of December 31, 2012, approval of appointment of the Haikin, Cohen, Rubin &amp; Co. offices as the auditing accountant of the company starting on January 1, 2013. November 28, 2013 - extraordinary annual general meeting – approval of the distribution of a dividend.</td>
</tr>
<tr>
<td>Name of the Company</td>
<td>Country and place of incorporation</td>
<td>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)</td>
<td>Names of the officers and other representatives who are serving or have served on behalf of the Company in the Company in 2013 and the compensation from the held corporation for this service</td>
<td>Material agreements between the Company and the held corporation, including guarantees to third parties for securing the liabilities of the Company</td>
<td>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</td>
</tr>
<tr>
<td>---------------------</td>
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<td>-------------------------------------------------------------------------------------------------</td>
<td>-------------------------------------------------------------------------------------------------</td>
<td>---------------------------------------------------------------------------------</td>
<td>---------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>The Managing Company of the Advanced Studies Fund of Israel Electric Corporation Ltd., Employees Ltd.</td>
<td>Israel</td>
<td>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%)</td>
<td>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.</td>
<td>None</td>
<td>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.</td>
</tr>
<tr>
<td>Name of the Company</td>
<td>Country and place of incorporation</td>
<td>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)</td>
<td>Names of the officers and other representatives who are serving or have served on behalf of the Company in the Company in 2013 and the compensation from the held corporation for this service</td>
<td>Material agreements between the Company and the held corporation, including guarantees to third parties for securing the liabilities of the Company</td>
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</tr>
<tr>
<td>---------------------</td>
<td>----------------------------------</td>
<td>-------------------------------------------------------------------------------------------------</td>
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<td>-------------------------------------------------------------------------------------------------</td>
<td>-------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>The Energy Resource Development Company Ltd.</td>
<td>Israel</td>
<td>The Company holds 40.00% 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</td>
<td>To the best of the Company’s knowledge and as of the date of the report, the company is inactive.</td>
<td>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.</td>
<td>No general meetings were held during 2013.</td>
</tr>
</tbody>
</table>
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, 2014
Chapter B

Board of Directors’ Report on the Status of the Company's Affairs

For the Year Ended December 31, 2013
Prominent Disclaimer

This English translation of the "Company's Board of Directors' Report on the Status of the Company's Affairs" for the year ended December 31, 2013 ("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.

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, 2015. 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 as of December 31, 2013 (hereinafter: the “Financial Statements”).

   b) **Condensed Review of the Changes in the Business Environment**

   1) One of the measures taken by the Management of the Company as part of the conclusions from the cessation of the Egyptian gas supply was the increase of the cash balance (safety cushion) to a sum of NIS 3 billion. In a decision by the Board of Directors on the subject, on November 5, 2011, it was decided that the increase will be executed gradually, up to the end of the second half of the year 2013. On February 27, 2014, the Board of Directors of the Company approved that the safety cushion of the Company will be NIS 2.2 billion and that the fuels inventory up to a value of NIS 800 million will be a completion to the sum of NIS 3 billion.

   2) The supply of liquid natural gas (“LNG”) to the Company from the gasification ship leased by the Company started on January 26, 2013. In October, 2013, the Company extended the contractual engagement with the Hadera Gateway LLC to lease the gasification ship until October 2017 (a total of 5 years). Use of LNG is carried out only during a stoppage/failure in the supply of gas from the Tamar field or in peak times.

   For additional details see Note 34 a 3 to the Financial Statements.
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)

3) The production of gas from the “Tamar” gas wells started on March 30, 2013. Until June 30, 2013 (hereinafter: the “Date”), the start of the gas flow and the burning of the gas is part of the running in of the production and delivery system to check their normal operation.

The gas quantities that will be supplied from this Date are according to the provisions of the agreement.

Commencing from this date, the binding period regarding ‘Take or Pay’ began, and fines will be imposed on the “Tamar” Partnerships (Shortfall) if they do not meet their contractual obligations with respect to the provision of hourly quantities in accordance with the provisions of the agreement.

The supply of natural and liquid gas enables the Company to utilize the advantages of natural gas in both the economic and environmental fields and reduces the use of more expensive alternative fuels. For additional details see Note 34 a 1 to the Financial Statements.

4) On March 21, 2013, the Board of Directors discussed the subject of the non-allowance pensionable components trust account and after reviewing the subject decided that the Company will turn to the Trustee and direct him to transfer the funds in the trust account to cover the deficit in the Central Pension Provident Fund for allowances and/or to refund the Company (subject to a court appeal as described below).

It was also decided that the money which had accumulated in the trust account for the non-allowance components listed in Annex A to the 1996 agreement for the first generation employees and which are designated to cover the payments to these employees and pensioners will remain in the trust account will be used for the above stated purpose.

On May 20, 2013 the Company filed a request with the Central District Court to implement the decision of the Board’s plenary session dated March 21, 2013.

On October 10, 2013, a Court hearing was conducted regarding the said application of the Company, and at present, the case is still pending in Court.


5) Following that stated in the Immediate Reports of the Company of September 24, 2012 (Ref. no. 2012-01-244725), of November 1, 2012 (Ref. no. 2012-01-270201), of November 25, 2012 (Ref. no. 2012-01-289041), of December 12, 2012 (Ref. no. 2012-01-308979), of June 10, 2013 (Ref. no. 2013-01-061179), and of June 11, 2013 (Ref. no: 2013-01-062277), regarding the gap in the cash flow forecast of the Company, as was published within the financial statements of the Company for the second quarter of 2012, and the cash flow forecast of the Company, until the end of 2012, according to the internal cash flow that was presented to the management of the Company on September 23 and 24, regarding the intention of the Securities Authority to engage with the Company in an arrangement to avoid initiating proceedings as stated in the Securities Law (the “Arrangement”). On November 28, 2013, the Administrative Enforcement Committee, appointed pursuant to section 52 of the Securities Law, approved the Arrangement the Company entered into with the Securities Authority. For additional details of the engagement by the Company for the Arrangement and its approval by the Administrative Enforcement Committee see Immediate Report of November 28, 2013 (Ref. no: 2013-01-208542).
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)**

The Arrangement does not include an admission by the Company of breach of the Securities Laws, but includes the Company’s agreement to the facts described within the arrangement, as well as a commitment by the Company to undertake upon itself the following enforcement means:

a) A financial sanction of NIS five million, as well as a conditional sanction of NIS five million will be imposed on the Company;

b) Completing the formulation of and adopting an internal enforcement plan that the Company is formulating, including the adoption of an information flow and update procedure with regard to the financial statements in general and the forecasted cash flow in particular, within 9 months from the date of approval of the arrangement (regarding this matter, the completion of writing the enforcement outline and enforcement procedures, and their approval, will be perceived as completion of formulating and adopting the enforcement plan).

c) Appointing an external supervisor who will be authorized to ensure the completion of the formulation and the effective implementation of the enforcement plan and the enforcement procedures adopted throughout the process. On the other hand, the Securities Authority undertook to refrain from taking enforcement proceedings with regard to the facts upon which the arrangement is based, and this is without the Company’s admission that these facts create any negligent acts or breach, and while maintaining the Company's full rights and claims with respect to these facts.

As of the date of this report, the Company is vigorously working to fulfill its undertakings under the Arrangement for effective implementation of the enforcement plan, including having paid the financial sanction of NIS 5 million, the writing and approval of the enforcement outline and enforcement procedures has been completed and extensive training has been executed with respect to them, as part of assimilating the enforcement plan in the Company. In addition, the Company has appointed an external supervisor, who has commenced working. For additional details of the internal enforcement plan, see section 4 c of the report of the Board of Directors.

6) In accordance with resolutions of the Government of Israel from 2010-2012, pertaining to the entry of the Company into operation in the field of communications through the establishment of a communications company that will be permitted to use the electricity network for deployment of a fixed infrastructure of optical fibers, a procedure to choose a private investor who will be the controlling shareholder of the Company was conducted by a selection committee (composed of State and Company representatives). At the end of the procedure, a controlling shareholder was chosen (composed of a consortium of companies) who will hold 60% of the share capital of the communications company, and 40% will be held by the Company.

On July 14, 2013, the communications company was incorporated under the name of I.B.C. Israel Broadband Company (2013) Ltd. (hereinafter: “IBC”.)

For additional details see Note 11 to the Financial Statements.

7) On July 5, 2013, the OPC Company began to produce electricity commercially. Additional private producers are expected to enter in 2013-2015 with a significant output, which is expected to affect the scope of revenue of the Company. For additional details regarding private producers see Note 34 a 6 to the Financial Statements, and for additional details regarding the transfer of electricity customers to private producers see section 2.2.1 in Chapter A – Description of the Business of the Company.

8) For details regarding the rating of the Company see Note 20 f to the Financial Statements.
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) On July 18, 2013, a new collective agreement (wage agreement) was signed between the Company, the employee organization and the National Labor Federation. The Company’s wage agreement is based on the wage agreement that was signed at the civil service in May 2013, and entered into effect on July 1, 2013, with the enactment of the Participation of Employees, Officeholders and Other Officers of the Civil Service in Measures to Stabilize the Fiscal Situation in the Country during the Years 2013 and 2014 (Temporary Order) Law, 5773-2013. For additional details see Note 12 to the Financial Statements.

10) On July 22, 2013, the Minister of Finance and the Minister of Energy and Water Resources appointed a steering team for the execution of a reform in the electricity sector and in the Electric Company, headed by Mr. Uri Yogev, and among their tasks are the examination of the optimal structure for the electricity sector and the Electric Company, as well as to suggest a comprehensive reform of the Company and the electricity sector. The timetable determined for the work of the team and formulation of its recommendations was until February 2014. For additional details see Note 11 to the Financial Statements.

11) The letter of the Commissioner of Wages regarding 4 wage deviations in the Company was received on October 10, 2013. Pursuant to the decision of the Court, the said decision will not enter into effect until a decision is reached in the main action filed in this matter. For additional details see Note 12 to the Financial Statements.

12) In December, 2013, the supply of the remainder of the gas quantity within the first agreement with “Yam Thetis” of 2002 ended, after the contractual gas quantity of 18 BCM was supplied in full. In accordance with the provisions of the original agreement and the compromise agreement, this agreement has expired. For details see Note 34 a 4 to the Financial Statements.

13) The Company executed a provision for doubtful debts with respect to debts whose collection is doubtful in the amount of NIS 272 million. The Management of the Company is acting to collect the debt. For additional details see Note 30 to the Financial Statements.

14) On January 1, 2014, the Office of the General Director of the Israel Antitrust Authority announced that it is considering the publication of a new directive to regulate the operation of the Electric Company as a monopoly under section 30 to the Antitrust Law, under which the Electric Company will not increase its production capacity, directly or indirectly, beyond the present production capacity, as long as the Electric Company holds more than 50% of the production capacity of the electricity sector. The Electric Company is preparing to present its position to the General Director. For additional details see Note 34 b 9 to the Financial Statements.

15) In light of the decision of transition to new technology and configuration of Project D as a dual fuel station that will be powered by gas with coal backup, the impairment was examined under accounting standard SFAS90. See Note 34 b 9 b) to the Financial Statements.

16) For details of labor disputes in the reporting period and after the date of the statement of financial position see Note 34 c to the Financial Statements.
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**

   **Targets and Strategy**

   For general details of the targets and strategy of the Company, including the strategic plan for sustainable development of the Company, see Section 26 in Chapter A—Description of the Business Affairs of the Corporation in the Company’s periodic report for the year ending December 31, 2013.

   In December, 2013, the Companies Authority, in collaboration with the Ministry of Environmental Protection, published a guidebook for sustainable development in the Government Companies, in order to assist companies to assimilate 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.

   The Company is studying the circular of the Companies Authority and is making preparations to submit the requested information on the required date.

   1) **The major financial targets of the Company.**

   The long term targets are presented below:

   (a) Financial debt ratio to EBITDA of 4 (as of December 31, 2013, the ratio is 8.02).

   (b) Total debt ratio to total balance will gradually decrease to 65% (as of December 31, 2013, the ratio stands at approximately 83%).

   (c) Independent international rating – BBB (for the present rating, see Note 20 f to the Financial Statements).

   (d) Cash in hand balance— not less than NIS 2.2 billion. In accordance with that stated above in section a1 b)(1), 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, 2013, the balance is NIS 3.4 billion).

   2) **Strategic emergency awareness and readiness plan:**

   In accordance with the Government Companies Authority Risk Management circular, the Company prepared a strategic emergency awareness and readiness plan. The program includes the following items:

   The Company’s emergency policies and objectives, main scenario references, the Company’s emergency deployment and activities, return to normal operation, a multi-annual program to improve emergency readiness and the Board of Director’s responsible activities and controls.

   The program was relayed to all the managers for review and was presented to the Board of Directors and approved by it on August 14, 2013.

   The plan was reported to the Companies Authority on August 21, 2013.

   (3) For additional details in accordance with the Government Companies Authority directives, see also Note 39 to the Financial Statements

Under the Government Companies Regulations (The Principles for Preparing Financial Statements of the Israel Electric Corporation Ltd.) (temporary order), 2004 (hereafter: "Government Companies Regulations for Preparing Financial Statements"), the Company is required to present the estimated impact of the implementation of the financial reporting rules in its Financial Statements as compared with International Financial Reporting Standards.

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 exemption from the duty to include comparative figures for two years in its first financial statements that are prepared according to full IFRS (the statements of 2015 only), and the Company will be permitted to include, in these statements alone, comparative figures for one year (the year 2014), and to determine accordingly the date of transition to IFRS on January 1, 2014.

In January 2014, Standard IFRS 14 was published which enables the recognition of regulatory assets / liabilities in financial statements prepared under IFRS also, see Note 2z4 in the Financial Statements.

Since the transition date is January 1, 2014, as stated, there is no impact due to adjustment of the financial statements in accordance with Accounting Opinion No. 36.

Pursuant to the above mentioned, as on December 31, 2013, there is no impact to the Financial Statements resulting from the application of IFRS.

According to the Company’s estimates which were presented to the Companies Authority and the Electricity Authority, the ceasing of the adjustment of the financial statements to the CPI, without finding a suitable solution, will erode profitability of the Company, so that with respect to each percent increase in inflation, the equity of the Company will be eroded by approximately NIS 490 million, net, after tax effect. The Company is conducting ongoing discussions with the professional team of the Electricity Authority in order to solve the issue.

In light of all the aforesaid, the Company believes that the transition to full implementation of the IFRS should be accompanied by an appropriate rate or accounting solution that will reflect the nominal financing costs and ensure the appropriate yield for the capital and also by updates of the rate, to prevent a significant delay between amounts due to the Company or to electricity consumers and the collection date, in order to prevent severe damage in the future which will eventually erode the equity of the Company and impair its ability to raise funds.
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**

   For information on the electricity rate and is updating, see Note 3 to the Financial Statements.

   1) The Company believes that the decisions of the Electricity Authority on the rate do not provide full and adequate coverage for its costs. Lack of recognition of all of the costs incurred by the Company, arising from different subjects, as detailed below, in the rate, caused a significant cumulative decline in the Company's revenues which are estimated at billions of NIS. The Electricity Authority is of the opinion, as presented to the Company, that the electricity rate is not intended to cover and not obliged to recognize all the costs of the Company according to its actual costs, if in the opinion of the Electricity Authority these are not required to fulfill the Company's duties as a vital service provider.

   This position is indeed included in the Electricity Law even though the Company’s position is that has many non-recognized costs within the rate that are required in order for the Company to fulfill its role and duty as an essential service provider.

   Over the years the Company transferred numerous documents to the Electricity Authority detailing the disputed subjects, including data and explanations of the non-recognized costs and requested coverage for these costs.

   The subjects which the Company addressed the Electricity Authority throughout the years include, inter alia, the following: objections of the Company to the process of determining the new generation rate, including non-recognition of all of the fixed assets construction costs, the mechanism for decreasing recognized costs to be applied to the Company in the events that it will fail to meet the normative timetables for operating generation units; reduction coefficients rate that were applied to the various segments and their accumulated effect over the years; the fuels basket (delays in converting power stations to natural gas); pension costs of the Company employees; delays in publication of the rate base for the distribution and transmission segments; consumer costs; exogenous expenses; financing costs; electricity consumption in Company facilities, as well as appealing the Authority’s decisions with regard to the annual update for the years 2012 and 2013 and update of the spread of the electricity rate increase, and more.

   The Electricity Authority reached a decision on the majority of the subjects, and did not decide at all on the remaining subjects. Decisions made by the Electricity Authority obligate the Company, unless the Electricity Authority will modify its decisions. As mentioned, the Company believes that the decisions of the Electricity Authority do not provide full coverage for its costs and it continues to address the Electricity Authority on these subjects, aiming to receive coverage for these costs in the rate.
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)

   2) Comparison between the Rate and the Expenses of the Company for the Period January – December 2013, in Millions NIS, at December 2013 NIS

<table>
<thead>
<tr>
<th>Income of the Company according to the formula of the rate</th>
<th>Expenses of the Company according to the Financial Statements *</th>
<th>Gap</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fuel and electricity purchases</td>
<td>16,345</td>
<td>16,547</td>
</tr>
<tr>
<td>Operation</td>
<td>3,778</td>
<td>4,857</td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>3,936</td>
<td>4,686</td>
</tr>
<tr>
<td>Financing expenses</td>
<td>1,851</td>
<td>2,170</td>
</tr>
<tr>
<td>Expenses with respect to pensioners</td>
<td>24</td>
<td>20</td>
</tr>
<tr>
<td>Advance due to new rate bases for transmission and distribution segments</td>
<td>362</td>
<td>-</td>
</tr>
<tr>
<td>Miscellaneous and differences</td>
<td>(315)</td>
<td>(196)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>25,981</strong></td>
<td><strong>28,084</strong></td>
</tr>
</tbody>
</table>

Return on equity approved by the Electricity Authority 1,295
Total loss before income taxes (808)

* After performing required classification actions for the adjustment of the rate formula. In addition, the data is after regulatory assets/liabilities. See further details in Note 9 to the Financial Statements and in the sections of the Statement of Operations.

Notes:

1. For the transmission and distribution segments the Electricity Authority applies reduction coefficients, on all components of the income and does not specify the specific component as to which the Company should become more efficient.
   It was assumed, for the calculation that the reduction coefficient is at an equal rate for all income components in these segments. However, it is not certain that the Electricity Authority interprets, in a similar way to the Company (equal rate), the application of the reduction coefficients to all components of the recognized costs.

2. In determining the rate, the Authority recognized some of the expense items not by the classifications recorded in the Financial Statements. This table includes adjustments to both the revenues and expenses of the items which the Electricity Authority recognized in a different classification than that recorded in the Financial Statements of the Company, to obtain an adequate comparison between the income and expenses of the Company.

3. The Company’s income was calculated based on the average rate, and according to net generation for the generation segment and the energy that is transferred to the rest of the segments.
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)**

   2) Comparison between the Rate and the Expenses of the Company for the Period January – December 2013, In Millions NIS, at December 2013 NIS (continued)

   The Main Explanations for the Gaps according to Components are detailed below:

   a) **Fuel**
   The gaps in fuel are due to the following:
   (1) A gap in quantities deriving from the normative recognition of the Electricity Authority, which differs from the actual performance of the Company.
   (2) A gap in the recognized prices of fuels, which may derive, inter alia, from recognition of marginal fuels prices, while fuels costs are recorded in the expense column at average costs.

   Additionally, fuels costs in the current period with respect to recognition of delayed profit from 2002 were decreased in accordance with accounting standard RE-6.

   b) **General**
   There is a decrease in revenues from electricity between the years 2013, compared to 2012. This decrease derives from:
   - A decrease in the demand of the electricity consumers in the sector.
   - The entry of private electricity producers that causes a decrease in the production of the Company.

   The decrease in demand due to the entry of private electricity producers was partially setoff through the electricity rate increase of May 2013.

   c) **Operation**
   Gaps in the operation component derive mainly from non-recognition of the full renovation costs of power stations and the continuous delay in updating the base rate of the transmission and distribution segments. In addition, provision for reserve for doubtful debts in light of debts that are difficult to collect.

   d) **Depreciation**
   The gaps 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.

   In addition there are other non-recognized items, such as non-recognition of the full depreciation expenses with respect to spare parts inventory etc. In addition, costs reduction of Project D was executed.

   e) **Financing Expenses**
   The decrease in the financing expenses derives mainly from erosion of foreign currency financial liabilities that were partially offset due to revaluation of the hedging transactions.
**Income of the Company according to the formula of the rate** | **Expenses of the Company according to Financial Statements** | **Gap**
--- | --- | ---
Fuel and electricity purchases | 16,252 | 15,447 | 805
Operation | 3,989 | 5,358 | (1,369)
Depreciation and amortization | 4,143 | 4,424 | (287)
Financing expenses | 2,029 | 2,691 | (662)
Expenses with respect to pensioners | 26 | 1,547 | (1,521)
Advance due to new rate bases for transmission and distribution segments | 231 | - | 231
Miscellaneous and differences | (19) | (156) | 137
**Total** | **26,645** | **29,311** | **(2,666)**

Return on equity approved by the Electricity Authority | 1,368
Total income before income taxes | (1,298)

*After transferring required classification actions for the adjustment of the rate formula. In addition, the data are after the effect of regulatory assets/liabilities. See further details in Note 9 to the Financial Statements and in the sections of the Statement of Operations.*

**Notes:**
1. The Electricity Authority applies reduction coefficients for the transmission and distribution segments on all components of the income and does not specify the specific component in which the Company should become more efficient. It was assumed, for the calculation that the reduction coefficient is at an equal rate for all income components in these segments. However, it is not certain that the Electricity Authority interprets the application of the reduction coefficients for all components of the recognized costs in the same manner (at an equal rate).
2. The Electricity Authority recognized some of the expense items for the determined rate, without adhering to the classifications specified in the Company’s Financial Statements. Adjustments were made in this table for both the revenues and expenses of the items which the Electricity Authority recognized in a different classification than that recorded in the Company’s Financial Statements, to obtain a correct comparison between the income and expenses of the Company.
3. The Company’s revenues were calculated based on the average rate and in accordance with the net production for the generation segment and the energy that is transferred to the other segments.
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)

3) Comparison between the Rate and the Expenses of the Company for the Period January – December 2012, In Millions NIS, at December 2013 NIS (continued)

The Main Explanations for the Gaps according to Components are detailed below:

   a) Fuel
   The gaps in fuel are due to the following two reasons:
      (1) A gap in quantities deriving from the normative recognition of the Authority, which differs from the actual performance of the Company.
      (2) A gap in the recognized prices of fuels, which may derive, inter alia, from recognition of marginal fuels prices, while fuels costs are recorded in the expense column as average costs.

      In addition, an accounting entry was performed in accordance with the provisions of RE6, due to which a regulatory asset with respect to profit that has not yet been realized was cancelled.

   b) Operation
   Gaps in the operational component derive mainly from non-recognition of the full renovation costs of power stations and from non-recognition of pension expenses. The non-recognition of pension expenses originates from the increase in related pension costs in the Financial Statements as a result of the agreement of linking the pension to the CPI.

   c) Depreciation
   The gaps 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.

      In addition there are other non-recognized items, such as non-recognition of the full depreciation expenses with respect to the spare parts inventory, etc.

   d) Financing Expenses
   The gap in the financing costs derives from the non-recognition of part of the Company’s fixed assets cost and from the increase in the financing expenses in the period. The increase in the financing expenses derives from two major reasons as described below:
      (1) An increase in interest expenses mainly arising from an increase in liabilities of the Company.
      (2) Revaluation of hedging transactions that were partially setoff from erosion of foreign currency financial liabilities.

   e) Expenses for Pensioners
   The non-recognition derives mainly from the agreement of linking the pension to the CPI. The change came into effect starting from January 2012.
1. **Explanations of the Board of Directors on the Business Condition of the Company (continued)**

   f) **Comparison between the Budget of the Company and the Actual Expenses in 2013 and 2012:**

   The Company’s Budget and its Detailed Expenses in 2013 (in Million NIS) in Current Prices

<table>
<thead>
<tr>
<th>Budget Target</th>
<th>Budget*</th>
<th>Actual Expense*</th>
<th>Difference</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current operation and maintenance budget</strong>*</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Electricity Generation system</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Most of the non-performance derives from non-utilization of the allocation for deductible in the insurance at Gezer unit 40 (the cost for purchasing the generator was recognized as investment) and from insurance reimbursements with respect to failures from previous years. In addition, performing renovations at a lower volume than planned, mainly in the following sites: Haifa (unit 3), Gezer CCGT unit 30, Reading (unit 3, Orot Rabin (units 1,2,4 and 5). Tzaft (CCGT 3), Hagit (units 5 and 6), Ramat Hovav (units 1,2,4 and CCGT 5), and jet gas turbines. Additionally, a smaller than planned performance with respect to a CSA maintenance contract at Eshkol and Alon Tavor, and a smaller than planned performance of current maintenance works mainly at the Eshkol, Rutenberg, Hagit, Ramat Hovav, Alon Tavor power stations and jet gas turbines. In comparison, a higher than planned volume of renovations mainly at Eshkol (unit 5), Alon Tavor (unit 3), Rutenberg (units 1,2,4), Ramat Hovav (unit 6), CSA maintenance contract at Tzaft and a LTSA contract at Haifa unit 30 and Reading - Gezer unit 30. Additionally, a higher than planned performance of current maintenance at Orot Rabin, Haifa, Reading - Gezer and Tzaft.</td>
</tr>
<tr>
<td>Transmission lines grid and substations system</td>
<td>2,149</td>
<td>2,020</td>
<td>(129)</td>
<td></td>
</tr>
<tr>
<td>Distribution system (High voltage and low voltage grid)</td>
<td>1,431</td>
<td>1,455</td>
<td>24</td>
<td>A lower than planned performance in maintaining the 103 call center due to the stormy weather at the end of the year, the activity of supervising the lines and a winter drill, handling the damage caused by an anonymous person and at the “Nativ Haor” project. In comparison, a lower than planned performance in preventive maintenance, collection activity, maintaining a DMS system, maintaining meters, commercial activity and national grid.</td>
</tr>
<tr>
<td>Administration and joint expenses</td>
<td>1,431</td>
<td>1,455</td>
<td>24</td>
<td>A lower than planned performance of examining the possibility of placing the underwater cable, of payments to consultants at the Finance and Economics Division. In comparison, a higher than planned performance in preparation for the optical fiber enterprise.</td>
</tr>
<tr>
<td>Distribution system (High voltage and low voltage grid)</td>
<td>341</td>
<td>326</td>
<td>(15)</td>
<td>A lower than planned performance at substations and switching stations and maintenance of high and ultra high power lines.</td>
</tr>
<tr>
<td>Administration and joint expenses</td>
<td>759</td>
<td>752</td>
<td>(7)</td>
<td>A lower than planned performance of examinations of the possibility of placing the underwater cable, of payments to consultants at the Finance and Economics Division. In comparison, a higher than planned performance in preparation for the optical fiber enterprise.</td>
</tr>
<tr>
<td>R&amp;D projects and KRT</td>
<td>14</td>
<td>14</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Reserve</td>
<td>8</td>
<td>-</td>
<td>(8)</td>
<td></td>
</tr>
<tr>
<td><strong>Total operating budget</strong></td>
<td>4,703</td>
<td>4,567</td>
<td>(136)</td>
<td></td>
</tr>
<tr>
<td><strong>Development Budget</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments in the electricity generation system</td>
<td>2,787</td>
<td>2,509</td>
<td>(278)</td>
<td>Most of the non-performance was in the scrubber installation projects and reduction of PM emissions at Orot Rabin and Rutenberg and at the SCR project at Orot Rabin, in the Stage B Emergency project. Non-utilization of the full budget for equipment, construction works, activation and unforeseeable due to delays and changes in the work plans. In comparison, a higher than planned performance of investment works at the operating power station following the recording of the cost of the generator acquisition as investment.</td>
</tr>
<tr>
<td>Investments in the transmission grids and substations</td>
<td>2,149</td>
<td>2,020</td>
<td>(129)</td>
<td>The volume of work for constructing high voltage power lines, constructing substations and expanding substations and switching stations is lower than planned due to changes in the work plans.</td>
</tr>
<tr>
<td>Investments in the distribution system (High &amp; low voltage grids)</td>
<td>1,292</td>
<td>1,251</td>
<td>(42)</td>
<td>A lower than expected performance, mainly in housing development and vehicle acquisition.</td>
</tr>
<tr>
<td>Different purchases and investments</td>
<td>618</td>
<td>577</td>
<td>(40)</td>
<td></td>
</tr>
<tr>
<td>Broadband communications</td>
<td>9</td>
<td>4</td>
<td>(5)</td>
<td></td>
</tr>
<tr>
<td>Reserve</td>
<td>40</td>
<td>-</td>
<td>(40)</td>
<td></td>
</tr>
<tr>
<td><strong>Total Development Budget</strong></td>
<td>5,512</td>
<td>5,032</td>
<td>(480)</td>
<td></td>
</tr>
</tbody>
</table>

Table continues on next page
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) Comparison between the Budget of the Company and the Actual Expenses in 2013 and 2012: (continued)

<table>
<thead>
<tr>
<th>Budget Target</th>
<th>Budget*</th>
<th>Actual Expense*</th>
<th>Difference</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crude</td>
<td>226</td>
<td>262</td>
<td>36</td>
<td></td>
</tr>
<tr>
<td>Coal</td>
<td>4,686</td>
<td>4,787</td>
<td>101</td>
<td></td>
</tr>
<tr>
<td>Diesel oil</td>
<td>1,242</td>
<td>1,281</td>
<td>39</td>
<td></td>
</tr>
<tr>
<td>Natural gas</td>
<td>4,599</td>
<td>4,697</td>
<td>98</td>
<td></td>
</tr>
<tr>
<td>Total Fuel Budget</td>
<td>10,753</td>
<td>11,027</td>
<td>274</td>
<td></td>
</tr>
</tbody>
</table>

* Does not include costs with respect to retrospective implementation of IAS 19 (2011).
** Less decrease of operating costs against regulatory asset with respect to not updating the electricity rate at the transmission and distribution segment and against regulatory asset with respect to a backup rate to cover the fixed operating costs that are recognized for the Company.
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) **Comparison between the Budget of the Company and the Actual Expenses in 2013 and 2012: (continued)**

| The Company’s Budget and its Detailed Expenses in 2012 (in Million NIS) In Current Prices |
|---------------------------------|----------------|-------------|----------|---------------------------------|
| **Budget Target**               | **Budget**    | **Actual Expense** | **Difference** | **Comments** |
| Current operation and maintenance budget |                      |                      |               |                |
| Electricity Generation system   | 2,056         | 2,023            | (34)         | Lower than expected performance mainly due to current maintenance work at the Haifa and Eshkol power stations, payment for water consumption and brine removal at the Gezer power station, and credit due to land development levies at the Eshkol site. In addition, a lower than expected performance of various renovations at the Gezer, Eshkol, Orot Rabin, Rutenberg, Ramat Hovav, Hagit, Zafit and Alon Tavor power stations and due to CSA maintenance contracts at Zafit and Eshkol and LTSA maintenance contracts at Hagit. On the other hand, a higher than expected performance of current maintenance work at the Orot Rabin, Rutenberg, Hagit, Ramat Hovav, Zafit and Alon Tavor power stations (due to faults discovered in the units resulting from increased use of diesel oil). |
| Transmission lines grid and sub-stations system | 349           | 339              | (10)        | Mainly executing sub stations and switching maintenance works and maintenance of 161 KV and 400 KV at a lower than scheduled scope. |
| Distribution system (High voltage and low voltage grid) | 1,352         | 1,365            | 13          | Mainly executing maintenance activity of the high and low voltage grids and collection activity in the districts at a higher than scheduled scope. |
| Administration and joint expenses | 703           | 660              | (43)        | A mainly lower than expected performance in the activity of public relations and the regulatory unit, feasibility studies for laying an underwater Israel-Cyprus cable and other business development projects, and due to provision for legal claims. |
| R&D projects and KRT            | 14            | 12               | (3)         | A mainly lower than scheduled performance in research and development activity and due to promoting technological ideas (KRT). |
| Reserve                         | 17            | -                | (17)        |                |
| **Total operating budget**      | **4,491**     | **4,398**        | **(93)**    |                |
| Development Budget              |                |                  |             |                |
| Investments in the electricity generation system | 3,226         | 2,700            | (526)       | The main non-performance in emergency projects phase B, installation of sulfur scrubbers and reduction of PM and SCR emissions at Orot Rabin. Establishing a steam supplement at Zafit and investment works at operating power stations. Non-utilization of the full budget for equipment, construction, activating and unforeseen events due to delays and changes in work plans. |
| Investments in the transmission grids and sub-stations | 591           | 648              | 58          | Scope of works for construction of high voltage lines and construction and expanding sub-stations is higher than scheduled, due to changes in the work plans. On the other hand, works for construction and expanding switching stations are at a lower than scheduled scope. |
| Investments in the distribution system (high & low voltage grids) | 1,219         | 1,243            | 24          | A higher than scheduled performance of construction of a high voltage grid. |
| Different purchases and investments | 621           | 585              | (36)        | Lower than scheduled performance, mainly in investment in computerizing, inventory purchases, and housing development. |
| Reserve                         | 26            | -                | (26)        |                |
| **Total Development Budget**    | **5,684**     | **5,176**        | **(507)**   |                |
| Fuel Budget                     |                |                  |             |                |
| Crude                           | 3,233         | 3,054            | (179)       | Non-performance in fuel derives mainly from a price variance of approximately NIS (628) million and a quantity variance of NIS 133 million which was offset by changes in related expenses, insurance and unforeseen events in an amount of approximately NIS (63) million. |
| Coal                            | 7,241         | 6,890            | (351)       |                |
| Diesel oil                      | 7,742         | 8,127            | 385         |                |
| Natural gas                     | 1,954         | 1,541            | (413)       |                |
| **Total Fuel Budget**           | **20,170**    | **19,612**       | **(558)**   |                |
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, 2013 and December 31, 2012 are as follows:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CURRENT ASSETS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>3,401</td>
<td>4,226</td>
<td>(825)</td>
<td>(20%)</td>
<td>a)1</td>
</tr>
<tr>
<td>Short term investments</td>
<td>493</td>
<td>-</td>
<td>493</td>
<td>-</td>
<td>a)2</td>
</tr>
<tr>
<td>Trade receivables for sales of electricity</td>
<td>4,345</td>
<td>4,127</td>
<td>218</td>
<td>5%</td>
<td>a)3</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>377</td>
<td>539</td>
<td>(162)</td>
<td>(30%)</td>
<td>a)4</td>
</tr>
<tr>
<td>Inventory – fuels</td>
<td>1,067</td>
<td>2,681</td>
<td>(1,614)</td>
<td>(60%)</td>
<td>a)5</td>
</tr>
<tr>
<td>Inventory – stores</td>
<td>144</td>
<td>149</td>
<td>(5)</td>
<td>(3%)</td>
<td>a)6</td>
</tr>
<tr>
<td>Regulatory assets, net</td>
<td>2,972</td>
<td>3,325</td>
<td>(353)</td>
<td>(11%)</td>
<td>a)7</td>
</tr>
<tr>
<td><strong>NON-CURRENT ASSETS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fuels inventory</td>
<td>1,736</td>
<td>-</td>
<td>1,736</td>
<td>-</td>
<td>b)1</td>
</tr>
<tr>
<td>Long term receivables</td>
<td>1,178</td>
<td>1,049</td>
<td>129</td>
<td>12%</td>
<td>b)2</td>
</tr>
<tr>
<td>Investment in an included company</td>
<td>98</td>
<td>-</td>
<td>98</td>
<td>-</td>
<td>b)3</td>
</tr>
<tr>
<td>Regulatory assets</td>
<td>696</td>
<td>4,875</td>
<td>(4,179)</td>
<td>(86%)</td>
<td>b)4</td>
</tr>
<tr>
<td><strong>Assets with respect to benefits after employment termination:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Excess pension plan assets over pension liability (*)</td>
<td>2,020</td>
<td>1,179</td>
<td>841</td>
<td>71%</td>
<td>b)5</td>
</tr>
<tr>
<td>Funds in trust</td>
<td>1,728</td>
<td>1,976</td>
<td>(248)</td>
<td>(13%)</td>
<td>b)6</td>
</tr>
<tr>
<td><strong>Fixed assets, net:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed assets in use, net (*)</td>
<td>58,646</td>
<td>58,721</td>
<td>(75)</td>
<td>-</td>
<td>c)</td>
</tr>
<tr>
<td>Fixed assets under construction (*)</td>
<td>6,075</td>
<td>5,952</td>
<td>123</td>
<td>2%</td>
<td></td>
</tr>
<tr>
<td><strong>Intangible assets, net (*)</strong></td>
<td>948</td>
<td>921</td>
<td>27</td>
<td>3%</td>
<td></td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>12,799</td>
<td>15,047</td>
<td>(2,248)</td>
<td>(15%)</td>
<td></td>
</tr>
</tbody>
</table>

(*) Retrospective implementation of International Accounting Standards 19 (2011) (hereinafter: “IAS”), see Note 37 to the Financial Statements.
### 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 September 30, 2013 and December 31, 2012 are as follows:

(continued)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CURRENT LIABILITIES</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit from banks and other credit providers</td>
<td>7,118</td>
<td>5,680</td>
<td>1,438</td>
<td>25%</td>
<td>d)1</td>
</tr>
<tr>
<td>Short term debentures</td>
<td>-</td>
<td>4,772</td>
<td>(4,772)</td>
<td>(100%)</td>
<td>d)2</td>
</tr>
<tr>
<td>Trade payables</td>
<td>1,726</td>
<td>2,008</td>
<td>(282)</td>
<td>(14%)</td>
<td>d)3</td>
</tr>
<tr>
<td>Accounts payable and accruals</td>
<td>1,742</td>
<td>1,581</td>
<td>161</td>
<td>10%</td>
<td>d)3</td>
</tr>
<tr>
<td>Customer advances, net of work in progress</td>
<td>398</td>
<td>468</td>
<td>(70)</td>
<td>(15%)</td>
<td>d)4</td>
</tr>
<tr>
<td>Provisions</td>
<td>730</td>
<td>732</td>
<td>(2)</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td><strong>NON CURRENT LIABILITIES</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debentures</td>
<td>32,770</td>
<td>32,834</td>
<td>(64)</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Liabilities to banks</td>
<td>8,572</td>
<td>6,945</td>
<td>1,627</td>
<td>23%</td>
<td></td>
</tr>
<tr>
<td>Liabilities with respect to other benefits after employment termination (*)</td>
<td>2,924</td>
<td>3,050</td>
<td>(126)</td>
<td>(4%)</td>
<td>e)5</td>
</tr>
<tr>
<td>Regulatory liabilities</td>
<td>1,397</td>
<td>2,384</td>
<td>(987)</td>
<td>(41%)</td>
<td>e)5</td>
</tr>
<tr>
<td>Provision for refunding amounts arising from restatement of the Financial Statements</td>
<td>2,565</td>
<td>2,449</td>
<td>116</td>
<td>5%</td>
<td></td>
</tr>
<tr>
<td>Deferred taxes, net (*)</td>
<td>5,088</td>
<td>4,909</td>
<td>179</td>
<td>4%</td>
<td></td>
</tr>
<tr>
<td>Debentures to the State of Israel</td>
<td>2,536</td>
<td>2,534</td>
<td>2</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Liabilities to the State of Israel</td>
<td>2,856</td>
<td>3,406</td>
<td>(550)</td>
<td>(16%)</td>
<td></td>
</tr>
<tr>
<td>Other liabilities</td>
<td>691</td>
<td>501</td>
<td>190</td>
<td>38%</td>
<td></td>
</tr>
<tr>
<td><strong>SHAREHOLDERS’ EQUITY</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share capital</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital reserves</td>
<td>1,137</td>
<td>1,137</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Capital remeasurement reserve (**)</td>
<td>1,030</td>
<td>1,030</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Retained earnings (**)</td>
<td>(1,025)</td>
<td>(1,305)</td>
<td>280</td>
<td>(21%)</td>
<td></td>
</tr>
<tr>
<td><strong>Total Shareholders’ Equity</strong></td>
<td>13,669</td>
<td>14,605</td>
<td>(936)</td>
<td>(6%)</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>14,811</td>
<td>15,467</td>
<td>(656)</td>
<td>(4%)</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>85,924</td>
<td>89,720</td>
<td>(3,796)</td>
<td>(4%)</td>
<td></td>
</tr>
</tbody>
</table>

(*) Retrospective implementation of IAS 19 (2011), see Note 37 to the Financial Statements.
a. **Explanations of the Board of Directors on the Business Condition of the Company (continued)**

2. **Financial Position (continued)**

   The following are explanations of the financial data of the Company, as detailed in the tables above, to December 31, 2013 compared to December 31, 2012 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). The comparative figures are after the effect of the retrospective implementation of IAS 19 (2011); see Section b5 below.

   a) **Current Assets**

   1) **Short Term Investments**

      The increase in short term investments arises from deposits into the dedicated bank account with respect to stage B of the emergency plan.

      For details, see Note 14j to the Financial Statements.

   2) **Customers**

      The major increase in customer receivables derives from the debts of the Palestinian Authority and the East Jerusalem Electricity Company.

      The following are details of the balances after provision for doubtful debts:

      |                                | As on December 31 2013 (in NIS millions) | As on December 31 2012 (in NIS millions) |
      |--------------------------------|------------------------------------------|------------------------------------------|
      | East Jerusalem Electricity Company | 712                                      | 380                                      |
      | Palestinian Authority | 395                                      | 134                                      |
      | Total | 1,107                                   | 514                                      |
      | Presented in trade receivables for sales of electricity item | 720                                      | 514                                      |
      | Presented in Long term receivables item | 387                                      | -                                        |
      | Total | 1,107                                   | 514                                      |

      As of the date of signing the financial statements, the balance with respect to issued electricity invoices and before provision for doubtful debts is approximately NIS 1.4 billion.

      The Company is holding advance negotiations, aided by various State entities, with regard to the spread and collection of these debts. In accordance with the consensus that is formulating, adequate provision for doubtful debts have been included in these financial statements and part of the remaining debt has been classified as long term.
a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

2. Financial Position (continued)
   a) Current Assets (continued)

3) Accounts Receivable
   The decrease of approximately NIS 162 million mainly derives from a decrease in advance expenses with respect to insurance and receivables.

4) Inventory – Fuels
   The total increase in fuels inventory (current and non-current) of approximately NIS 122 million mainly derives from an increase in the fuel oil and diesel oil inventory due to Company policy of maintaining inventory for the purpose of backup and availability of the electricity system in case of failure of the gas supply, that is partially offset by a decrease in coal inventory.

   The fuels inventory presented in the current assets reflects the Company forecast for fuels use in 2014. The remainder of the fuels inventory, which will serve the Company beyond 2014 according to its forecast, is presented in the non-current assets.

5) Regulatory Assets / Liabilities

   (a) Background
   For details on regulatory assets/ liabilities, see Note 9 to the Financial Statements.

   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 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 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).

   Fulfillment of Financial Accounting Standards 71 (hereinafter “FAS”) Directives
   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.
a. **Explanations of the Board of Directors on the Business Condition of the Company (continued)**

2. **Financial Position (continued)**
   a) **Current Assets (continued)**
   5. **Regulatory Assets / Liabilities (continued)**
      (a) **Background (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.
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, this criteria was 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 7.5% of the total installed generation capacity in the sector.
a. **Explanations of the Board of Directors on the Business Condition of the Company (continued)**

2. **Financial Position (continued)**
   a) **Current Assets (continued)**

5. **Regulatory Assets / Liabilities (continued)**
   a) **Background (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”.

(b) For details of the amounts of the Regulatory Assets and Liabilities see Note 9b to the Financial Statements.
a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

2. Financial Position (continued)
   a) Current Assets (continued)
      5. Regulatory Assets / Liabilities (continued)

   (c) Regulatory assets
   The decrease in regulatory assets (presented in the current assets and in the non-current assets) in the amount of NIS 4,532 million is mainly due to:

   • Increase in compensation asset due to delay in continuous update of the rate (without the fuel component) in the amount of NIS 113 million (see Note 9 d to the Financial Statements).

   • An increase in asset due to social rate for needy populations in the amount of NIS 99 million (see Note 9 e to the Financial Statements).

   • A decrease in regulatory asset due to purchase of electricity from private electricity producers and photo voltaic installations and arrangements to manage the load in the amount of NIS 302 million due to the excess collection since the collection in this year is based on the advances with respect to purchase of electricity that were given within the rate in accordance with the data known at the beginning of the year and that were higher than the actual purchase of electricity in 2013 (see Note 9 f to the Financial Statements).

   • A decrease in the regulatory asset in the amount of approximately NIS 4,242 million with respect to the 2012 fuels debt (the gas crisis that started in 2011 and caused high fuel costs in 2012) in view of the commencement of collecting this asset from the consumers starting from May 2013 according to the decision of the Authority of May 6, 2013, regarding the update of the spread of the rate increase.

   An also from excess collection with respect to fuels during 2013 since the collection in this year is 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 2013 (see Note 9 h to the Financial Statements).

   • A decrease in regulatory assets due to an increase in current maturities in the amount of approximately NIS 389 million with respect to shortening the period of repaying the debt to consumers for financing stage B of the Emergency Plan pursuant to the decision of the Authority of May 6, 2013. (See Notes 3a3) and 9i of the Financial Statements).

   • A creation of a new regulatory asset in the amount of NIS 90 million due to cover of fixed operation costs recognized in the generation segment following the entry of private producers (see Note 9 k to the Financial Statements).

   Detailed current assets according to electricity chain segments are as follows:
   - Generation Segment - NIS 8,138 million, deriving mainly from trade receivables due to the sale of electricity amounting to approximately NIS 3,391 million (this section is attributed to segments according to the ratio of revenues). Fuels inventory (fully attributed to the generation segment) amounting to approximately NIS 1,067 million and from a balance of cash and cash equivalents of approximately NIS 1,763 million;

   - Transmission Segment - NIS 1,624 million, deriving mainly from trade receivables due from the sale of electricity and from the balance of the cash and cash equivalents;

   - Distribution Segment - 3,037 million, deriving mainly from trade receivables due to electricity sales and from balances of cash and cash equivalents.
a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

2. Financial Position (continued)

b) Non-Current Assets (not including fixed assets)

1) For details of the reasons for the change in the fuels inventory balance see section a)4) above.

2) **Long Term Receivables**
   The increase in long term debts in an amount of approximately NIS 129 million mainly derives from classification of trade receivables for sales of electricity to long term with setoff of the influence of a decrease in debt of the Gas Lines Company with respect to the gas transmission project, due to repayments that occurred during the period and the decrease in the Dollar exchange rate. (For additional details of the agreement with the Gas Lines Company see Note 33 to the Financial Statements). There has also occurred an offsetting influence due to changes in the fair value of currency swap transactions.

3) **Investment in an Included Company**
   The investment in the included company derives from the establishment of the communications company. For additional details see Note 11 to the Financial Statements.

4) **Regulatory Assets**
   For details of the reasons for the change in the balance of regulatory assets see section a)5(c) above.

5) **IAS 19 (2011) - "Employee Benefits"**
   The Company has been applying the provisions of International Accounting Standard No. 19 (2011) "Employee Benefits" dated January 1, 2013 in a retrospective manner since January 1, 2011 (except for the need to adjust the book value of the assets, the cost of which includes employee benefits such as fixed assets, for the periods prior to January 1, 2011). For additional details see Note 2 y 3) and Note 37 to the Financial Statements.

6) **Funds in Trust**
   The decrease of NIS 248 million derives from transfers to the pension fund and fair value revaluation of fund assets.

**The Long Term Liabilities according to the Electricity Segments are as follows (not including fixed assets):**

- **Generation segment**: NIS 5,467 million;
- **Transmission segment**: NIS 688 million;
- **Distribution segment**: NIS 2,249 million.
a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

2. Financial Position (continued)

c) Investments in Fixed Assets

The sum total of investments in fixed assets for the reporting period amounted to approximately NIS 5,289 million net compared to NIS 6,185 million net for the same period last year, a decrease of 14.49% or approximately NIS 896 million.

Company investments in Fixed Assets in the Reporting Period were as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>In NIS millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Power stations, CCGTs, structures</td>
<td>2,800</td>
</tr>
<tr>
<td>Sub-stations and high voltage lines</td>
<td>371</td>
</tr>
<tr>
<td>Switching stations and ultra high 400 Kilowatt voltage lines</td>
<td>137</td>
</tr>
<tr>
<td>Distribution grids and meters</td>
<td>766</td>
</tr>
<tr>
<td>Inventory - stores</td>
<td>830</td>
</tr>
<tr>
<td>Joint property and others</td>
<td>385</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>5,289</strong></td>
</tr>
</tbody>
</table>

**Detailed investments in fixed assets according to electricity chain segments are as follows:**

- **Generation segment**: NIS 30,625 million;
- **Transmission segment**: NIS 14,332 million;
- **Distribution segment**: NIS 19,764 million.

The direct assets were attributed to the appropriate segments and the joint assets (some 3.24% 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 2,847 million, approximately NIS 508 million and approximately NIS 766 million in direct assets in the generation, transmission and distribution segments, respectively. In addition, a sum of approximately NIS 1,168 million was invested in joint property.

d) Current Liabilities

1. **Credit from Banking Corporations and Other Credit Providers**

   The increase in an amount of approximately NIS 1,438 million derives mainly from an increase in the current maturities of the long-term loans.

2. **Short term debentures**

   The decrease in the amount of approximately NIS 4,772 million derives from payments that were made during the period.

3. **Suppliers and Service Providers**

   The decrease in the amount of approximately NIS 282 million mainly derives from a decrease in the scope of fuels purchase, due to a decrease in the use of expensive alternative fuels due to the commencement of large scale use of natural gas.

4. **Advances from work orders less works in progress**

   The decrease in the amount of approximately NIS 70 million derives from works that have ended.

**Detailed Current Liabilities according to Electricity Chain Segments are as follows:**

- **Generation segment**: NIS 6,060 million;
- **Transmission segment**: NIS 2,433 million;
- **Distribution segment**: NIS 3,221 million.
THE ISRAEL ELECTRIC CORPORATION LIMITED
BOARD OF DIRECTORS' REPORT
ON THE STATUS OF THE COMPANY'S AFFAIRS
FOR THE YEAR ENDED DECEMBER 31, 2013

Explanations of the Board of Directors on the Business Condition of the Company (continued)

Financial Position (continued)

Non-Current Liabilities
The change in total non-current liabilities of the Company derives mainly loans taken by the Company.

1) Loans, Debentures and Liabilities to Banking Corporations and other long term liabilities

The long term liabilities of the Company include debentures, liabilities to banking corporations, hedging transactions and other long term liabilities amounting to NIS 47,425 million as detailed below:

a) Debentures, liabilities to banking corporations, and other long term liabilities: a total of NIS 17,051 million index linked, NIS 3,322 million unlinked, NIS 19,080 million in USD, NIS 2,007 million in Euros, NIS 2,480 million in Japanese Yen and non-financial balances of NIS 703 million.


c) The decrease in the balance of liabilities to the State of Israel derives mainly from repayments that occurred during the period and from the decrease in the exchange rate of the Dollar.

The Electricity Authority decided to transfer the real exposure to the currencies basket, amounting to approximately NIS 3.03 billion, out of these liabilities of the Company, to the electricity consumers and to the creation of a regulatory liability with respect to the financing its liabilities.

Currency Swap Transactions

<table>
<thead>
<tr>
<th>Purchase of:</th>
<th>In Millions of NIS</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Dollar</td>
<td>12,483</td>
</tr>
<tr>
<td>Euro</td>
<td>973</td>
</tr>
<tr>
<td>Yen</td>
<td>2,376</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>15,832</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>In Return for:</th>
<th>In Millions of NIS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Linked NIS</td>
<td>17,819</td>
</tr>
<tr>
<td>NIS</td>
<td>820</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>18,639</strong></td>
</tr>
</tbody>
</table>

Net total 2,807

As of December 31, 2013, the Company has long term liabilities for these transactions, amounting to approximately NIS 2,782 million (after transferring the amount of NIS 25 million to current maturities).

2) Forward contracts:
The Company has a short term liabilities as of December 31, 2013 due to Dollar - NIS forward transactions of approximately NIS 3 million.

3) Interest Rate Swap contracts:
The Company does not have interest rate swap contracts as of December 31, 2013.

Distribution of long term Loans, Debentures, Liabilities to Banks and Other Liabilities of the Company according to Electricity Chain Segments are as follows:

<table>
<thead>
<tr>
<th>Segment</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Generation segment</td>
<td>NIS 24,313 million;</td>
</tr>
<tr>
<td>Transmission segment</td>
<td>NIS 11,742 million;</td>
</tr>
<tr>
<td>Distribution segment</td>
<td>NIS 11,370 million.</td>
</tr>
</tbody>
</table>

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 Other Benefits, after Employment Termination, according to Electricity Chain Segments is as follows:

- Generation segment: NIS 1,514 million
- Transmission segment: NIS 208 million
- Distribution segment: NIS 1,202 million

5) Regulatory Liabilities

The decrease in the balance of long-term regulatory liabilities of approximately NIS 987 million is composed of a sum of NIS 741 million for the shortening of the period for repaying the debt to consumers for financing stage B of the Emergency Plan and reclassification of a larger sum for current maturities presented in the current assets (see Note 3a3(c) and Note 9i to the Financial Statements), and a sum of approximately NIS 246 million is with respect to decreasing the liability for the old hedging mechanism due to the passage of time (see Note 9c to the Financial Statements).

The following is a breakdown of the regulatory liability by Electricity Chain Segments:

- Generation segment: NIS 633 million
- Transmission segment: NIS 303 million
- Distribution segment: NIS 461 million

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: NIS 1,162 million
- Transmission segment: NIS 556 million
- Distribution segment: NIS 847 million
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 Operation and Other Comprehensive Income in Millions NIS:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>27,656 (100%)</td>
<td>28,320 (100%)</td>
<td>(664)</td>
<td>(2%)</td>
<td>b)</td>
</tr>
<tr>
<td>Cost of operating the electricity system</td>
<td>24,256 (88%)</td>
<td>23,442 (83%)</td>
<td>814</td>
<td>3%</td>
<td>c)</td>
</tr>
<tr>
<td>Profit from operating the electricity system</td>
<td>3,400 (12%)</td>
<td>4,878 (17%)</td>
<td>(1,478)</td>
<td>(30%)</td>
<td>d)</td>
</tr>
<tr>
<td>Sales and marketing expenses</td>
<td>905 (3%)</td>
<td>1,067 (4%)</td>
<td>(162)</td>
<td>(15%)</td>
<td>e)</td>
</tr>
<tr>
<td>Administrative and general expenses</td>
<td>1,113 (4%)</td>
<td>871 (3%)</td>
<td>242</td>
<td>28%</td>
<td>f)</td>
</tr>
<tr>
<td>Expenses from liabilities to pensioners, net</td>
<td>20 -</td>
<td>1,547 (5%)</td>
<td>(1,527)</td>
<td>(99%)</td>
<td>g)</td>
</tr>
<tr>
<td>Income from current operations</td>
<td>1,362 (5%)</td>
<td>1,393 (5%)</td>
<td>(31)</td>
<td>(2%)</td>
<td>h)</td>
</tr>
<tr>
<td>Financial expenses, net</td>
<td>2,170 (8%)</td>
<td>2,691 (10%)</td>
<td>(521)</td>
<td>(19%)</td>
<td>i)</td>
</tr>
<tr>
<td>Loss before taxes on income</td>
<td>(808) (3%)</td>
<td>(1,298) (5%)</td>
<td>490</td>
<td>(38%)</td>
<td>j)</td>
</tr>
<tr>
<td>Taxes on income</td>
<td>126 -</td>
<td>(294) (1%)</td>
<td>420</td>
<td>(143%)</td>
<td>k)</td>
</tr>
<tr>
<td>Loss, net</td>
<td>(934) (3%)</td>
<td>(1,004) (4%)</td>
<td>70</td>
<td>(7%)</td>
<td>l)</td>
</tr>
<tr>
<td>Loss due to associate companies</td>
<td>(2) -</td>
<td>-</td>
<td>(2)</td>
<td>-</td>
<td>m)</td>
</tr>
<tr>
<td>Loss after associate companies</td>
<td>(936) (3%)</td>
<td>(1,004) (4%)</td>
<td>68</td>
<td>(7%)</td>
<td>n)</td>
</tr>
</tbody>
</table>

Consolidated Reports of Other Comprehensive Income (Loss):

Sums that will Not Be Attributed in the Future to statement of operations (Loss):

| Remeasurements of a benefit plan defined after tax | 280 (1%)          | (786) (3%)          | 1,066 | (136%)   |
| Other Comprehensive Income (Loss) for period after tax | 280 (1%)          | (786) (3%)          | 1,066 | (136%)   |
| Comprehensive Income (Loss) for period            | (656) (2%)        | (1,790) (6%)        | 1,134 | (63%)    |

* Retrospective application of IAS19 (2011), for details see d Note 37 of the Financial Statements.

b) Revenues

The total revenues for the reporting period is NIS 27,656 million compared to NIS 28,320 million for the corresponding period the previous year.

Of this, net revenues from the sale of electricity for the reporting period from the sale of 53,506 million kWh, amounted to approximately NIS 27,276 million, compared to approximately NIS 28,013 million from the sale of 57,085 million kWh for the corresponding period the previous year. This consists of an approximately NIS 737 million decrease in revenues, a decrease of approximately 2.63%.

The change in revenues noted above derives from two reasons, which are:
- An increase of approximately NIS 1,019 million as a result of a real increase in average income per kWh (an increase of approximately 3.64%).
- A decrease of approximately NIS 1,756 million as a result of a decrease in consumption (a decrease of approximately 3,579 million kWh, which constitutes a decrease of approximately 6.27%).
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):

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 21,289 million compared to approximately NIS 22,486 million in the same period last year, a decrease in revenue of approximately NIS 1,197 million. The change in revenue derives from two main factors: An increase of approximately NIS 212 million deriving from a real increase in the electricity rate and also from a decrease in consumption of approximately NIS 3,579 million kWh at a rate of approximately 6.27% constituting a decrease of approximately NIS 1,409 million.

Transmission Segment – Net revenue deriving from sales of electricity for the transmission period in the cumulative period amounted to approximately NIS 3,081 million compared to approximately NIS 2,648 million in the same period last year, an increase in revenue of approximately NIS 433 million.

Distribution Segment – Net revenue deriving from sales of electricity for the distribution segment in the cumulative period amounted to approximately NIS 2,906 million compared to approximately NIS 2,879 million in the corresponding period last year, an increase in revenue of approximately NIS 27 million.

c) Cost of Operating the Electricity System

The cost of operating the electricity system in the reported period amounted to NIS 24,256 million, as compared to NIS 23,442 million in the corresponding period last year, an increase of NIS 814 million. The increase was mainly due to transfer of expenses from regulatory asset with offset of use of cheaper fuels mix as detailed below:

The cost of fuels consumed (without the salary component) in the reporting period amounted to a sum of approximately NIS 10,962 million and a sum of approximately NIS 11,116 million (including the salary component), compared to approximately NIS 19,910 million (without the salary component) and a sum of approximately NIS 20,077 million (including the salary component) for the same period the previous year, a decrease of approximately NIS 8,948 million (without the salary component) and of approximately NIS 8,961 million (with the salary component), which constitutes a decrease of approximately 44.94% (without the salary component) and approximately 44.63% (with the salary component).

In the reporting period, expenses in an amount of approximately NIS 4,333 million were transferred from a regulatory asset, compared to NIS 5,269 million which were transferred to a regulatory asset during the same period in the previous year.
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)

c) Cost of Operating the Electricity System (continued)

The major part of the change is explained by the following:

<table>
<thead>
<tr>
<th>Fuel Type</th>
<th>Changed Consumption</th>
<th>Change in Prices</th>
<th>Total</th>
<th>Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crude</td>
<td>(2,868)</td>
<td>7</td>
<td>(2,861)</td>
<td>(1)</td>
</tr>
<tr>
<td>Coal</td>
<td>(1,092)</td>
<td>(1,134)</td>
<td>(2,226)</td>
<td>(2)</td>
</tr>
<tr>
<td>Diesel oil</td>
<td>(7,017)</td>
<td>(10)</td>
<td>(7,027)</td>
<td>(3)</td>
</tr>
<tr>
<td>Natural gas</td>
<td>2,729</td>
<td>424</td>
<td>3,153</td>
<td>(4)</td>
</tr>
<tr>
<td>Total</td>
<td>(8,248)</td>
<td>713</td>
<td>(8,961)</td>
<td></td>
</tr>
</tbody>
</table>

(1) A decrease in the quantity of crude fuel consumed of approximately NIS 2,868 million and an increase in the real price of approximately NIS 7 million (a decrease of approximately 2.47% in the average cost per ton compared to the corresponding period last year).

(2) A decrease in the quantity of coal consumed of NIS 1,092 million and a decrease in the real price of approximately NIS 1,134 million (a decrease of approximately 19.07% in the average cost per ton compared to the corresponding period last year).

(3) A decrease in the quantity of diesel fuel consumed of approximately NIS 7,017 million, and a decrease in the real price amounting to approximately NIS 10 million (a decrease of 0.74% in the average cost per ton compared to the corresponding period last year).

(4) An increase in the quantity of natural gas consumed of approximately NIS 2,729 million and an increase in the real price of approximately NIS 424 million (an increase of approximately 9.84% in the average cost per ton compared to the corresponding period last year).

The following are the details of consumed quantities during the quarter ending:

<table>
<thead>
<tr>
<th>Fuel Type</th>
<th>For the Year Ending December 31, 2013</th>
<th>For the Year Ending December 31, 2012</th>
<th>Increase (decrease)</th>
<th>Change Rate in %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crude (Ton)</td>
<td>84,134</td>
<td>996,372</td>
<td>(912,238)</td>
<td>(92%)</td>
</tr>
<tr>
<td>Coal (Standard Ton)</td>
<td>11,814,313</td>
<td>13,983,642</td>
<td>(2,169,329)</td>
<td>(16%)</td>
</tr>
<tr>
<td>Diesel oil (Ton)</td>
<td>307,646</td>
<td>1,951,001</td>
<td>(1,643,355)</td>
<td>(84%)</td>
</tr>
<tr>
<td>Natural gas (Ton)</td>
<td>3,527,735</td>
<td>1,290,310</td>
<td>2,237,425</td>
<td>173%</td>
</tr>
</tbody>
</table>

Following are actual expenses in NIS millions according to types of fuel:

<table>
<thead>
<tr>
<th>Fuel Type</th>
<th>For the Year Ending December 31, 2013</th>
<th>For the Year Ending December 31, 2012</th>
<th>Increase (decrease)</th>
<th>Change Rate in %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crude (Ton)</td>
<td>271</td>
<td>3,132</td>
<td>(2,861)</td>
<td>(91%)</td>
</tr>
<tr>
<td>Coal (Standard Ton)</td>
<td>4,814</td>
<td>7,040</td>
<td>(2,226)</td>
<td>(31%)</td>
</tr>
<tr>
<td>Diesel oil (Ton)</td>
<td>1,304</td>
<td>8,331</td>
<td>(7,027)</td>
<td>(84%)</td>
</tr>
<tr>
<td>Natural gas (Ton)</td>
<td>4,727</td>
<td>1,574</td>
<td>3,153</td>
<td>200%</td>
</tr>
<tr>
<td>Subtotal</td>
<td>11,116</td>
<td>20,077</td>
<td>(8,961)</td>
<td>(44%)</td>
</tr>
<tr>
<td>Transfer of fuels to regulatory asset</td>
<td>4,333</td>
<td>(5,269)</td>
<td>9,602</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>15,449</td>
<td>14,808</td>
<td>641</td>
<td></td>
</tr>
</tbody>
</table>

- For details regarding depreciation and amortization, see Section f below.

The decrease in fuels expenses mainly derives from a change of the fuels mix that derives from the use of liquid gas (LNG) in the beginning of the year 2013, and a significant scope of consumption of natural gas from the “Tamar” reserve commenced from the second quarter, and from a decrease in demand due to the entry of private electricity producers.
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) Marketing and Sales Expenses
The decrease of NIS 162 million derives mainly from a decrease in the salary costs attributed to sale and marketing expenses compared to these expenses in 2012, in which a one-off expense was recorded with respect to linking pensions to the CPI.

e) Administrative and General Expenses
The increase of NIS 272 million derives mainly from an increase in provision for doubtful debts.

f) 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:

<table>
<thead>
<tr>
<th>Depreciation and Amortization</th>
<th>1-12/2013</th>
<th>1-12/2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electricity system operation cost</td>
<td>4,662</td>
<td>4,408</td>
</tr>
<tr>
<td>Sales and marketing expenses</td>
<td>142</td>
<td>143</td>
</tr>
<tr>
<td>Administrative and general expenses</td>
<td>123</td>
<td>133</td>
</tr>
<tr>
<td><strong>Total depreciation expenses</strong></td>
<td><strong>4,927</strong></td>
<td><strong>4,684</strong></td>
</tr>
</tbody>
</table>

The increase in depreciation expenses mainly derives from provision for impairment in accordance with the provisions of FAS90 with respect to Project D and the generator at Gezer.

Details of Depreciation and Amortization Expenses by Electricity Chain Segments:
- **Production Segment** – The depreciation and amortization expenses presented in the production segment profit and loss statement during the cumulative period amounted to approximately NIS 2,825 million compared to NIS 2,666 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 929 million, compared with about NIS 854 million during the same period in the previous year, an increase of approximately NIS 75 million.
- **Distribution Segment** – The depreciation and amortization expenses presented in the distribution segment profit and loss statement during the cumulative period, amounted to approximately NIS 1,173 million, compared to NIS 1,164 million during the same period in the previous year, an increase of approximately NIS 9 million.

g) Expenses with respect to Liabilities to Pensioners
The decrease of approximately NIS 1,527 million derives mainly from the implementation of the agreement linking pensions to the CPI which was implemented in 2012.

Detailed Expenses With Respect to Liabilities to Pensioners, Net, according to Electricity Segments is as follows:
The pension expenses are divided between the various segments according to the operating expenses current electricity chain salary ratio in the reporting period: generation – 51.76%, transmission – 7.12% and distribution 41.12%.
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)

h) Financial Expenses

The decrease in financial expenses for the cumulative period compared to the same period in the previous year, are as follows:

<table>
<thead>
<tr>
<th>Sum Difference Analysis</th>
<th>Difference</th>
<th>For the year ending</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>31/12/2013</td>
</tr>
<tr>
<td></td>
<td>NIS in millions</td>
<td></td>
</tr>
<tr>
<td><strong>A. Erosion of Financial Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase in revenues from erosion of foreign currency financial liabilities in the amount of NIS 1,288 million, net, deriving from increase in a real revaluation of 5.2% in the previous year to a real revaluation of 10.77% in the reporting period, composed of:</td>
<td>(1,288)</td>
<td>(2,442)</td>
</tr>
<tr>
<td>Increase in financing revenues, net, less deposits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase in financing expenses from hedging transactions.</td>
<td>806</td>
<td>2,161</td>
</tr>
<tr>
<td>Total transfer from financing expenses to revenues</td>
<td>(482)</td>
<td>(281)</td>
</tr>
<tr>
<td>Increase in financing 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 an increase in the real revaluation of the rate basket which was partly offset by a decrease of the protected amount.</td>
<td>55</td>
<td>331</td>
</tr>
<tr>
<td>Increase in financing income resulting from changes between the known CPI and the CPI in lieu to and the erosion of unlinked shekel loans, net.</td>
<td>(11)</td>
<td>(81)</td>
</tr>
<tr>
<td>Decrease in expenses as a result of the erosion of working capital, loans and receivables items</td>
<td>(6)</td>
<td>25</td>
</tr>
<tr>
<td>Total decrease in expenses from erosion of financial liabilities</td>
<td>(444)</td>
<td>6</td>
</tr>
<tr>
<td><strong>B. Other Financing Expenses</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Decrease in interest expenses</td>
<td>(53)</td>
<td>2,667</td>
</tr>
<tr>
<td>Decrease in expenses from interest hedge transactions</td>
<td>(5)</td>
<td>3</td>
</tr>
<tr>
<td>Decrease in expenses transferred to a regulatory asset due to normative interest differences from the actual interest expenses</td>
<td>14</td>
<td>(77)</td>
</tr>
<tr>
<td>Increase in financing income, loans and receivables</td>
<td>(32)</td>
<td>(138)</td>
</tr>
<tr>
<td>Total decrease in other financing expenses:</td>
<td>(76)</td>
<td>2,455</td>
</tr>
<tr>
<td>Total decrease in financing expenses before capitalization</td>
<td>(520)</td>
<td>2,449</td>
</tr>
<tr>
<td><strong>C. Capitalization of projects under construction</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase in financing expenses due to capitalization</td>
<td>1</td>
<td>279</td>
</tr>
<tr>
<td>Total decrease 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</td>
<td>(521)</td>
<td>2,170</td>
</tr>
</tbody>
</table>

**Presented in the Financial Statements**

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Other financing expenses</td>
<td>2,195</td>
<td>2,784</td>
</tr>
<tr>
<td>Transfer of financing income to a regulatory liability</td>
<td>254</td>
<td>185</td>
</tr>
<tr>
<td>Capitalization of financing expenses</td>
<td>(279)</td>
<td>(278)</td>
</tr>
<tr>
<td>Total financing expenses</td>
<td>2,170</td>
<td>2,691</td>
</tr>
</tbody>
</table>
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)

h) 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.

A decrease compared to the same period last year was recorded in the financing expenses in the generation segment of approximately NIS 234 million, in the transmission segment of approximately NIS 118 million and in the distribution segment of approximately NIS 169 million.

i) Business Results during the Reporting Period

1) A decrease in income from the sale of electricity in the amount of approximately NIS 737 million (2.63%) derives from a decrease in consumption in the amount of approximately NIS 1,756 million (6.27%) and from a real decrease in income per kWh in the amount of NIS 1,019 million (3.64%).

2) An increase in fuels costs in an amount of approximately NIS 641 million derived mainly from transfer of expenses from regulatory assets with offset of the influence of the decrease in demand and the use of a cheaper fuels mix, due to the entry of the natural gas from the Tamar reserve at a significant scope. For additional details see section c above.

3) A decrease in financing expenses of approximately NIS 521 million (19%) deriving mainly from an increase in revenues from erosion of the foreign currency financial liabilities with offset of the change in the fair value of the hedging transactions.

4) The EBITDA during the reporting period was NIS 6,289 million.
a. **Explanations of the Board of Directors on the Business Condition of the Company (continued)**

4. **Comparison and Analysis of Operating Results for 2013 compared to 2012**

a) **Statements of Operation and Comprehensive Income in Millions NIS:**

<table>
<thead>
<tr>
<th></th>
<th>December 31, 2012</th>
<th>December 31, 2011</th>
<th>Change</th>
<th>Change %</th>
<th>Explanatory Paragraph</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>28,320</td>
<td>25,386</td>
<td>2,934</td>
<td>12%</td>
<td>b)</td>
</tr>
<tr>
<td>Cost of operating the electricity system</td>
<td>23,442</td>
<td>20,756</td>
<td>2,686</td>
<td>13%</td>
<td>c)</td>
</tr>
<tr>
<td>Profit from operating the electricity system</td>
<td>4,878</td>
<td>4,630</td>
<td>248</td>
<td>5%</td>
<td>d)</td>
</tr>
<tr>
<td>Sales and marketing expenses</td>
<td>1,067</td>
<td>910</td>
<td>157</td>
<td>17%</td>
<td>e)</td>
</tr>
<tr>
<td>Administrative and general expenses</td>
<td>871</td>
<td>739</td>
<td>132</td>
<td>18%</td>
<td>g)</td>
</tr>
<tr>
<td>Expenses (revenues) from liabilities to pensioners, net</td>
<td>1,547</td>
<td>155</td>
<td>1,392</td>
<td>898%</td>
<td>h)</td>
</tr>
<tr>
<td>Income from current operations</td>
<td>1,393</td>
<td>2,826</td>
<td>(1,433)</td>
<td>(51%)</td>
<td>i)</td>
</tr>
<tr>
<td>Financial expenses, net</td>
<td>2,691</td>
<td>2,260</td>
<td>431</td>
<td>19%</td>
<td>j)</td>
</tr>
<tr>
<td>Income on income before tax</td>
<td>(1,298)</td>
<td>566</td>
<td>(1,864)</td>
<td>(329%)</td>
<td>k)</td>
</tr>
<tr>
<td>Taxes on income</td>
<td>(294)</td>
<td>1,399</td>
<td>(1,693)</td>
<td>(121%)</td>
<td>l)</td>
</tr>
<tr>
<td>Net income for period</td>
<td>(1,004)</td>
<td>(833)</td>
<td>(171)</td>
<td>21%</td>
<td>m)</td>
</tr>
</tbody>
</table>

**Consolidated reports of other comprehensive income (loss):**

**Sums that will not be attributed in future to the income (loss) report:**

<p>| | | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Remeasurements of a benefit plan defined after tax</td>
<td>(786)</td>
<td>(627)</td>
<td>(159)</td>
<td>25%</td>
<td></td>
</tr>
<tr>
<td>Other Comprehensive Income for period after tax</td>
<td>(786)</td>
<td>(627)</td>
<td>(159)</td>
<td>25%</td>
<td></td>
</tr>
<tr>
<td>Comprehensive income for period</td>
<td>(1,790)</td>
<td>(1,460)</td>
<td>(330)</td>
<td>23%</td>
<td></td>
</tr>
</tbody>
</table>

* Retrospective application of IAS19 (2011), for details see Note 37 of the Financial Statements.

b) **Revenues**

The total revenues for 2012 are NIS 28,320 million compared to NIS 25,386 million for 2011. Net revenues from the sale of electricity for the year 2012 from the sale of 57,085 million kWh, amounted to approximately NIS 28,013 million, compared to approximately NIS 25,118 million from the sale of 53,062 million kWh for the year 2011. This consists of an approximately NIS 2,895 million increase in revenues, which constitutes an increase of approximately 11.52%.

The change in revenues noted above derives from:
- An increase of approximately NIS 991 million as a result of a real increase in average income per kWh (an increase of approximately 3.94%).
- An increase of approximately NIS 1,904 million as a result of an increase in consumption (an increase of approximately 4,023 million kWh, which constitutes an increase of approximately 7.58%).

Regarding the peak in electricity demand during the year 2012 see section 7.5 in Chapter A - Description of the Business Affairs of the Company.
a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

4. Comparison and Analysis of Operating Results for 2013 compared to 2012 (continued)

b) Revenues (continued):

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 year 2012 amounted to approximately NIS 22,486 million compared to approximately NIS 20,597 million in the year 2011, an increase in revenue of approximately NIS 1,889 million. The change in revenue derives from two main factors: An increase in revenue of approximately NIS 328 million deriving from a real increase in the electricity rate and also from an increase in consumption of approximately 4,023 million kWh at a rate of approximately 7.58% constituting a decrease of approximately NIS 1,561 million.

Transmission Segment – Net revenue deriving from sales of electricity for the transmission period in the year 2012 amounted to approximately NIS 2,648 million compared to approximately NIS 1,854 million in the year 2011, an increase in revenue of approximately NIS 794 million.

Distribution Segment – Net revenue deriving from sales of electricity for the distribution segment in the year 2012 amounted to approximately NIS 2,879 million compared to approximately NIS 2,667 million in the year 2011, an increase in revenue of approximately NIS 212 million.

c) Cost of Operating the Electricity System

The cost of operating the electricity system in the year 2012 amounted to NIS 23,442 million, as compared to NIS 20,756 million in the corresponding period in the year 2011, an increase of NIS 2,686 million. The increase was mainly due to the use of a more expensive fuels mix, as detailed below:

The cost of fuels consumed (without the salary component) in the year 2012 amounted to a sum of approximately NIS 19,910 million and a sum of approximately NIS 20,077 million (including the salary component), compared to approximately NIS 13,151 million (without the salary component) and a sum of approximately NIS 13,294 million (including the salary component) for the year 2011, an increase of approximately NIS 6,759 million (without the salary component) and of approximately 6,783 (including the salary component), which constitutes an increase of approximately 51.39% (without the salary component) and approximately 51.02% (with the salary component).

In the year 2012, expenses in an amount of approximately NIS 5,269 million were transferred to a regulatory asset, compared to 2011 in which there was no transfer to a regulatory asset due to fuels.
a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

4. Comparison and Analysis of Operating Results for 2013 compared to 2012 (continued)

c) Cost of Operating the Electricity System (continued)

The major part of the change is explained by the following:

| Detailed Changes in NIS Millions NIS for the Year Ending December 31, 2012 |
|---------------------------|-----------------|----------------|-----------------|----------------|
| Fuel Type                | Changed Consumption | Change in Prices | Total     | Note |
| Crude                    | 2,073            | 381             | 2,455      | (1)  |
| Coal                     | 649              | (266)           | 383        | (2)  |
| Diesel oil               | 6,433            | (1,229)         | 5,204      | (3)  |
| Natural gas              | (1,533)          | 274             | (1,259)    | (4)  |
| Total                    | 7,622            | (839)           | 6,783      |      |

(1) An increase in the quantity of crude fuel consumed of approximately NIS 2,073 million and an increase in the real price of approximately NIS 381 million (an increase of approximately 13.87% in the average cost per ton compared to 2011).

(2) An increase in the quantity of coal consumed of NIS 649 million and a decrease in the real price of approximately NIS 266 million (a decrease of approximately 3.64% in the average cost per ton compared to 2011).

(3) An increase in the quantity of diesel fuel consumed of approximately NIS 6,433 million, and a decrease in the real price amounting to approximately NIS 1,229 million (a decrease of 12.86% in the average cost per ton compared to 2011).

(4) A decrease in the quantity of natural gas consumed of approximately NIS 1,533 million and an increase in the real price of approximately NIS 274 million (an increase of approximately 21.06% in the average cost per ton compared to 2011).

The following are the details of consumed quantities during the quarter ending:

<table>
<thead>
<tr>
<th>Fuel Type</th>
<th>For the Year Ending December 31, 2012</th>
<th>For the Year Ending December 31, 2011</th>
<th>Increase (decrease)</th>
<th>Change Rate in %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crude (Ton)</td>
<td>996,372</td>
<td>245,280</td>
<td>751,092</td>
<td>306%</td>
</tr>
<tr>
<td>Coal (Standard Ton)</td>
<td>13,983,642</td>
<td>12,742,237</td>
<td>1,241,405</td>
<td>10%</td>
</tr>
<tr>
<td>Diesel oil (Ton)</td>
<td>1,951,001</td>
<td>637,999</td>
<td>1,313,002</td>
<td>206%</td>
</tr>
<tr>
<td>Natural gas (Ton)</td>
<td>1,290,310</td>
<td>2,810,122</td>
<td>(1,519,812)</td>
<td>(54%)</td>
</tr>
</tbody>
</table>

Following are actual expenses in NIS millions according to fuel types:

<table>
<thead>
<tr>
<th>Fuel Type</th>
<th>For the Year Ending December 31, 2012</th>
<th>For the Year Ending December 31, 2011</th>
<th>Increase (decrease)</th>
<th>Change Rate in %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crude (Ton)</td>
<td>3,132</td>
<td>667</td>
<td>2,455</td>
<td>363%</td>
</tr>
<tr>
<td>Coal (Standard Ton)</td>
<td>7,040</td>
<td>6,657</td>
<td>383</td>
<td>6%</td>
</tr>
<tr>
<td>Diesel oil (Ton)</td>
<td>8,330</td>
<td>3,126</td>
<td>5,204</td>
<td>166%</td>
</tr>
<tr>
<td>Natural gas (Ton)</td>
<td>1,575</td>
<td>2,834</td>
<td>(1,259)</td>
<td>(44%)</td>
</tr>
<tr>
<td>Subtotal</td>
<td>20,077</td>
<td>13,294</td>
<td>6,783</td>
<td>51%</td>
</tr>
<tr>
<td>Transfer of fuels to regulatory asset</td>
<td>(5,269)</td>
<td>-</td>
<td>(5,269)</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>14,808</td>
<td>13,294</td>
<td>1,514</td>
<td></td>
</tr>
</tbody>
</table>

- For details regarding depreciation and amortization, see Section G below.

The change in the fuels mix that is use of a more expensive fuels mix in 2012 was mainly influenced by exogenous factors:

A large increase in consumption of diesel oil and crude as a result of the shortage of natural gas due to the depletion of the Yam Thetis natural reserve, the non-supply of Egyptian gas and the instructions of the lateral order of the Ministry for Environmental protection.
a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

4. Comparison and Analysis of Operating Results for 2013 compared to 2012 (continued)

d) **Sales and Marketing Expenses**
The increase of NIS 157 million derives mainly from the implementation of the agreement of linkage of the pension to the CPI in 2012.

e) **Administration and General Expenses**
The increase of NIS 132 million derives mainly from the implementation of the agreement of linkage of the pension to the CPI in 2012.

f) **Expenses with Respect to Liabilities to Pensioners**
The increase of NIS 1,392 million derives mainly from the implementation of the agreement of linkage of the pension to the CPI in 2012.

g) **Depreciation and Amortization**
Following are details of depreciation and amortization expenses presented in the profit and loss statement for 2012 and 2011:

<table>
<thead>
<tr>
<th>Depreciation and Amortization</th>
<th>1-12/2012</th>
<th>1-12/2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electricity system operation cost</td>
<td>4,408</td>
<td>4,225</td>
</tr>
<tr>
<td>Sales and marketing expenses</td>
<td>143</td>
<td>141</td>
</tr>
<tr>
<td>Administrative and general expenses</td>
<td>133</td>
<td>130</td>
</tr>
<tr>
<td><strong>Total depreciation expenses</strong></td>
<td><strong>4,684</strong></td>
<td><strong>4,496</strong></td>
</tr>
</tbody>
</table>

**Details of Depreciation and Amortization Expenses by Electricity Chain Segments is as follows:**
- **Production Segment** – The depreciation and amortization expenses presented in the production segment profit and loss statement during the year 2012 amounted to approximately NIS 2,666 million compared to NIS 2,409 million during the year 2011, an increase of approximately NIS 257 million.
- **Transmission Segment** – The Depreciation and amortization expenses presented in the transmission segment profit and loss statement during the year 2012 amounted to approximately NIS 854 million, compared with about NIS 925 million during the year 2011, a decrease of approximately NIS 71 million.
- **Distribution Segment** – The depreciation and amortization expenses presented in the distribution segment profit and loss statement during the year 2012, amounted to approximately NIS 1,164 million, compared to NIS 1,162 million during the year 2011, an increase of approximately NIS 2 million.

**Detailed Expenses Deriving from Liabilities to Pensioners, Net, according to Electricity Segments is as follows:**
The pension expenses are divided between the various segments according to the operating expenses current electricity chain salary ratio in the year 2012: generation – 52.41%, transmission – 7.79% and distribution 39.80%.
### a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

### 4. Comparison and Analysis of Operating Results for 2013 compared to 2012 (continued)

#### h) Financial Expenses

The increase in financial expenses for the cumulative period compared to the same period in the previous year, are as follows:

<table>
<thead>
<tr>
<th>Sum Difference Analysis</th>
<th>For the Year Ending</th>
<th>31/12/2012</th>
<th>31/12/2011</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. Erosion of Financial Liabilities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transition from expenses to income from erosion of foreign currency financial liabilities of NIS 2,213 million, net, deriving from a transfer from a real devaluation from a rate of 5.11% last year to a revaluation of 5.24% in the reporting year.</td>
<td></td>
<td>(2,212)</td>
<td>1,154</td>
<td>1,058</td>
</tr>
<tr>
<td>Transition from income to financial expenses in financial hedging transactions.</td>
<td></td>
<td>2,565</td>
<td>1,355</td>
<td>(1,210)</td>
</tr>
<tr>
<td><strong>Total transition from financing revenues to expenses</strong></td>
<td></td>
<td>353</td>
<td>201</td>
<td>(152)</td>
</tr>
<tr>
<td>Transition from financing expenses to financing income from erosion that was 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 real devaluation to a real revaluation of the rate basket.</td>
<td></td>
<td>416</td>
<td>276</td>
<td>(140)</td>
</tr>
<tr>
<td>Transition from financing expenses to income resulting from changes between the known CPI and the CPI in lieu and erosion of NIS non-linked loans, net.</td>
<td></td>
<td>(220)</td>
<td>(70)</td>
<td>150</td>
</tr>
<tr>
<td>A decrease in expenses as a result of the erosion of working capital, loans and receivables items</td>
<td></td>
<td>(57)</td>
<td>31</td>
<td>88</td>
</tr>
<tr>
<td><strong>Total transition from income to expenses due to erosion of financial liabilities</strong></td>
<td></td>
<td>492</td>
<td>438</td>
<td>(54)</td>
</tr>
<tr>
<td><strong>B. Other Financing Expenses</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase in interest expenses</td>
<td></td>
<td>205</td>
<td>2,720</td>
<td>2,515</td>
</tr>
<tr>
<td>Decrease in financing expenses from interest hedging transactions</td>
<td></td>
<td>(11)</td>
<td>8</td>
<td>19</td>
</tr>
<tr>
<td>Decrease in expenses transferred to a regulatory asset due to normative interest differences, from the actual interest expenses</td>
<td></td>
<td>46</td>
<td>(91)</td>
<td>(137)</td>
</tr>
<tr>
<td>Transition from expenses to financing income, loans and receivables</td>
<td></td>
<td>(230)</td>
<td>(106)</td>
<td>124</td>
</tr>
<tr>
<td><strong>Total increase in other financing expenses:</strong></td>
<td></td>
<td>10</td>
<td>2,531</td>
<td>2,521</td>
</tr>
<tr>
<td><strong>Total increase in financing expenses before capitalization</strong></td>
<td></td>
<td>502</td>
<td>2,969</td>
<td>2,467</td>
</tr>
<tr>
<td><strong>C. Capitalization of projects under construction</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase in the capitalization of financing expenses</td>
<td></td>
<td>71</td>
<td>278</td>
<td>207</td>
</tr>
<tr>
<td><strong>Total increase in financing expenses in the reporting year, compared to the previous year, after the transfer to a regulatory asset and after capitalization of financing expenses</strong></td>
<td></td>
<td>431</td>
<td>2,691</td>
<td>2,260</td>
</tr>
<tr>
<td><strong>Presented in the Financial Statements</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other financing expenses</td>
<td></td>
<td>2,784</td>
<td>2,744</td>
<td></td>
</tr>
<tr>
<td>Transfer of financing income to a regulatory liability</td>
<td></td>
<td>185</td>
<td>(277)</td>
<td></td>
</tr>
<tr>
<td>Capitalization of financing expenses</td>
<td></td>
<td>(278)</td>
<td>(207)</td>
<td></td>
</tr>
<tr>
<td><strong>Total financing expenses</strong></td>
<td></td>
<td>2,691</td>
<td>2,260</td>
<td></td>
</tr>
</tbody>
</table>
a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

4. Comparison and Analysis of Operating Results for 2013 compared to 2012 (continued)

h) 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.
An increase in year 2012 compared to the year 2011 was recorded in the financing expenses of approximately NIS 189 million, in the transmission segment of approximately NIS 85 million and in the distribution segment of approximately NIS 157 million.

i) Business Results for 2012:

1) An increase in income from the sale of electricity in the amount of approximately NIS 2,895 million (11.52%) derives from an increase in consumption in the amount of approximately NIS 1,904 million (7.58%) and from a real increase in income per kWh in the amount of NIS 991 million (3.94%).

2) An increase in fuels costs in an amount of approximately NIS 1,514 million derived mainly from use of an expensive fuels mix, due to the shortage in natural gas in 2012 with offset of the effect of transferring the expenses to regulatory assets. For additional details see section c above.

3) An increase in financing expenses of approximately NIS 431 million (19%) deriving mainly from revaluation of the hedging transactions with setoff of the erosion of financial liabilities.

4) The EBITDA for 2012 is NIS 8,000 million (after neutralizing the one-off influence of the agreement of linking the pension to the CPI).
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 2013**

Adjusted to NIS of December 2013, NIS in millions

<table>
<thead>
<tr>
<th></th>
<th>1st Quarter</th>
<th>2nd Quarter</th>
<th>3rd Quarter</th>
<th>4th Quarter</th>
<th>Annual Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(Unaudited)</td>
<td>(Audited)</td>
<td>(Audited)</td>
<td>(Audited)</td>
<td></td>
</tr>
<tr>
<td>Revenues</td>
<td>6,419</td>
<td>6,296</td>
<td>8,495</td>
<td>6,446</td>
<td>27,656</td>
</tr>
<tr>
<td>Cost of operating the electricity system</td>
<td>5,620</td>
<td>6,019</td>
<td>6,491</td>
<td>6,126</td>
<td>24,256</td>
</tr>
<tr>
<td>Profit from operating the electricity system</td>
<td><strong>799</strong></td>
<td><strong>277</strong></td>
<td><strong>2,004</strong></td>
<td><strong>320</strong></td>
<td><strong>3,400</strong></td>
</tr>
<tr>
<td>Sales and marketing expenses</td>
<td>230</td>
<td>217</td>
<td>221</td>
<td>237</td>
<td>905</td>
</tr>
<tr>
<td>Administrative and general expenses</td>
<td>205</td>
<td>195</td>
<td>200</td>
<td>513</td>
<td>1,113</td>
</tr>
<tr>
<td>Expenses from liabilities to pensioners, net</td>
<td>6</td>
<td>3</td>
<td>7</td>
<td>4</td>
<td>20</td>
</tr>
<tr>
<td><strong>Income (loss) from current operations</strong></td>
<td><strong>358</strong></td>
<td><strong>(138)</strong></td>
<td><strong>1,576</strong></td>
<td><strong>(434)</strong></td>
<td><strong>1,362</strong></td>
</tr>
<tr>
<td>Financial expenses, net</td>
<td>696</td>
<td>345</td>
<td>793</td>
<td>336</td>
<td>2,170</td>
</tr>
<tr>
<td><strong>Income (loss) from current operations before income tax</strong></td>
<td><strong>(338)</strong></td>
<td><strong>(483)</strong></td>
<td><strong>783</strong></td>
<td><strong>(770)</strong></td>
<td><strong>(808)</strong></td>
</tr>
<tr>
<td>Expenses (income) from taxes on income</td>
<td>(84)</td>
<td>(123)</td>
<td>535</td>
<td>(202)</td>
<td>126</td>
</tr>
<tr>
<td><strong>Income (loss), net</strong></td>
<td><strong>(254)</strong></td>
<td><strong>(360)</strong></td>
<td><strong>248</strong></td>
<td><strong>(568)</strong></td>
<td><strong>(934)</strong></td>
</tr>
<tr>
<td>Income (loss) due to associate companies</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Income (loss) after associate companies</strong></td>
<td><strong>(254)</strong></td>
<td><strong>(360)</strong></td>
<td><strong>248</strong></td>
<td><strong>(570)</strong></td>
<td><strong>(936)</strong></td>
</tr>
<tr>
<td>Other comprehensive income (loss)</td>
<td>456</td>
<td>(249)</td>
<td>149</td>
<td>(76)</td>
<td>280</td>
</tr>
<tr>
<td><strong>Comprehensive income (loss)</strong></td>
<td><strong>202</strong></td>
<td>(609)</td>
<td><strong>397</strong></td>
<td><strong>(646)</strong></td>
<td><strong>(656)</strong></td>
</tr>
</tbody>
</table>
The changes in operating results between quarters are due, inter alia, to:

a) **Revenues**

The total revenues in the fourth quarter of 2013 amounted to approximately NIS 6,446 million compared to approximately NIS 6,651 in the same period the previous year.

Net revenues from the sale of electricity for the fourth quarter from the sale of 12,249 million kWh, totaled to approximately NIS 6,359 million, compared to approximately NIS 6,561 million from the sale of 13,506 million kWh for the same period the previous year. This consists of an approximately NIS 202 million decrease in revenues, a decrease of approximately 3.08%.

The change in revenues noted above derives from:

A) An increase of approximately NIS 409 million as a result of a real increase in average income per kWh at a rate of approximately 6.23%.

B) A decrease of approximately NIS 611 million as a result of a decrease in consumption at a rate of approximately 9.31%.

b) **Fuel Cost**

The cost of fuel consumed (without the salary component) in the fourth quarter amounted to a sum of approximately NIS 2,110 million, and a sum of approximately NIS 2,148 million (including the salary component) compared to approximately NIS 3,540 million (without the salary component) and a sum of approximately NIS 3,578 million (including the salary component) for the same period the previous year.

A decrease of approximately NIS 1,430 million (including salary and without the salary component) which constitutes a decrease of approximately 40.41% (without the salary component) and approximately 39.97% (with the salary component). In the past quarter, an amount of NIS 1,556 was transferred from a regulatory asset compared to NIS 700 million that were transferred to a regulatory asset in the same period the previous year. The main changes are as follows:

1) A decrease in the consumed quantity of diesel fuel of approximately NIS 812 million while the real price remained without change.

2) An increase in the quantity of natural gas consumed of approximately NIS 800 million and a real price decrease of approximately NIS 269 million, (a decrease of approximately 20.2% in the average cost per ton compared to the same period the previous year).

3) A decrease in the quantity of crude consumption of approximately NIS 453 million and a real price increase of approximately NIS 6 million (an increase of approximately 59.33% in the average cost per ton compared to the same period the previous year).

4) A decreased amount of coal consumed equaling NIS 486 million and a real price decrease of approximately NIS 214 million (a decrease of approximately 18.48% in the average cost per ton compared to the same period the previous year).

c) **Financing Expenses**

The fluctuations in the financing expenses between the quarters mainly derive from changes in the exchange rates and CPIs that affect the erosion of the financial liabilities and revaluation of the hedging transactions. In addition, there is an increase of the interest expenses in the second half of 2013, due to raisings that began in the months of June and July 2013 (for details of the Company raisings see Note 20 c to the Financial Statements).
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 negative cash flow of approximately NIS 825 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 5,779 million, compared to a negative flow of approximately NIS 1,053 million in the corresponding period last year.

The change in the cash flow from current operations in the amount of approximately NIS 6,832 million derives mainly from the commencement of collection of the fuels debt from 2012 (as a result of the gas crisis that began during 2011 and caused high fuels costs in 2012) from the consumers starting from April 2013 and in accordance with the decision of the Electricity Authority, and from the earlier than expected entry of the natural gas and the transition to use of a cheaper fuels mix.

2) Cash Flow for Investment Activities:

Cash used for investment activities in the period reached a negative flow of approximately NIS 4,968 million, compared to a negative flow of approximately NIS 4,359 million in the corresponding period last year.

The change in the cash flow from investment activity in the amount of approximately NIS 609 million derives mainly from deposit of sums during the current period compared to withdrawal of deposits in the corresponding period last year.

3) Cash Flow from Financing Activity:

Cash flow from financing activities in the report period amounted to a negative flow of approximately NIS 1,636 million, compared to a positive flow of approximately NIS 8,446 million in the corresponding period last year.

The change in the cash flow from financing activity in the amount of approximately NIS 10,082 million derives mainly from higher repayments of debentures that occurred during the current period compared to higher issuances of debentures in the corresponding period the previous year. For additional details of material raisings and repayments during the reporting period see Note 20 to the Financial Statements.

For additional details regarding the cash flow of the Company see the cash flow report of the Company.
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**

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, 2013 and December 31, 2012, is approximately NIS 47,425 million, and is approximately NIS 46,220 million detailed as follows:

<table>
<thead>
<tr>
<th>Liabilities in Index-Linked NIS</th>
<th>As at December 31</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013</td>
</tr>
<tr>
<td>Index-linked debentures to the public</td>
<td>17,077</td>
</tr>
<tr>
<td>Debentures to the State of Israel</td>
<td>2,536</td>
</tr>
<tr>
<td>Other index-linked loans</td>
<td>1,505</td>
</tr>
<tr>
<td><strong>Total Linked NIS Liabilities</strong></td>
<td><strong>21,118</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Non-linked NIS Liabilities</th>
<th>As at December 31</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-linked NIS debentures in public offerings</td>
<td>657</td>
</tr>
<tr>
<td>Non-linked NIS loans</td>
<td>(3) 4,650</td>
</tr>
<tr>
<td><strong>Total Non-Linked NIS</strong></td>
<td><strong>5,307</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Dollar Linked Liabilities</th>
<th>As at December 31</th>
</tr>
</thead>
<tbody>
<tr>
<td>Money raised from a private offering for the sale of debentures in the US in US Dollars</td>
<td>7,202</td>
</tr>
<tr>
<td>Loans in US Dollars</td>
<td>(2) 4,187</td>
</tr>
<tr>
<td>Money raised from a private offering for the sale of debentures in Europe, in US Dollars</td>
<td>139</td>
</tr>
<tr>
<td>Offering debentures to institutional investors in Europe and the US, listed for trade on the Singapore stock exchange, in US Dollars</td>
<td>7,810</td>
</tr>
<tr>
<td><strong>Total Liabilities Linked to US Dollars</strong></td>
<td><strong>19,338</strong></td>
</tr>
</tbody>
</table>

| Money raised from a private offering for the sale of debentures in Japan in yen | 2,480 | 3,422 |
| Loans in Euros | 2,359 | 2,262 |
| **Total** | **50,602** | **49,236** |

Less discounts/premiums on debentures, current maturities, issuance expenses and hedge contracts, net

| (3,849) | (3,498) |

| **Total debentures and liabilities to banks and others** | **46,753** | **45,738** |
| **Long term accounts payable** | 672 | 482 |
| **Total** | **47,425** | **46,220** |

(1) Including loans and debentures guaranteed by the State of Israel equaling NIS 3,228 million as of December 31, 2013, and NIS 3,323 million as of December 31, 2012.

(2) Including loans guaranteed by the State of Israel equaling NIS 593 million as of December 31, 2013, and NIS 717 million as of December 31, 2012.

(3) Including loans guaranteed by the State of Israel equaling NIS 4,400 million as of December 31, 2013, and NIS 2,036 million as of December 31, 2012.
Details of Loans Recorded in the Company’s Books, Secured by a State Guarantee are as follows:

<table>
<thead>
<tr>
<th>Contract Details</th>
<th>Source Currency</th>
<th>Balance in NIS in Millions as of December 31, 2013</th>
<th>Weighted Interest*</th>
<th>Date of final repayment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan from Discount Bank</td>
<td>NIS</td>
<td>25</td>
<td>5.47</td>
<td>25/04/2014</td>
</tr>
<tr>
<td>Loan from Bank Hapoalim</td>
<td>NIS</td>
<td>144</td>
<td>4.96</td>
<td>25/07/2016</td>
</tr>
<tr>
<td>Loan from Citi Bank</td>
<td>$</td>
<td>593</td>
<td>5.84</td>
<td>17/06/2025</td>
</tr>
<tr>
<td>Debenture series 24</td>
<td>NIS</td>
<td>2,038</td>
<td>1.03</td>
<td>09/07/2015</td>
</tr>
<tr>
<td>Debenture series 25</td>
<td>NIS</td>
<td>1,021</td>
<td>1.70</td>
<td>09/07/2017</td>
</tr>
<tr>
<td>Loan from Bank Hapoalim</td>
<td>NIS</td>
<td>200</td>
<td>3.15</td>
<td>27/06/2014</td>
</tr>
<tr>
<td>Loan from Bank Leumi Israel</td>
<td>NIS</td>
<td>1,000</td>
<td>2.94</td>
<td>27/06/2014</td>
</tr>
<tr>
<td>Loan from Discount Bank</td>
<td>NIS</td>
<td>500</td>
<td>3.05</td>
<td>27/06/2014</td>
</tr>
<tr>
<td>Loan from International Bank</td>
<td>NIS</td>
<td>300</td>
<td>2.66</td>
<td>27/06/2014</td>
</tr>
<tr>
<td>Loan from Bank Hapoalim</td>
<td>NIS</td>
<td>750</td>
<td>2.28</td>
<td>31/03/2015</td>
</tr>
<tr>
<td>Loan from Bank Mizrahi</td>
<td>NIS</td>
<td>250</td>
<td>2.27</td>
<td>31/03/2015</td>
</tr>
<tr>
<td>Loan from Discount Bank</td>
<td>NIS</td>
<td>200</td>
<td>2.42</td>
<td>31/03/2015</td>
</tr>
<tr>
<td>Loan from Discount Bank</td>
<td>NIS</td>
<td>200</td>
<td>2.26</td>
<td>31/03/2015</td>
</tr>
<tr>
<td>Loan from Bank Leumi Israel</td>
<td>NIS</td>
<td>700</td>
<td>2.38</td>
<td>31/03/2015</td>
</tr>
<tr>
<td>Loan from Bank Leumi Israel</td>
<td>NIS</td>
<td>300</td>
<td>2.26</td>
<td>31/03/2015</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>8,221</td>
<td></td>
</tr>
</tbody>
</table>

* 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, 2013**

The credit is taken from banking corporations and others. The average credit for the reporting periods was NIS 51,903 million and is mainly long term loans and debentures (including hedging transactions, deferred, premium/discount of debentures).

4) **Credit from Banks and Other Credit Providers**

Average Short Term Credit received from banks and others, as of December 31, 2013 was approximately NIS 6,485 million and consisted mainly of current maturities of debentures and the long-term loans.

5) **Suppliers’ and Customers’ Credit**

Average Suppliers’ Credit Period as of December 31, 2013 is approximately 41 days. Average credit from suppliers for the reporting period amounted to approximately NIS 1,651 million.

Average Customers’ Credit Period as of December 31, 2013 is approximately 59 days. Average credit to customers for the reporting period amounted to approximately NIS 4,622 million.
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. 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 2013.

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 the 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, 2013, an amount of NIS 23,567 million is in foreign currency and constitutes 53% of the long term financial obligations of the Company (without State of Israel bonds, before entering into hedging transactions), is in 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 gains 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 for each segment of the electricity supply chain. The hedging mechanism was updated on the annual update of the electricity rate date, according to Company liabilities denominated in foreign currency, which are recognized by the Electricity Authority. This recognition was decreasing gradually up to the complete cancellation of the hedging mechanism planned for April 2013, according to the following schedule:

<table>
<thead>
<tr>
<th>Starting Point</th>
<th>April 2010</th>
<th>April 2011</th>
<th>April 2012</th>
<th>April 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>36%</td>
<td>27%</td>
<td>18%</td>
<td>9%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>0%</td>
</tr>
</tbody>
</table>

   The Company applied to the Electricity Authority requesting to leave the hedging component in the rate, which was expected to be cancelled in April 2013. Following this, on May 6, 2013, the Electricity Authority decided to freeze the path of the hedging mechanism that was determined in the update of the rate base for the generation segment and to leave the composition of the financing basket according to the composition from April 2012. On September 16, 2013, the Electricity Authority decided that freezing the rate of hedging at 9% of the sum of the foreign capital that was determined at the base of the rate in April 2012 (hereinafter: a “hedged sum”) will remain until the next annual update date.

   The hedged sum 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/income derived from the exposure of the Company to foreign currency and transfer it to electricity consumers. As a result of the decision of the Electricity Authority to decrease the rate of the hedged financing component in the rate, the Company was required to increase the volume of hedging transactions in the capital market.
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)
   1) Financial Liabilities (continued):

   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.

   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.
b. **Details about the Exposure to Market Risks and their Management (continued)**

2. **Description of the Company’s Market Risks (continued)**


d) **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 of Generation A and Generation B, 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 l 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 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.

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. Details about the Exposure to Market Risks and their Management (continued)
3. The Company’s Policy for Managing Market Risks (continued)

(b) The Company’s policy regarding interest risk
For details, see Note 27 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 to 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) Aiming to reduce the fluctuations in transfers to the Fund, mainly due to the change in the yields curve for capitalizing the actuarial liability, the Company acted to spread the "exceptional debt".
(5) On November 15, 2010, the change in the articles of the Main Pension Fund was approved by the Supervisor of the Capital Market in the Ministry of Finance.
(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 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 related 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.
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 system 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) Further Details Concerning the Management of Financial Market Risks

1) Events Concerning Exposure to Market Risks and Management of Market Risks after the Statement of Financial Position Date
There are no events of exposure to market risks after the statement of financial position date.

2) The chances of loss from the various investments, and the debts to the Company as a result of the possibility that the opposing party in the transaction or the Company’s debts will fail to meet their obligations or in the absence of the possibility to legally enforce the existence of a debt, are equal to the balance of these assets in the Company’s balance sheets.

3) The Company has no market risk from off balance sheet positions as the purpose of these transactions is purely defensive.

(g) Linkage Base Report

See Note 27 to the Financial Statements for information regarding linkage terms of the financial balances of the Company as of December 31, 2013 and the period last year.

(h) Sensitivity Tests

See Note 27 to the Financial Statements for information regarding sensitivity tests.

(i) Derivatives Positions

See Note 27 to the Financial Statements for information regarding the maximum holding in derivatives.
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**
   As of the date of this report, the Company has six Directors possessing accounting and financial expertise: Directors who possess accounting and financial skills are: Dr. Ziv Reich, Mr. Mordechai Ben-Ami, Ms. Vered Itzhaki, Dr. Izhak Lax, Mr. Arie Rapoport and Dr. Ophir Bashan. For details see Regulation 26 (The Directors of the Corporation) in Chapter D – Additional details about the Company on December 31, 2013.

3. **The Company’s Internal Auditor**
   a) **Details of the Internal Auditor**
      1) The Internal Auditor for the reporting year (hereinafter: the “Internal Auditor”) is Mr. Igal Harel, who began his service as the Internal Auditor on March 17, 2011.
      2) The Internal Auditor conforms to the conditions stipulated in section 146(b) of the Companies Law and to the directives of sections 3a and 8 of the Internal Audit Law - 1992 ("Internal Audit law").
      3) The Internal Auditor is an employee of the Company and does not act in any other capacity in the Company, in addition to the Internal Audit, except for the position of the ombudsman for public and employees’ complaints. Fulfilling these additional roles does not affect his ability to perform his primary role.
      4) The Internal Auditor does not have any material business relations or other material relations with the Company and does not hold any position outside the Company which creates, or may create, a conflict of interests with his role as an Internal Auditor.
   
   b) **Appointment Process**
      On March 17, 2011, the Company's Board of Directors unanimously decided to adopt the recommendation of the Audit Committee from March 3, 2011 and appoint Mr. Igal Harel, as the Acting Internal Auditor until the appointment of a permanent Internal Auditor by the Board of Directors, according to the proposal of the Audit Committee, who will be chosen through a process according to the Circular of the Companies Authority on the subject of Appointing an Internal Auditor 2010-2011, and according to any law applied to the appointment of an internal auditor.
      According to the Circular of the Companies Authority on the subject, the Company's Board of Directors approved on August 25, 2011, the election format of the internal auditor, as presented by the Audit Committee. The Location Committee, appointed to conduct this process, reviewed the candidates who presented their candidacy according to the determined process, rated the candidates according to predefined criteria and recommended Mr. Igal Harel as the most suitable candidate for the position.
      On November 17, 2011, the Company's Board of Directors decided to adopt the recommendation of the Audit Committee and appoint Mr. Igal Harel as the 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” on the Company. This Internal Audit procedure is approved by the Audit Committee.
c. Aspects of Corporate Governance (continued)

3. The Company's Internal Auditor (continued)

d) Work Plan

1) In 2010, the internal audit completed a general processes risks review. The risks review served as the basis for outlining a multi-year work plan for the Internal Audit for the years 2011 - 2013. The multi-year work plan (2011-2013) was approved by the Audit Committee and was submitted to and discussed by the Audit Committee and by the Board of Directors in December 2010.

2) 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 2013 was approved by the Audit Committee and approved by the Board of Directors in December 2012.

3) 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.

4) 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 with 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.

5) The Internal Auditor submitted an audit report in 2013 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 2012.

6) The work plan for 2013 provides the Internal Auditor for unplanned tasks in the scope of 30 tasks.

7) During the period of January – December 2013, the Internal Audit submitted audit reports, including follow-up reports in the area of computerized information systems.

8) 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.

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.
c. Aspects of Corporate Governance (continued)

3. The Company's Internal Auditor (continued)

f) Scope of Employment

1) The number of employment hours of the Internal Auditor during the report year:

<table>
<thead>
<tr>
<th></th>
<th>Internal Audit</th>
<th>Public Complaints</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit of activities in</td>
<td>Approx 42,500</td>
<td>Approx 18,000</td>
</tr>
<tr>
<td>Israel</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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 July 2010, by the Audit Committee and approved by the Board of Directors in December 2010, the Company estimates that the work scope of the Internal Audit is required and sufficient to perform internal audits of 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 his 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 his representatives are entitled to enter every asset and inspect it, in conformance with the contents of Section 9 of the Internal Audit Law.

i) Reports of the Internal Auditor

1) Reports of the Internal Auditor are submitted in writing. Biannually, the Internal Auditor submits a summarized report of the work of the Internal Audit and a follow-up report on implementation of decisions and recommendations.

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 2013, the Internal Auditor presented 143 reports: 113 audit reports and 30 examination reports. During this period, the Audit Committee of the Board of Directors held 10 discussions on the Internal Auditor’s findings and recommendations which took place on January 3, February 7, March 14, April 25, May 30, July 18, August 29, October 17, November 20, December 26.
c. Aspects of Corporate Governance (continued)

3. The Company’s Internal Auditor (continued)

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 his 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 his wages do not affect the ability of the Internal Auditor to exercise his professional consideration.

l) Miscellaneous
1) According to the professional standards of the International Institute of Internal Auditors, and circular 2011-4-2 of the Government Companies Authority, an examination of the quality of the internal audit has to be executed every 5 years. The previous one was conducted in 2007. This examination started in October 2012, by the accounting firm of Fahn Kanne.

In May 2013, the external audit report was presented to the chairman of the Audit Committee.

In the conclusion of the report, the reviewer noted:

“We wish to point out that in general, we found that the Internal Audit Division of the Electric Company is operating in accordance with the instructions of the Government Companies Authority and the internal regulations of the Company. It was found that the Division demonstrates a good professional level compared to similar bodies we know.

However, there are a number of areas wherein we believe it is possible to improve the effectiveness of the internal audit and which will improve its prestige with the Management.

These recommendations derive mainly from the development of the internal audit profession in recent years due to an increase in the importance of improving control systems in companies. These recommendations were presented as “recommendations for improving the process”, in distinction from recommendations to fulfill instructions, professional standards and regulations that were presented as “compliance recommendations.”

Recommendations for improvement were presented. Some of the recommendations have been implemented and some are in the process of being implemented.

A discussion of the subject was held by the Audit Committee in July 2013.

The summary of the discussion stated that the Committee made note of the report given with regard to the Internal Audit quality.
c. Aspects of Corporate Governance (continued)

3. The Company’s Internal Auditor (continued)

   l) Miscellaneous (continued)

   2) After it was discovered that a manager’s written evaluation regarding a candidate for the position of Deputy Internal Auditor was removed from his personal file or was not placed in it and was not presented to the Search Committee for the position, the Audit Committee of the Board of Directors decided that the issue will be examined by an external investigator.

   The external investigator presented the report regarding the issue.

   The Audit Committee decided to accept the position of the internal auditor that he did not take, and did not request to take the evaluation prepared about a Company employee by the previous internal auditor of the Company, out of his personal file, one day before the termination of his service as internal auditor of the Company. It also accepted his statement that he made a mistake when exercising his discretion by not updating the members of the Search Committee about the existence of the stated evaluation. However, this is an error of judgment that did not affect any decision making by the Search Committee.

   In light of the above mentioned, the committee decided that a managerial comment should be made and kept in the personal file of the internal auditor, but clarified that the said mistake does not prevent him from continuing the office of Mr. Igal Harel as internal auditor of the Company and expressed the Company’s confidence in his professional work.

   On November 4, 2013, the internal auditor notified the Chairman of the Board of Directors of his decision to request to end his term as internal auditor of the Company in January 2014. The Chairman of the Board of Directors accepted the request of the internal auditor and concluded that the internal auditor will end his term on January 19, 2014.

   On January 23, 2014, Mr. Shmuel Schatz was appointed as acting Internal Auditor.

   On February 6, 2014, Ms. Nitza Rogozinski was appointed as the internal auditor of the Company. The appointment will enter into effect upon termination of the present term of Ms. Rogozinski as Internal Auditor at “Amitim, the Veteran Pension Funds”, and no later than three months from the date of her appointment.
Aspects of Corporate Governance (continued)

4. Internal Enforcement Plan

As of the date of publication of the report, the Company is in the process of implementation and integration of the outline of the internal enforcement plan in the Company, which was adopted and approved by the Board of Directors of the Company on June 14, 2012. The outline of the enforcement plan was formulated in the Company according to the criteria published by the Securities Authority on August 15, 2011, regarding the recognition of an internal enforcement plan in the field of securities as an effective enforcement plan (hereinafter: the “Criteria”), and while reviewing the work procedures and regulations currently existing in the Company, updating them and integrating them within the proposed outline and identifying the factors involved in the work processes.

Within the work on the internal enforcement plan, the Company has set a schedule for implementation of the milestones required to complete the process of adoption and implementation of the plan. Within the enforcement plan, the Board of Directors of the Company appointed a dedicated committee of the Board of Directors - a Corporate Responsibility Committee, which deals, amongst others, with the adoption and implementation of the internal enforcement plan in the Company in accordance with the functions designated to it within the outline of the plan. In addition, the legal advisor and secretary of the Company, Advocate David Yahav, was appointed as supervisor of the of the internal enforcement in the field of securities and a national enforcement and compliance team as well as enforcement and compliance teams, contacts and key persons in the various Company units were appointed. Additionally, reporting entities were appointed for the purpose of information flow for immediate reports.

The Company executes intensive enforcement acts and has completed basic training for the teams, contacts and key persons for assimilating the subject of internal enforcement in the Company, and six master procedures have been written within the enforcement plan and they were published as Company procedures and in-depth training has been executed with regard to them.

Additionally, the Company has entered into an engagement with the office of Ziv Haft Consultation and Management Ltd. for the employment of an accompanying expert for the purpose of conducting a compliance survey for locating gaps and failures in the Company’s activity and the exposure of the Company to the Securities Laws, according to criteria. The compliance survey began in July 2013. In accordance with the instructions of the administrative enforcement regulation that was signed between the Company and the Securities Authority, which was approved by the administrative enforcement committee on November 28, 2013, in February 2014 the Company appointed an external supervisor whose function is, inter alia, to ensure the completion of the formation and effective implementation of the enforcement plan and its procedures (for additional details of the enforcement regulation see Immediate Report of November 28, 2013, ref. no.: 2013-01-208542).

5. Financial Statements Approval Process

a) For details regarding the approval proceeding of the financial statements as required by the Securities Regulations see the 2013 Corporate Governance Questionnaire.
c. Aspects of Corporate Governance (continued)

5. Financial Statements Approval Process (continued)

b) Other Steps taken in the Company to Ensure the Correctness of the Company Financial Statements and the Board of Directors’ Report

The Company has established a “Disclosure Committee Work in Financial Reporting Disclosures” procedure which includes the establishment of a Disclosure Committee. The committee was established and is headed by the CEO of the Company, Mr. Eliyahu Glickman, and its goal is to ensure in an optimal manner that the financial statements of the Company include full presentations and disclosures as required.

The duties of the committee:

The disclosure committee, headed by the CEO, 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.

Members of the committee:

Company CEO - chairman of the committee, Deputy CEO’s, the legal advisor, Head of Accounting and Economics Division, Head of Finances Division, Head of Accounting and Financial Statements Department and Head of Sox Department.

The Committee convenes twice a quarter, at the beginning of the process of producing the financial statement and towards the end of the production of the financial statement, close 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 Senior Vice President of Finance and Economics, Vice President Human Resources, the CEO, 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.

6. The Link between Rewards to Senior Position Holders and Interested Parties in the Company and Their Contribution to the Company

On March 24, 2013, 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 7 below.
c. **Aspects of Corporate Governance (continued)**

7. **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.

Following are details of the main instructions of the compensation policy (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):

a. The compensation policy is a perennial policy that will be in force for a period of 3 years from the date of its approval by the general meeting as mentioned above and subject to that required by law.

b. The considerations and principles at the base of the compensation policy:

1) Promoting the vision of the Company, its targets, goals, work plans and policy with a long term view - the Company produces, transmits, distributes and supplies most of the electricity consumed by the Israeli economy and constitutes an essential service supplier in the electricity market. The Company aspires to continue to be the leading business company in its field in Israel, to adapt itself to the changing market conditions and economic, social and technological changes in Israel and worldwide, while advancing renewable energies and encouraging energy saving, and breaking through to new and international markets.

2) Creating appropriate incentives for the office holders of the Company - the heavy responsibility laid upon the office holders of the Company, due to the status of the Company and the challenges it is going to face, obliges to employ the best professionals through appropriate incentives.

3) Adjusting the compensation to the size of the Company and the scope of its activity - the Company is one of the biggest companies in the Israeli economy and employs approximately 12,000 employees, and its annual budget is almost NIS 30 billion.

4) The relation between the service and employment terms of an office holder and the salary of the rest of the Company employees and contractor’s workers employed at the Company which was found to be reasonable, lower than that customary in other companies, and does not adversely affect the labor relations in the Company.

c. The salary components detailed in the policy relate to office holders employed by personal work contract according to a unified version of personal employment agreements for senior employees in Government Companies (“Personal Work Contract”). Regarding office holders employed under the collective employment terms - only the collective employment terms apply, subject to the provisions of section 29 to the Budget Foundations Law.
c. **Aspects of Corporate Governance (continued)**

7. **Policy for the Compensation of Officers under Amendment No. 20 to the Companies Law (continued)**

**Compensation Policy for Senior Office Holders (continued)**

d. The employment terms under a Personal Work Contract are, as stated, according to a unified version of personal employment agreements for senior employees of the Companies Authority, and in accordance with the instructions of the Companies Authority as will be updated from time to time, and they include:

1) A comprehensive salary that is determined as a function of the classification of the Company according to the instructions of the Companies Authority, and can be updated according to the consumer price index upon the approval of the compensation committee and the Board of Directors.

2) Additional components such as vehicle, telephone expenses, board and lodging, clothing, advance study fund, annual leave, convalescence, sick leave, insurance for loss of working capacity, provision for pension, compensation and severance pay.

3) Changing component based on results - according to the instructions of the Companies Authority and the decisions of the classification committee at the Companies Authority, office holders employed by a personal work agreement whose salary is not derived from a 10(1) classification level of the classification scale of business government companies may be entitled to an annual compensation of up to 10% from their pension salary, subject to the approval of the compensation committee and the Board of Directors of the Company based on an excellence test. The personal compensation will be mainly based (80%) on a measurable grant which will be calculated according to meeting quantitative criteria that can be measured (key performance indicators and general social targets) and in its non-material part (20%) on a grant that will be based on qualitative criteria and which be subject to consideration.

e. An external director of the Company will be entitled to annual compensation and compensation for participation in a meeting at the minimal sums detailed in the second and third supplement to the Companies Regulations (Rules of Compensation and Expenses for External Directors) - 2000.

f. Compensation and expenses for an outside director (including an independent director) are determined in accordance with the Government Companies Regulations (Rules of Compensation and Expenses for an Outside Director at Government Companies) - 1994.

g. An office holder will return to the Company sums that were paid to him as part of the office and employment terms if their payment was based on data that turned out to be erroneous and were newly presented in the financial statements of the Company.

h. In view of the provisions of the law that apply to the Company as a Government Company, the compensation of office holders of the Company will not include a capital component.

i. Bonus to office holders will be paid according to law and the instructions of the Companies Authority, and the manner of its establishment will be according to the decision of the compensation committee, the Board of Directors and the Companies Authority.

j. The Board of Directors is authorized to approve payment of up to 100% additional severance pay for an office holder employed by a personal work agreement, and any payment beyond that requires the approval of the Board of Directors of the Company and the Government Companies Authority. Furthermore, the Board of Directors is permitted to approve, for the office holders whose salary is derived from a 10(1) classification grade, payment of an additional salary with respect to every work year in the Company but not more than three salaries with respect to every year of service as a senior employee as its meaning in the Government Companies Law (the lower of the two).
The Israel Electric Corporation Limited Board of Directors' Report on the Status of the Company's Affairs for the Year Ended December 31, 2013

C. Aspects of Corporate Governance (continued)

8. 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.

b) At the Annual General Meeting of November 22, 2012, 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. The Government Companies Authority announced that since the recommendation of the committee appointed for this matter by virtue of the Rules of Government Companies (Appointment and Pay of External Auditors) – 1994 (hereinafter: the "Committee") has yet to be received, 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.

c) As the committee has not yet convened, also during the last annual general meeting of the Company of January 9, 2014, 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 stated in the decision of the General Meeting of January 9, 2014, 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 (audited, reviewed, budgetary), report of the Board of Directors and reports of internal and external audits.

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 2012 – 2013 are detailed below:

<table>
<thead>
<tr>
<th>For the year ended on December 31</th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Hours</td>
<td>NIS thousands</td>
</tr>
<tr>
<td>Brightman Almagor Zohar &amp; Co.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. Fees for audit services, for services related to audits and for tax services</td>
<td>21,917</td>
<td>4,603</td>
</tr>
<tr>
<td>b. Other fees - total fees for services provided by the outside auditor which are not included in paragraph (a) above</td>
<td>3,250</td>
<td>682</td>
</tr>
</tbody>
</table>

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 accompanying services: 3,250
c. Aspects of Corporate Governance (continued)

8. External Auditors of the Company (continued)

c) (continued)

<table>
<thead>
<tr>
<th>Hours dedicated by the External Auditor in providing other related services in 2012:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Work related to a draft prospectus that was not published and a prospectus in Israel</td>
<td>3,500</td>
</tr>
<tr>
<td>Work related to the communication between the auditors and the Government Companies Authority</td>
<td>100</td>
</tr>
<tr>
<td>Special tax work</td>
<td>220</td>
</tr>
<tr>
<td>Work on providing special auditor confirmations</td>
<td>250</td>
</tr>
<tr>
<td><strong>Total hours dedicated to other accompanying services</strong></td>
<td><strong>4,070</strong></td>
</tr>
</tbody>
</table>

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.

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.
d. Instructions for Disclosure Related to the Financial Reporting of the Company

1. The Financial Reporting of the Company

On January 1, 2015, the Company will fully implement the International Financial Reporting Standards (IFRS).

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 36 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 Annual Financial Statements.

   b) Additional details regarding the critical accounting estimates of the Company are presented below.
      1) Benefits to employees: For details of the critical accounting estimates related to employee benefits see Note 12 r to the Financial Statements.

      2) Assets depreciation in accordance with IAS 36:
         Sensitivity test according to the weighted cost of capital (WACC)
         | WACC  | -0.4% | -0.2% | Determined Capital Prices | +0.22% | +0.4% |
         |       |       |       |                         |        |       |
         | Minimum usage value in NIS million | 68,786 | 68,692 | 68,599 | 68,506 | 68,414 |

The books value as of December 31, 2013 is NIS 68,464 million.

For more information on the sensitivity test and its impact see Annex B (Assets Impairment Test) to the Annual Financial Statements.

3) Fair value of financial instruments – see Note 27 c to the Financial Statements.
d. **Instructions for Disclosure Related to the Financial Reporting of the Company (continued)**

4. **Material and Highly Material Valuations**

   a) In accordance with Section 8(b) of the Securities Law Regulations and also according to the legal position No. 105-23 of the Securities Authority on the subject and the attached clarification:

   When a material valuation serves as the basis to determine the value of data in a periodic report, including determining that there is no need to change the value of the data, the report will disclose different parameters detailed in the regulations and in the event of a highly material valuation, it will be attached to the report.

   The Securities Authority determined "quantitative" tests (statement of financial position test and results test) to examine the materiality of the valuations. Nevertheless, the Securities Authority stated that an alternative test may be defined, where a qualitative examination of the features of the corporation justify it.

   According to the results test, as determined by the Securities Authority, the effect of the change in value arising from the valuation should be related to the total net or comprehensive profit respectively, of the Company in the reporting period ("The Results Test of the Securities Authority"). The Company is of the opinion that the profit test (the Results Test) of the Security Authority, is not a reflective test of the Company, considering the unique features of the Company and its activities, as detailed below:

   1) The Company's profit is low in relation to the volume of operations of the Company and is highly affected by fluctuations of external parameters.
   2) The revenues of the Company are based on a rate determined by the Electricity Authority.
   3) The Company is subject to regulatory supervision. Its control on its revenues is almost non-existent, since the rate is predetermined and the quantity is affected by the demand for its services and products and it is a rigid demand.
   4) The Company believes that the profitability index is of secondary importance compared to criteria of financial soundness and the ability to repay obligations.
   5) The high differences in profit both in annual and quarterly results depend on factors outside of the Company's control.
   6) A considerable part of the Company's operations is in investment, which is not expressed in the net profit results.

   In light of the qualitative considerations specified in sections 1)-6) above, the Company concluded that the Results Test, as defined by the Securities Authority, is not a suitable tool for reviewing the valuation materiality of the Company. The Company will examine the materiality of the valuations according to a different qualitative results test that reflects correctly the materiality subject in valuations in the Company's financial statements.

   Based on the aforementioned the Company will examine the materiality of the valuation according to the following tests:

   (a) Statement of financial position test – to examine the valuation in relation to the total assets of the Company, as presented in the consolidated statement of financial position as of the last date of the reported period (identical to the statement of financial position test determined by the Securities Authority).
   (b) Results test – to examine the effect of the change in the value of a single asset/liability on the net profit or comprehensive income, as the case may be, of the average of recent years, neutralizing incidental effects (after tax) hereinafter: the "Normalized Profit". The net normalized profit calculated for 2013 is approximately NIS 940 million (net after tax effect). The comprehensive normalized profit calculated for 2013 is NIS 1,169 million.
d. Instructions for Disclosure Related to the Financial Reporting of the Company (continued)
4. Material and Highly Material Valuations (continued)

A valuation that maintains a ratio of a single asset/liability, where its value constitutes 10% or more of the total assets of the Company as of the Financial Statements date, or a single asset/liability, where the change in their value consists of 10% or more of the profit, calculated as aforementioned, and provided that as regards the results test, the effect of the change in value as a result of valuation of the net profit or comprehensive profit, as the case may be, constitutes at least 5% of the equity of the Company will be considered highly material. A valuation that maintains a ratio of 5% or more will be considered material. The materiality of the valuations will be examined separately for each stand-alone asset/liability, provided that there is no dependence between certain assets to certain liabilities requiring an examination as one group. The subject was submitted to the Company’s Committee for Reviewing the Financial Statements and these tests were approved by the Board of Directors.

b) Disclosure with respect to a valuation that served as the basis to determine the value of data in the Financial Statements

Material and Highly Material Valuations
Details of valuations classified as material/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.

<table>
<thead>
<tr>
<th>Identification of Valuation subject</th>
<th>Actuarial obligation for employee benefits in accordance with International Accounting Standard 19 (IAS 19)</th>
</tr>
</thead>
<tbody>
<tr>
<td>The timing of the evaluation:</td>
<td>December 31, 2013</td>
</tr>
<tr>
<td>Determined in accordance with the evaluation</td>
<td>NIS 25,942 million</td>
</tr>
<tr>
<td>Identifying the appraiser and his characteristics:</td>
<td>Assessment was carried out by Ernst &amp; Young (Israel) Ltd. (hereinafter: Ernst &amp; 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.</td>
</tr>
<tr>
<td>Dependency on evaluation order</td>
<td>On March 29, 2011 the new actuary of the Company from Ernst &amp; Young (Israel) Ltd., who provides actuarial services to the Company from the first quarter of 2010, received a letter of indemnification from the Company. For details, see Note 33 f) to the Financial Statements</td>
</tr>
<tr>
<td>Evaluation model which the appraiser used</td>
<td>Discounted Cash Flow (hereinafter: “DCF”)</td>
</tr>
</tbody>
</table>
| 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 2.29%  
Real update of salary during the work period - Individual salary development model of active employees and including salary increase between current salary agreements or general future salary agreements (offsetting inflationary effect). Real update of pension amounts after employment termination – individual pension development model of pensioners (offsetting inflationary effect). 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 | The Company's Human Resources Department, which convened the team that decided on recruiting the new actuary of the Company was responsible for the initial agreement. In 2011, the engagement contract was renewed by the Head of Accounting and Economics Department. |
**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)**
  - **Material and Highly Material Valuations (continued)**

2) **Very high Material Valuation of Asset Impairment, implementation of IAS 36:**

<table>
<thead>
<tr>
<th>Identification of valuation subject</th>
<th>Asset impairment - examination of the asset impairment of the Company within the implementation of International Accounting Standard 36 (IAS 36) - the assets of the three operational segments of the Company.</th>
</tr>
</thead>
<tbody>
<tr>
<td>The timing of the evaluation:</td>
<td>December 31, 2013</td>
</tr>
<tr>
<td>The value of the evaluation subject a short time before the date of valuation, where the generally accepted accounting principles, including depreciation and amortization, would not have obliged the change of its value according to the value evaluation:</td>
<td>NIS 68,464 million (book value).</td>
</tr>
<tr>
<td>Balance Sheet value determined in accordance with the evaluation</td>
<td>NIS 68,599 million</td>
</tr>
</tbody>
</table>

**Identifying the appraiser and his characteristics:**

The Financial Department of Ernst & Young Israel Ltd. provides accompanying and consultation services to many leading companies of the Israeli Economy. The department is managed by Accountant Alon Lugassi, senior partner of the office who runs the entire branch. Mr. Lugassi has a BA in Economics, Business Administration and Accounting from the University of Haifa and an MBA from the University of Haifa. His experience includes accompanying transactions, financial advising, evaluations, due diligence, and business development.

**Dependency on evaluation order**

No

**Evaluation model which the appraiser used**

Discounted Cash Flow method

**Assumptions according to which the appraiser performed the valuation, depending on the model estimates:**

Forecast of future cash flows, that are expected to result from one cash yielding unit, was performed on the basis of the structure of the present rates and on the basis of assumptions that represent, inter alia, the economic conditions that will prevail during the useful lifespan of the unit assets, the main ones of which are:

- While examining the cash yielding units, the Company identified the three operational segments of the Company as one cash yielding unit.
- The present rate structure in the generation segment, as was determined in February 2010, will end at the end of 2014, and a new rate will enter into effect in July 2015. The new rate basis will provide full cover for the investment and operation costs of the Company, in accordance with the Electricity Sector Law.
- The new rate basis for the transmission and distribution segments, when published, will apply from April 1, 2012. The new rate basis for the transmission and distribution segments will provide full cover for the investment and operation costs of the Company from January 1, 2014, in accordance with the Electricity Sector Law.
- Fuel costs that the Company will bear will be covered within the electricity rate throughout the forecast periods.
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)**

   **Material and Highly Material Valuations (continued)**

   2) **Very high Material Valuation of Asset Impairment, implementation of IAS 36: (continued)**

   - The Weighted Average Cost of Capital 4.7% for the generation segment. This value reflects the time value of the money, and the specific risks as determined in the electricity rate for the operation segment; due to the transmission and distribution segments, the capitalization rate was assumed to be equal to the yield rate that will be granted by the Electricity Authority, in order to reflect the assumption of the management of the Company with regard to the full cover in these segments, as stated.

   The body in the Company that decided to enter an agreement with the appraiser: Head of Accounting and Economics Division.

   3) **Material valuation of Swap Transactions in accordance with IAS 39:**

<table>
<thead>
<tr>
<th>The timing of the evaluation:</th>
<th>December 31, 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identifying the evaluation subject and its balance sheet value:</td>
<td>- Swap transaction no. 300357 transaction of exchanging non-linked NIS with Dollars liability of NIS 311 million</td>
</tr>
<tr>
<td></td>
<td>- Swap transaction no. 300580 transaction of exchanging linked NIS with Yen liability of NIS 72 million</td>
</tr>
<tr>
<td></td>
<td>- Swap transaction no. 300617 transaction of exchanging linked NIS with Yen liability of NIS 101 million</td>
</tr>
<tr>
<td></td>
<td>- Swap transaction no. 300619 transaction of exchanging linked NIS with Yen liability of NIS 120 million</td>
</tr>
<tr>
<td></td>
<td>- Swap transaction no. 300678 transaction of exchanging linked NIS with Dollars credit balance of NIS 103 million</td>
</tr>
<tr>
<td></td>
<td>- Swap transaction no. 300687 transaction of exchanging linked NIS with Yen liability of NIS 218 million</td>
</tr>
<tr>
<td></td>
<td>- Swap transaction no. 300727 transaction of exchanging linked NIS with Dollars liability of NIS 148 million</td>
</tr>
</tbody>
</table>

   Identifying the appraiser and his characteristics: As of the Financial Statements of June 30, 2012, the Company independently evaluates, through its SAP system, the fair value of the swap transactions.

   Evaluation model which the appraiser used: - The swap transactions are currency exchange transactions where one party transfers a certain amount to another party in currency A and receives a certain amount in currency B at fixed dates and fixed interest rates.
   - Transaction values are measured using a bond swapping method, which constitutes a customary method of measuring transactions of this kind: the fair value of the swap transaction is calculated as the difference between the cash flows capitalized with appropriate risk-free interest rates.

   Assumptions according to which the appraiser performed the valuation, depending on the model estimates: The swap transactions valuation was calculated based on the interest curve structure of the two currencies (source: Reuters) and the exchange rate on the evaluation date. Additionally, an adjustment for credit risk was made in respect of the transaction.
d. Instructions for Disclosure Related to the Financial Reporting of the Company (continued)

4. Material and Highly Material Valuations (continued)

c) Disclosure of Quantitative Tests Results applied to Examine the Materiality of the Valuation

In accordance with Legal Position No. 105-23 of the Securities Authority where a valuation is classified as material/highly material, as the case may be, according to tests established by the Securities Authority, but according to the alternate test performed by the Company, the valuation is not material/highly material, the results of the quantitative tests applied by the Company should be detailed, including tests established by the Securities Authority.

As of the date of this report, the Company has no valuations of swap transactions which would be classified as a material/very highly material valuation if tested in accordance with test methods prescribed by the Securities Authority, however, according to the alternative test established by the Company, these valuations are not considered to be material/very highly material valuations as the case may be.

5. Disclosure of the Forecasted Cash Flow of the Company for Financing Repayment of Corporate Liabilities

a) The Company is over the terminated fuels crisis, which began with the cessation of the Egyptian gas supply following recurring sabotage of the gas supply pipeline, a situation that forced the Company to purchase alternative and more expensive fuels for supplying electricity.

b) Following a number of steps taken by the Company and various Government entities, such as: spreading the surplus fuels costs over several years in the electricity rate, receiving State guarantees to finance the surplus fuels costs and from the beginning of gas supply from the Tamar field as well, a significant improvement has occurred in the financial position of the Company.

c) In accordance with the decision of the Board of Directors of the Company, the Company maintains a safety cushion of a financial value of not less than NIS 3 billion, and the cash balance will not be less than NIS 2.2 billion, and the crude and diesel oil inventory surplus will be a part of the safety cushion up to a value of NIS 800 million.

d) As of the date of the report, warning signs according to section 10(b)(14)(a) of the Securities Regulations do not apply to the Company.

In light of the above mentioned, the Company is not publishing a forecasted cash flow.

e) According to the raising needs of the Company, the Company plans to raise approximately NIS 1.8 billion in 2014 through private debenture placement in the Israeli capital market (for details of the approval of the Board of Directors of the Company of March 24, 2014, for executing a private debenture placement of approximately NIS 1 billion, see Note 36 n to the financial statements). As part of the Company’s preparations for the placement, the Company approached the Government Companies Authority, the Tel Aviv Stock Exchange, the credit rating company Midroog, and the Minister of National Infrastructures, Energy and Water, requesting the required approvals. Additionally, the Company has engaged with distributors and is examining the worthwhile raising channels. The Company estimates that it will be able to raise the above mentioned debt.

f) In view of the above mentioned, the Company is not expected to decrease from the safety cushion as was approved by the Board of Directors as detailed above.

g) Regarding the comparison between the cash flow for 2013 that was published in the financial statement as of December 31, 2012, and the actual performance, see Appendix A to this report.
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 methodologies and standards, the COSO and the COBIT model (for information systems), 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 the financial statements for the year 2011, 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, 2013 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.
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)**

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.

On October 10, 2013, the decision of the Commissioner of Wages pertaining to four salary irregularities in the Company was received, as detailed in the financial statements.

On March 10, 2014, the Regional Labor Court decided that the agreements regarding the four salary components remain valid until the Court will make its ruling.

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, 2013, 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 Security 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.
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 326 main sites, as well as a ledger of less important assets (about 13,299 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 37 sites, and with respect to 76 additional sites, caveats were recorded, 56 lease contracts were signed with the Israel Lands Administration, 242 contracts for purchasing transformation rooms were executed, 29 easements for access to a transformers room were registered and 329 other assets were identified.

   b) **Liabilities with respect to Employee – Employer Relations**

   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, 2013.
e. Dedicated Disclosure to Debentures Holders

1. Details of Debentures of the Group Traded in Israel
   a) Details of debentures (series 22) as at December 31, 2013, as required in the eighth addition to the Securities:

   1) Series Debentures (Series 22)

<table>
<thead>
<tr>
<th>Series</th>
<th>Debentures (Series 22)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issue date (initial)</td>
<td>May 29, 2002, according to the prospectus of the Company on May 21, 2002</td>
</tr>
<tr>
<td>Total nominal value on the issue date (initial)</td>
<td>NIS 500,000,000 nominal value.</td>
</tr>
<tr>
<td>Nominal value on December 31, 2013</td>
<td>NIS 3,000,000,000 nominal value</td>
</tr>
<tr>
<td>Revaluated nominal value in accordance with linkage conditions for the report date (December 31, 2013)</td>
<td>NIS 3,146,512,686</td>
</tr>
<tr>
<td>Accumulated interest (as of December 31, 2013)</td>
<td>NIS 22,724,814</td>
</tr>
<tr>
<td>Its fair value included in the last Financial Statements¹</td>
<td>The fair value of the marketable series in the stock exchange value, see below</td>
</tr>
<tr>
<td>Stock exchange value of debenture series on December 31, 2013</td>
<td>NIS 3,296,250,000</td>
</tr>
<tr>
<td>Interest type (fixed or variable) and rate</td>
<td>Fixed annual interest at 6.5% rate</td>
</tr>
<tr>
<td>Principal payment dates</td>
<td>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</td>
</tr>
<tr>
<td>Interest payment dates</td>
<td>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</td>
</tr>
<tr>
<td>Linkage basis</td>
<td>Linked (principal and interest) to the CPI published on May 15, 2002 of April 2002</td>
</tr>
<tr>
<td>It was determined that the debentures can be converted to another security</td>
<td>No</td>
</tr>
<tr>
<td>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</td>
<td>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.</td>
</tr>
<tr>
<td>A guarantee was issued for payment of the entity’s liability, in accordance with a trust deed</td>
<td>No</td>
</tr>
<tr>
<td>Pledged Assets</td>
<td>No</td>
</tr>
<tr>
<td>Rating</td>
<td>See Note 20 f to the financial statements</td>
</tr>
<tr>
<td>Is this debenture series considered material under regulation 10 (b)(13) of the Securities Regulations</td>
<td>No</td>
</tr>
</tbody>
</table>

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 2013, namely December 31, 2013.
e. Dedicated Disclosure to Debentures Holders (continued)

1. Details of Debentures of the Group Traded in Israel (continued)

a) Details of debentures (series 22) as at December 31, 2013, as required in the eighth addition to the Securities: (continued)

4) Rating of Debentures (Series 22) by a Rating 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) Partial repayment of the above debenture was made on February 20, 2014. For details see Note 20 to the Financial Statements.

b) Following are details of debentures (series 24) issued by the Company, as of December 31, 2013, as required in the eighth addition to the Securities Regulations:

<table>
<thead>
<tr>
<th>Series</th>
<th>Debentures (Series 24)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issue date (initial)</td>
<td>July 8, 2012, according to the prospectus of the Company of June 26, 2012</td>
</tr>
<tr>
<td>Total nominal value on the issue date (initial)</td>
<td>NIS 996,525,000 nominal value.</td>
</tr>
<tr>
<td>Nominal value as of December 31, 2013</td>
<td>NIS 1,996,525,000 nominal value</td>
</tr>
<tr>
<td>Revaluated nominal value in accordance with linkage conditions for the report date December 31, 2013</td>
<td>NIS 2,038,510,945</td>
</tr>
<tr>
<td>Accumulated interest (as of December 31, 2013)</td>
<td>NIS 6,293,903</td>
</tr>
<tr>
<td>Its fair value included in the last Financial Statements</td>
<td>The fair value of the marketable series is the stock exchange value, see below</td>
</tr>
<tr>
<td>Stock exchange value of debenture series on December 31, 2013</td>
<td>NIS 2,078,182,873</td>
</tr>
<tr>
<td>Interest type (fixed or variable) and rate</td>
<td>Fixed annual interest at 0.65% rate</td>
</tr>
<tr>
<td>Principal payment dates</td>
<td>One payment on July 9, 2015</td>
</tr>
<tr>
<td>Interest payment dates</td>
<td>On July 9 of each of the years 2013 to 2015</td>
</tr>
<tr>
<td>Linkage basis</td>
<td>Linked (principal and Interest) to the CPI published on June 15, 2012, of May 2012</td>
</tr>
<tr>
<td>It was determined that the debentures can be converted to another security</td>
<td>No</td>
</tr>
<tr>
<td>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</td>
<td>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.</td>
</tr>
</tbody>
</table>

2Market value on the last trading day in December 2013, namely December 31, 2013.
e. Dedicated Disclosure to Debentures Holders (continued)

1. Details of Debentures of the Group Traded in Israel (continued)

b) Following are details of debentures (series 24) issued by the Company, as of December 31, 2013, as required in the eighth addition to the Securities Regulations (continued):

<table>
<thead>
<tr>
<th>Series</th>
<th>Debentures (Series 24)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A guarantee was issued for payment of the entity’s liability, in accordance with a trust deed</td>
</tr>
<tr>
<td>Pledged Assets</td>
<td>A floating charge was provided over all the Company’s assets in favor of the guarantor – the State of Israel</td>
</tr>
<tr>
<td>Rating</td>
<td>Is this debenture series considered material under regulation 10 (b)(13) of the Securities Regulations</td>
</tr>
</tbody>
</table>

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.

4) Rating of Debentures (Series 24) by a Rating Company:
See Note 20 f to the Annual 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.
e. Dedicated Disclosure to Debentures Holders (continued)

1. Details of Debentures of the Group Traded in Israel (continued)

c) Following are details of debentures (series 25) issued by the Company, as of December 31, 2013, as required in the eighth addition to the Securities Regualtions:

<table>
<thead>
<tr>
<th>Series</th>
<th>Debentures (Series 25)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issue date (initial)</td>
<td>July 8, 2012, according to the prospectus of the Company of June 26, 2012</td>
</tr>
<tr>
<td>Total nominal value on the issue date (initial)</td>
<td>NIS 500,000,000 nominal value.</td>
</tr>
<tr>
<td>Nominal value as of December 31, 2013</td>
<td>NIS 1,000,000,000 nominal value</td>
</tr>
<tr>
<td>Revaluated nominal value in accordance with linkage conditions for the report date (December 31, 2013)</td>
<td>NIS 1,021,029,511</td>
</tr>
<tr>
<td>Accumulated interest (as of December 31, 2013)</td>
<td>NIS 5,819,868</td>
</tr>
<tr>
<td>Its fair value included in the last Financial Statements</td>
<td>The fair value of the marketable series is the stock exchange value, see below</td>
</tr>
<tr>
<td>Stock exchange value of debenture series on December 31, 2013</td>
<td>NIS 1,073,800,000</td>
</tr>
<tr>
<td>Interest type (fixed or variable) and rate</td>
<td>Fixed annual interest at 1.20% rate</td>
</tr>
<tr>
<td>Principal payment dates</td>
<td>One payment on July 9, 2017</td>
</tr>
<tr>
<td>Interest payment dates</td>
<td>On July 9 of each of the years 2013 to 2017</td>
</tr>
<tr>
<td>Linkage basis</td>
<td>Linked (principal and Interest) to the CPI published on June 15, 2012, of May 2012</td>
</tr>
<tr>
<td>It was determined that the debentures can be converted to another security</td>
<td>No</td>
</tr>
<tr>
<td>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</td>
<td>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.</td>
</tr>
<tr>
<td>A guarantee was issued for payment of the entity’s liability, in accordance with a trust deed</td>
<td>A warranty by the State of Israel was issued</td>
</tr>
<tr>
<td>Pledged Assets</td>
<td>A floating charge was provided over all the Company’s assets in favor of the guarantor – the State of Israel</td>
</tr>
<tr>
<td>Rating</td>
<td>See Note 20 f to the financial statements</td>
</tr>
<tr>
<td>Is this debenture series considered material under regulation 10 (b)(13) of the Securities Regulations</td>
<td>No</td>
</tr>
</tbody>
</table>

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](http://www.rpn.co.il)

3) The debentures cannot be converted.

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3 Market value on the last trading day in December 2013, namely December 31, 2013.
e. Dedicated Disclosure to Debentures Holders (continued)
1. Details of Debentures of the Group Traded in Israel (continued)
c) Details of debentures (series 25) issued by the Company, as of December 31, 2013, as required in the eighth addition to the Securities Regulations (continued):

4) Rating of Debentures (Series 25) by a Rating Company: See Note 20 f to the Annual 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.

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 exposed to different environmental hazards 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, non-ionizing radiation 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 more strict in the coming years, according to international awareness and requirements and, inter alia, in accordance with that which is customary in Western countries.
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. In July 2011, the Ministry of Environmental Protection approved the emission reduction plan that the Company submitted, under which devices to reduce emissions in the Company’s coal fired power stations will be gradually installed and some of the units will be converted to natural gas. Recently, the Company filed possible options for the periods of shutdown of the project units. And in February 2014 the approval of the Ministry for Environmental Protection was received, subject to conditions, for postponing the completion dates of the project to June 30, 2018. 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. The expected investment cost is approximately NIS 5.6 billion. This project constitutes the flagship environmental project of the Company.
For additional details of environmental hazards and ways of managing them, see sections 7.13, 8.9 and 9.11 in Chapter A of the 2013 Report of Description of the Company's Business Affairs.

2. Dividend Distribution and Appropriation of Income
See Note 26 to the Financial Statements.

3 Taxation
See Note 22 to the Financial Statements.

4. Legal Proceedings and Labor Disputes
See Note 34 to the Financial Statements.
f. Miscellaneous (continued)

5. Agreements including Agreements Requiring Government Approval

According to section 11(a)(9a) of the Government Companies Law, a decision of the Company as a Government company, to grant rights or assume an obligation, which may directly or indirectly limit the Government, either in its controlling position or in its status as a shareholder in the Company, including in relation to implementing structural changes and privatization, promotion of competition and regulating the sector in which the Company acts, requires the approval of the Government.

According to the directives of the Government Companies circular, the Company is required to provide details of agreements that are subject to the approval of the Government, in accordance with section 11(a)(9a) of the Government Companies Law. The following are details on agreements entered by the Company in the report period that required approval of the Government:

a) On April 8, 2013, the Ministerial Committee for Social and Economic Affairs (hereinafter: the “Socio-Economic Cabinet”) gave the Company its approval to include, within a loan agreement between the Company and the Citibank N.A. and Barclays Bank Plc (in this section - the “Loan”) banks, a stipulation that enables early repayment in case of change in the control of the Company. The total loan amount is USD 500 million and it is intended to serve as a bridging loan until an alternative debt is raised by the Company during 2013. As of the date of this report, this loan has been repaid in full.

b) On April 17, 2013, the Socio-Economic Cabinet gave the Company approval to include, within a financing agreement between the Company and a consortium of banks (Citibank Europe plc, HSBC Bank plc, Commerzbank Aktiengesellschaft and Komercni banka) (in this section - the “Financing Agreement”), a stipulation enabling early repayment in case of a change in the control of the Company, as well as to pledge in favor of these banks, with a first ranking fixed charge, the equipment for which financing the Company engaged in the Financing Agreement. The loan of the Financing Agreement is up to USD 153 million and another EUR 110 million including foreign trade risk insurance premiums and the interest at the time of establishment. The Company entered the Financing Agreement in order to purchase three steam additions to the gas turbines at the Hagit, Eshkol and Ramat Hovav sites and auxiliary services within the Stage B Emergency Plan.

c) On June 9, 2013, a Government resolution was reached, enabling the Company to expand its framework program for the issue of debentures in the international market (Global Medium-Term Note Program) (the “GMTN Program”) in the amount of USD 3 billion, and to include in the program documents a stipulation enabling to place the debentures for immediate repayment in case of change in the control of the Company. According to this decision, in June 2013, the Company issued debentures in the international market in the amount of USD 1.1 billion to approved institutional purchasers in the U.S.A, under rule 144A of the U.S. Securities Act, 1933, and outside the U.S.A. on the basis of regulations of this Act. In addition, in July, 2013, the Company issued debentures in the international market by way of expansion of debenture series that were issued in June 2013 as mentioned above, in a total amount of USD 300 million. In light of the expansion of the GMTN Program as stated above, the Company is permitted to issue debentures by virtue of the GMTN Program in a total amount that will not exceed USD 5 billion, and as of the date of the report the Company has issued, within the framework of the GMTN Program, debentures in a total amount of USD 3.4 billion.

For details of the terms of the debentures issued under the GMTN Program see Note 20 to the Financial Statements.

d) On December 26, 2012, the Socio-Economic Cabinet gave the Company approval to include, within a financing agreement with a consortium of banks from Germany (Landesbank Baden-Wuerttemberg and KFW), a stipulation enabling early repayment in case of a change in the control of the Company (in this section - the “Financing Agreement”). The Financing Agreement is intended for purchasing equipment and auxiliary services within the project for reducing emissions at the coal powered stations of the Company, and the loan is in the amount of up to EUR 150 million including a Hermes premium and the interest at the time of the establishment. The estimated loan period is approximately 16 years, and the approximate utilization period of the loan is for 4 years and the repayment period is 12 years. On May 6, 2013, all the preconditions for realizing the Financing Agreements were fulfilled.
5. Agreements including Agreements Requiring Government Approval (continued)

On June 4, 2013, the Finance Committee of the Knesset approves a State guarantee for the Company in the amount of up to NIS 2.4 billion for recycling debentures that were raised with a State guarantee in 2012. According to this approval, on June 18, 2013, the Audit Committee of the Board of Directors of the Company and the Board of Directors of the Company approved the engagement of the Company in an agreement for placing a guarantee, under which the State of Israel provided four letters of guarantee for banking corporations in Israel, for repayment of the unpaid balance of the backed liabilities of the Company under loan agreements that were signed between the Company and these corporate banks, in a total amount of NIS 2.4 billion.

For additional details of the rest of the contractual engagements of the Company see Note 34 to the Financial Statements.

6. Limitations and Supervision on Activities of the Company

See Section 22 in the report Chapter A - Description of the Company's Business Affairs for 2013.

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


9. The State Comptroller’s Report

Since October 17, 2012, the date of publication of the State Comptroller’s Report 63 A (the “Report”), regarding pension arrangements of the Company employees, capital raisings, replacing the partner in charge in the office of the external auditor, Government preparation for property and infrastructure insurance in case of disasters and safety aspects of the operation of the natural gas transmission system, only one report (report 64 A) published by the State Comptroller contains the following subjects in which the Company is mentioned: ensuring the supply of natural gas, handling private enterprise and preparedness and preparations for environmental effects of gas and oil drilling at sea. This report holds no findings or recommendations with regard to the Company.

Regarding Report 63 A, a fault resolution team was appointed by the CEO (in accordance with the circular of the Companies Authority), which discussed ways to resolve the faults, presented them to the Board of Directors of the Company and reported to the State Comptroller and the Companies Authority of the actions that the Company executed and is executing to resolve the faults.

10. Corporate Sustainability Report

At the end of 2012, the Company decide 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.
10. Corporate Sustainability Report (continued)

This report is a direct continuation of this liability that the Company undertook to increase the transparency of its activity and implement corporate sustainability and responsibility with regard to its interested parties. The report reviews the operation of the Company in 2012, and also presents its performance in previous years for comparison.

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.

11. Appointments and Retirement of Directors and Position Holders during the Reporting Period:
- On January 5, 2013, Ms. Rochelle Don-Yechiya ended her term as a Director of the Company.
- On February 20, 2013, Ms. Rachel Don Yichye was again appointed as a Director of the Company.
- On January 31, 2013, Mr. Israel Movshowitz ended his role as Acting Vice President Customers in the Company following the permanent appointment of Mr. Yacov Hain to the position.
- On January 31, 2013, Mr. Yitzhak Balmas ended his role as Acting Vice President of Engineering Projects in the Company and was appointed Vice President of Production and Transmission.
- On January 31, 2013 Mr. Ron Weiss was appointed Vice President of Engineering Projects in the Company.
- On April 24, 2013, Ms. Deborah Chen ended her term as a Director of the Company.
- On April 24, 2013, Ms. Iris Stark ended her term as a Director of the Company.
- On April 25, 2013, Mr. Moshe Bachman ended his role as Acting Vice President Finance and Economics and is continuing his role as Head of the Accounting and Economics Division.
- On April 25, 2013, Mr. Tamir Polikar was appointed as Senior Vice President of Finances and Economics.
- On May 2, 2013, Mr. Raik Abu Raish ended his term as Director.
- On June 20, 2013, Mr. Michael Lazar ended his term.
- On July 11, 2013, Mr. Yosef Schenk was appointed Vice President of Teleprocessing and will continue to serve as Head of the Information Systems and Teleprocessing Division.
- On September 15, 2013, Mr. Yiftah Ron-Tal ended his service as Director and Chairman of the Board of Directors of the Company.
- On September 30, 2013, Mr. Yiftah Ron-Tal was appointed as a Director of the Company, and after the financial statements date on October 2, 2013, Mr. Yiftah Ron-Tal was reappointed Chairman of the Board of Directors of the Company.
- On October 25, Mr. Yehuda Yosef Adler was appointed as a director of the Company.
- On December 19, Mr. Ram Ehrlichman ended his term as director of the Company.
- On January 19, 2014, Mr. Yigal Har’el ended his term as internal auditor of the Company.
- On January 23 Mr. Shatz Shmuel was appointed acting internal auditor of the Company until the appointment of a permanent internal auditor.
- On February 6, 2014, Ms. Nitza Rogozinski was appointed as internal auditor of the Company. The appointment will enter into effect upon termination of the present term of Ms. Rogozinski as Internal Auditor at “Amitim, the Veteran Pension Funds” and not later than three months from the date of her appointment.

For details regarding the appointment and termination of services that occurred after the date of the Financial Statements, see Note 36 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, 2014
Annex A to the Board of Director’s report
A table of comparison between the projected cash flow of the Company as published in the Board of Director’s report of December 31, 2012 and the realization in practice is presented below:

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<tr>
<th></th>
<th>2013 forecast</th>
<th>2013 performance</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Brought forward:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>4,135</td>
<td>4,135</td>
<td>-</td>
</tr>
<tr>
<td><strong>Sources:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total cash flow from operating activities</td>
<td>7,171</td>
<td>7,806</td>
<td>635</td>
</tr>
<tr>
<td>Cash flow from financing activities:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private placement</td>
<td>3,700</td>
<td>6,903</td>
<td>3,203</td>
</tr>
<tr>
<td>Loans from banking corporations</td>
<td>1,292</td>
<td>1,111</td>
<td>(181)</td>
</tr>
<tr>
<td>State guaranteed loans from banks in Israel</td>
<td>3,900</td>
<td>2,400</td>
<td>(1,500)</td>
</tr>
<tr>
<td>Interest on deposits</td>
<td>70</td>
<td>37</td>
<td>(33)</td>
</tr>
<tr>
<td>Total cash flow from financing activities</td>
<td>8,962</td>
<td>10,451</td>
<td>1,489</td>
</tr>
<tr>
<td>Total cash flow from investment activities</td>
<td>162</td>
<td>123</td>
<td>(39)</td>
</tr>
<tr>
<td><strong>Anticipated Liabilities:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash flow for financing activities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans</td>
<td>2,037</td>
<td>2,731</td>
<td>694</td>
</tr>
<tr>
<td>Guaranteed loans</td>
<td>-</td>
<td>161</td>
<td>161</td>
</tr>
<tr>
<td>Negotiable debentures</td>
<td>2,471</td>
<td>2,499</td>
<td>28</td>
</tr>
<tr>
<td>Guaranteed negotiable debentures</td>
<td>2,403</td>
<td>2,404</td>
<td>1</td>
</tr>
<tr>
<td>Non-negotiable debentures</td>
<td>887</td>
<td>1,830</td>
<td>943</td>
</tr>
<tr>
<td>Guaranteed non-negotiable debentures</td>
<td>1,500</td>
<td>1,500</td>
<td>-</td>
</tr>
<tr>
<td>Hedge transactions</td>
<td>100</td>
<td>128</td>
<td>28</td>
</tr>
<tr>
<td>Total cash flow for financing activities</td>
<td>9,398</td>
<td>11,253</td>
<td>1,855</td>
</tr>
<tr>
<td>Total cash flow for investment activities</td>
<td>5,760</td>
<td>5,013</td>
<td>(747)</td>
</tr>
<tr>
<td>Offset VAT</td>
<td>1,354</td>
<td>1,808</td>
<td>454</td>
</tr>
<tr>
<td>Transfers to Central Pension Fund</td>
<td>703</td>
<td>550</td>
<td>(153)</td>
</tr>
<tr>
<td><strong>Closing balance</strong></td>
<td>3,215</td>
<td>3,891</td>
<td>676</td>
</tr>
<tr>
<td>Dedicated account - opening balance and deposits in dedicated account for emergency project Stage B</td>
<td>1,217</td>
<td>1,216</td>
<td>1</td>
</tr>
<tr>
<td>Withdrawal from the dedicated account for emergency project Stage B</td>
<td>(729)</td>
<td>(724)</td>
<td>5</td>
</tr>
<tr>
<td><strong>Total in the dedicated account</strong></td>
<td>488</td>
<td>492</td>
<td>4</td>
</tr>
<tr>
<td>Balance after deposits and withdrawals from the dedicated account</td>
<td>2,727</td>
<td>3,399</td>
<td>672</td>
</tr>
</tbody>
</table>
Annex B to the Board of Director’s report
Explanations for the differences between the cash flow forecast of the Company and actual performance in 2013

a. Total cash flow from operating activities - the increase of approximately NIS 0.6 billion mainly derives from the following changes:

1. An increase in cash flow from operating activities of approximately NIS 2.7 billion.
   - A decrease in fuels quantity acquisition and electricity purchase due to the early entry of ‘Tamar’, the decrease in demand and delays in entry of private electricity producers in an amount of approximately NIS 2 billion.
   - A decrease in fuel prices of approximately NIS 0.6 billion.
   - Other - approximately NIS 0.1 billion.

2. A decrease in cash flow from operating activities of approximately NIS 2.1 billion.
   - An increase of approximately NIS 0.5 billion in debts of the Palestinian Authority and the East Jerusalem Electricity Company.
   - A rate increase of an approximate average of 5.5%, in effect from the middle of May, 2013, in relation to an expected rate increase of approximately 6.5%, in effect from April 2013, approximately NIS 0.4 billion.
   - A decrease in electricity demand mainly due to milder than average weather caused a decrease in receipts of approximately NIS 1.2 billion.

b. Total cash flow from investment activities - the decrease in the amount of approximately NIS 0.7 billion derives from an unrealized supplier and contractor budget, mainly due to delay of the date of beginning of the emission reduction project, emergency project stage B, decrease in investment in voltage lines and grids and decrease in various purchases and investments.

c. Transfers to Central Pension Fund - a decrease of approximately NIS 0.2 billion that derives mainly from a decrease of the actuarial liability following the salary research executed by the actuary of the fund in accordance with the provisions of the capital market and the change in the interest vector to capitalization of the liability.

d. Increase in cash flow from financing activity and to financing activity mainly derives from a bridging loan in the amount of approximately NIS 1.8 billion that was received by the Company in April 2013 and was paid in June 2013.
The Israel Electric Corporation Ltd.

Supplement

Additional Report Regarding the Effectiveness of the Internal Control Over Financial Reporting

For the Year Ended
December 31, 2013
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, 2013 ("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.

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, 2013, 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.

On October 10, 2013, the decision of the Commissioner of Wages regarding the four wage irregularities in the Company was received, as detailed in the financial statements.

On March 10, 2014, the Regional Court of Labor determined that the consents regarding the four wage components remain in effect until the Court reaches a decision.

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, 2013, 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, 2014
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, 2013, 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.
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, 2013). 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, 2013), 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, 2012, 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, 2013, based on the criteria established in *Internal Controls — Integrated Framework* issued by COSO.

We have also audited, in accordance with Israeli generally accepted auditing standards, the consolidated financial statements of the Company as of December 31, 2013 and 2012 and for each of the three years in the period ended on December 31, 2013 and our report dated March 24, 2014 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, 2014
Chapter C
Consolidated Annual Financial Statements

For the Year Ended December 31, 2013

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<td>Consolidated Statements of Changes in Equity for the Years ended December 31, 2013, 2012 and 2011</td>
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Accounting and Financial Statements
Accounting and Economic Division
Haifa, March 24, 2014
Prominent Disclaimer

This English translation of the “Consolidated Annual Financial Statements” for the year ended December 31, 2013 ("English Translation") is provided for information purposes only.

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The Company reserves the right to effect such amendments to this English Translation as may be necessary to remove such conflict or inconsistency.
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, 2013 and 2012, 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, 2013. 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, 2013 and 2012 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, 2013, 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 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, there is still uncertainty regarding the final 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 1g 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, 4, 6 and 7) regarding class action suits, a derivative suit and other material claims that were filed against the Company.

5. The contents of Note 2a(4) regarding the aspects in which the financial reporting principles applied in the Company's financial statements, in conformity with the Government Companies Regulations, differ from International Financial Reporting Standards (IFRS).

Notes 38, 39 and other notes in the financial statements, include additional information pursuant to requirements of the Government Companies Authority (by virtue of section 33b to the Government Companies Law), excluding information regarding land rights as discussed in Note 14k.

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, 2013, 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, 2014 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, 2014
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, 2013 ("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.

__________________________
Tamir Polikar
March 24, 2014
Senior Vice-President of Finance and Economics
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, 2013 ("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.

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   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.

__________________________________________
Eliyahu Glickman
Chief Executive Officer

March 24, 2014
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, 2013 ("the reports").

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   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.

______________________________
Dr. Ziv Reich
Chairman, Committee for Reviewing the Financial Statements

March 24, 2014
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, 2013 ("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.

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   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.

_____________________________________________________________________
Yiftah Ron-Tal
Chairman of the
Board of Directors

March 24, 2014
<table>
<thead>
<tr>
<th>Note</th>
<th>December 31 2013</th>
<th>December 31 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>CURRENT ASSETS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>4</td>
<td>3,401</td>
</tr>
<tr>
<td>Short term investments</td>
<td>5</td>
<td>493</td>
</tr>
<tr>
<td>Trade receivables for sales of electricity</td>
<td>6</td>
<td>4,345</td>
</tr>
<tr>
<td>Other current assets</td>
<td>7</td>
<td>377</td>
</tr>
<tr>
<td>Inventory- fuel</td>
<td>8</td>
<td>1,067</td>
</tr>
<tr>
<td>Regulatory assets, net</td>
<td>9</td>
<td>2,972</td>
</tr>
<tr>
<td><strong>NON-CURRENT ASSETS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventory- fuel</td>
<td>8</td>
<td>1,736</td>
</tr>
<tr>
<td>Long-term receivables</td>
<td>10</td>
<td>1,178</td>
</tr>
<tr>
<td>Investment in associate</td>
<td>11</td>
<td>98</td>
</tr>
<tr>
<td>Regulatory assets</td>
<td>9</td>
<td>696</td>
</tr>
<tr>
<td>Assets with respect to benefits after employment termination:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Excess pension plan assets over pension liability*</td>
<td>12</td>
<td>2,020</td>
</tr>
<tr>
<td>Funds in trust</td>
<td>13</td>
<td>1,728</td>
</tr>
<tr>
<td><strong>Fixed assets, net</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed assets in use, net*</td>
<td>14</td>
<td>58,646</td>
</tr>
<tr>
<td>Fixed assets under construction*</td>
<td></td>
<td>6,075</td>
</tr>
<tr>
<td>Intangible assets, net*</td>
<td>15</td>
<td>948</td>
</tr>
<tr>
<td>****</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>85,924</strong></td>
<td></td>
<td><strong>89,720</strong></td>
</tr>
</tbody>
</table>

* Retrospective implementation of IAS 19 (2011) – see Note 37 below.

The accompanying notes are an integral part of the Financial Statements.
## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(NEW ISRAELI SHEKELS, IN MILLIONS)

(Adjusted to NIS purchasing power of December 2013)

### CURRENT LIABILITIES

<table>
<thead>
<tr>
<th>Note</th>
<th>December 31 2013</th>
<th>December 31 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>16</td>
<td>7,118</td>
<td>5,680</td>
</tr>
<tr>
<td>20</td>
<td>-</td>
<td>4,772</td>
</tr>
<tr>
<td>17</td>
<td>1,726</td>
<td>2,008</td>
</tr>
<tr>
<td>18</td>
<td>1,742</td>
<td>1,581</td>
</tr>
<tr>
<td>19</td>
<td>398</td>
<td>468</td>
</tr>
<tr>
<td></td>
<td>730</td>
<td>732</td>
</tr>
<tr>
<td></td>
<td>11,714</td>
<td>15,241</td>
</tr>
</tbody>
</table>

### NON CURRENT LIABILITIES

<table>
<thead>
<tr>
<th>Note</th>
<th>December 31 2013</th>
<th>December 31 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>20</td>
<td>32,770</td>
<td>32,834</td>
</tr>
<tr>
<td>20</td>
<td>8,572</td>
<td>6,945</td>
</tr>
<tr>
<td>12</td>
<td>2,924</td>
<td>3,050</td>
</tr>
<tr>
<td>9</td>
<td>1,397</td>
<td>2,384</td>
</tr>
<tr>
<td>21</td>
<td>2,565</td>
<td>2,449</td>
</tr>
<tr>
<td>22</td>
<td>5,088</td>
<td>4,909</td>
</tr>
<tr>
<td>23</td>
<td>2,536</td>
<td>2,534</td>
</tr>
<tr>
<td>33</td>
<td>2,856</td>
<td>3,406</td>
</tr>
<tr>
<td>20</td>
<td>691</td>
<td>501</td>
</tr>
<tr>
<td></td>
<td>59,399</td>
<td>59,012</td>
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</tbody>
</table>

### SHAREHOLDERS' EQUITY

<table>
<thead>
<tr>
<th>Note</th>
<th>December 31 2013</th>
<th>December 31 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>24</td>
<td>1,137</td>
<td>1,137</td>
</tr>
<tr>
<td>25</td>
<td>1,030</td>
<td>1,030</td>
</tr>
<tr>
<td>25</td>
<td>(1,025)</td>
<td>(1,305)</td>
</tr>
<tr>
<td>26</td>
<td>13,669</td>
<td>14,605</td>
</tr>
<tr>
<td></td>
<td>14,811</td>
<td>15,467</td>
</tr>
<tr>
<td></td>
<td>85,924</td>
<td>89,720</td>
</tr>
</tbody>
</table>

* Retrospective implementation of IAS 19 (2011) – see Note 37 below.

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, 2014  
Date of approval of the Financial Statements
### Comprehensive Elements

The accompanying notes are an integral part of the Financial Statements.

#### Consolidated Statements of Profit (Loss):

<table>
<thead>
<tr>
<th>Note</th>
<th>For the Year ended December 31</th>
<th>2013</th>
<th>2012*</th>
<th>2011*</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenues</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>27,656</td>
<td>28,320</td>
<td>25,386</td>
</tr>
<tr>
<td><strong>Cost of operating the electricity system:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wages</td>
<td></td>
<td>1,938</td>
<td>2,366</td>
<td>1,743</td>
</tr>
<tr>
<td>Fuel</td>
<td></td>
<td>10,962</td>
<td>19,910</td>
<td>13,151</td>
</tr>
<tr>
<td>Transfer of regulatory asset to fuel (transfer of fuel to regulatory assets)</td>
<td></td>
<td>4,333</td>
<td>(5,269)</td>
<td>-</td>
</tr>
<tr>
<td>Purchases of electricity</td>
<td></td>
<td>1,006</td>
<td>879</td>
<td>486</td>
</tr>
<tr>
<td>Transfer of regulatory asset to purchases of electricity</td>
<td></td>
<td>311</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Operation of the generation system</td>
<td></td>
<td>709</td>
<td>841</td>
<td>779</td>
</tr>
<tr>
<td>Operation of the transmission and distribution system</td>
<td></td>
<td>335</td>
<td>307</td>
<td>372</td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td></td>
<td>4,662</td>
<td>4,408</td>
<td>4,225</td>
</tr>
<tr>
<td><strong>Profit from operating the electricity system</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>24,256</td>
<td>23,442</td>
<td>20,756</td>
</tr>
<tr>
<td><strong>Sales and marketing expenses</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Administrative and general expenses</td>
<td></td>
<td>905</td>
<td>1,067</td>
<td>910</td>
</tr>
<tr>
<td>Expenses for liabilities to pensioners, net</td>
<td></td>
<td>1,113</td>
<td>871</td>
<td>739</td>
</tr>
<tr>
<td><strong>Income from current operations</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>2,038</td>
<td>3,485</td>
<td>1,804</td>
</tr>
<tr>
<td><strong>Financial expenses, net:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial expenses</td>
<td></td>
<td>2,195</td>
<td>2,784</td>
<td>2,744</td>
</tr>
<tr>
<td>Capitalization of financial expenses</td>
<td></td>
<td>(279)</td>
<td>(278)</td>
<td>(207)</td>
</tr>
<tr>
<td>Transfer of financial income (expenses) to a regulatory asset/liability due to hedging</td>
<td></td>
<td>254</td>
<td>185</td>
<td>(277)</td>
</tr>
<tr>
<td><strong>Income (loss) before income taxes</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(808)</td>
<td>(1,298)</td>
<td>(566)</td>
</tr>
<tr>
<td><strong>Income taxes:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other deferred taxes</td>
<td></td>
<td>(203)</td>
<td>(294)</td>
<td>151</td>
</tr>
<tr>
<td>Expenses from adjustment of deferred taxes balances due to a change in the future tax rate</td>
<td></td>
<td>329</td>
<td>-</td>
<td>1,248</td>
</tr>
<tr>
<td><strong>Loss after income tax</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Company’s share of the loss of associated companies, net</td>
<td></td>
<td>(2)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Loss for the year</strong></td>
<td></td>
<td>(936)</td>
<td>(1,004)</td>
<td>(833)</td>
</tr>
</tbody>
</table>

#### Consolidated Statements of Other Comprehensive Income (Loss):

*Retrospective implementation of IAS 19 (2011) – see Note 37 below. The accompanying notes are an integral part of the Financial Statements.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th>2013</th>
<th>2012*</th>
<th>2011*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Remeasurement of a defined benefit plan after tax</td>
<td></td>
<td>280</td>
<td>(786)</td>
<td>(627)</td>
</tr>
<tr>
<td>Other comprehensive income (loss) for the year, after taxes</td>
<td></td>
<td>280</td>
<td>(786)</td>
<td>(627)</td>
</tr>
<tr>
<td><strong>Comprehensive loss for the year</strong></td>
<td></td>
<td>(656)</td>
<td>(1,790)</td>
<td>(1,460)</td>
</tr>
</tbody>
</table>
### THE ISRAEL ELECTRIC CORPORATION LIMITED

**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**

*(NEW ISRAELI SHEKELS, IN MILLIONS)*

(Adjusted to NIS purchasing power of December 2013)

<table>
<thead>
<tr>
<th>Paid-up share capital</th>
<th>Capital reserves</th>
<th>Capital remeasurement reserves*</th>
<th>Retained earnings*</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>In NIS millions</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Balance as of January 1, 2011** ............ 1,137 1,030 108 16,442 18,717

Loss for the year............................................. - - - (833) (833)

Other comprehensive loss for the year.............................. - - (627) - (627)

**Balance as of December 31, 2011** ...... 1,137 1,030 (519) 15,609 17,257

Loss for the year............................................. - - - (1,004) (1,004)

Other comprehensive loss for the year.............................. - - (786) - (786)

**Balance as of December 31, 2012** ...... 1,137 1,030 (1,305) 14,605 15,467

Loss for the year............................................. - - - (936) (936)

Other comprehensive loss for the year.............................. - - 280 - 280

**Balance as of December 31, 2013** ...... 1,137 1,030 (1,025) 13,669 14,811

* Retrospective implementation of IAS 19 (2011) – see Note 37 below.

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.
## Cash flow from operating activities:
Loss for the year according to the statement of profit and loss
(936) (1,004) (833)
Adjustments required to present cash flow from operating activities (Annex A)
6,715 (49) 2,483
**Net cash provided by (used in) operating activities**
5,779 (1,053) 1,650

## Cash flow from investing activities:
Investment in fixed assets, net of consumers’ participation in assets
(4,703) (5,405) (4,285)
Investment in intangible assets
(172) (195) (182)
Transfer to Central Pension Fund (see Note 12)
254 356 -
Proceeds from sale of fixed assets
64 50 73
Collection of long-term receivables, net
82 68 (1)
Repayment (deposit) of bank deposits, net
(493) 767 (209)
**Net cash used in investing activities**
(4,968) (4,359) (4,604)

## Cash flow from financing activities:
Issuance (repayment) of short-term debentures, net
(4,713) 4,784 -
Issuance of long-term debentures
5,101 5,173 4,155
Other long-term loans received
3,378 2,036 1,119
Repayment of long-term debentures
(3,571) (2,919) (2,789)
Repayment of other long-term loans
(1,076) (960) (1,027)
Deposit/repayment of hedging transactions, net
(196) 270 (837)
Increase (decrease) of short-term credit from banks, net
(559) 62 133
**Net cash provided by (used in) financing activities**
(1,636) 8,446 754

## Additional information about cash flow:
Interest paid during the period for:
3,528 3,187 2,924
Income tax
4 8 8
3,532 3,195 2,932

Cash received during the period for:
Interest
753 507 373
Income tax
4 - -
757 507 373

* Retrospective implementation of IAS 19 (2011) – see Note 37 a below.

The accompanying notes are an integral part of the Financial Statements.
## ANNEX A - ADJUSTMENTS REQUIRED TO PRESENT CASH FLOWS FROM OPERATING ACTIVITIES

<table>
<thead>
<tr>
<th>Note</th>
<th>For the Year ended December 31</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013</td>
</tr>
</tbody>
</table>

### Income and expenses not affecting cash flows:

- **Loss from investment in an associate**: 11 2 - -
- **Depreciation and amortization**: 4,785 4,826 4,588
- **(Decrease) increase in deferred taxes, net**: 122 (297) 1,395
- **Increase (decrease) in liabilities with respect to employee benefits, net**: (517) 2,032 (289)
- **Revaluation (erosion) of loans, debentures and net hedging transactions**: (436) 200 48
- **Increase in provision for refunding amounts to consumers**: 116 114 111
- **Decrease in exposure of the Company to changes in foreign currency transferred to consumers**: (291) (591) (1,021)
- **Decrease (increase) in fuel regulatory liabilities**: 4,449 (5,681) (2,686)
- **Increase (decrease) in other regulatory liabilities, net**: (595) 112 104
- **Revaluation of debts collectible**: 38 39 (4)
- **Capital gain on sale of fixed assets**: 44 35 62

**Total**: 7,717 789 2,308

### Changes in assets and liabilities:

- **Increase in trade receivables for sales of electricity (including those presented in long-term receivables)**: 6 (605) (129) (676)
- **Decrease (increase) in other current assets**: 97 (53) (118)
- **Increase in inventory – fuels (including noncurrent fuels inventory)**: (130) (654) (153)
- **Increase in long term receivables, net**: 86 81 37
- **Increase in customer advances for work ordered, net of work in progress**: (70) 55 2
- **Increase (decrease) in trade payables (including long term)**: (282) (51) 818
- **Increase (decrease) in other current liabilities**: (98) (87) 265

**Total**: (1,002) (838) 175

**Net**: 6,715 (49) 2,483

* Retrospective implementation of IAS 19 (2011) – see Note 37 a below.

The accompanying notes are an integral part of the Financial Statements.
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 thereby. 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, 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, 2015. By virtue of Amendment 12 to the Electricity Sector Law in accordance with section 60 (d11) to the Electricity Sector Law, a further extension of the licenses until January 1, 2016 would require an order to be 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. This authority of the Ministers is limited to one period only, which will not exceed one year, and therefore 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.

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 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, 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, and owing to whose actions Financial Statements that are separate from the other actions of the license holder will be submitted.
2) Presenting Separate Financial Statements as Required by the Implementation of the Electricity Sector Law (continued)

Notwithstanding, the Company does not submit audited Financial Statements for profit centers as required in most of its licenses (including the new generation licenses that the Company has received) and 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.

The Company wishes to note that the issue of financial reporting and administering the activity of the Company according to profit centers constitutes a component in the outline of understandings that was formed with respect to the structural change (see Note 1.e below), according to which the Company shall operate through profit centers that will enable complete transparency and attribution of costs in a model that will be determined in accordance with the nature of the activity of the Company. Therefore, 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 that was published on March 23, 2014, see Note 1 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 g below.

c. Decisions of the Government Regarding the Electricity Sector and Activities of the Company

Over the years, the Governments of Israel has 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 during the last year 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)6 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.

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) 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.

5) 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.

6) 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).
The Company is a Government Company, and the arrangements set in this 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. For additional information required according to the Companies Authority, see Note 39 below.

e. Structural Change

The Electricity Sector Law determines, inter alia, a regulatory framework whose purpose is to promote the efficiency in the Electricity sector, through the achievement of competition in the Israeli Electricity sector by various means. Although the Company generates, transmits, distributes and supplies most of the electricity that is consumed in the Israeli economy, and operates as the system administrator, over the years the Electricity Sector Law was amended several times, and these amendments outline a 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, 2015.

During 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. In addition, during 2010, a document was formulated, stating a possible outline of a structural change in the Company (hereinafter: the “Outline of Understandings”), and which is inconsistent with the provisions of the Electricity Sector Law as worded at the time of the report. See below.

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”). The following was included in the letter of appointment of the Steering Team (hereinafter: the “Letter of Appointment”): “Since 1996, upon legislation of the Electricity Sector Law - 1966, the electricity sector in Israel operates under a regime of licenses for all its activities. The Electric Company holds a license for transmission, distribution, supply, sale of electricity and trading in it, as well as a license for generating electricity. The licenses of the Electric Company have been extended from time to time, and are going to expire at the end of this year. In accordance with the provisions of the Electricity Sector Law, in its present version, it is not possible to grant new licenses to the Electric Company in its present structure. The licenses are naturally required for the continuation of the activity and supply of essential services in the electricity sector. The present economic and financial position of the Electric Company also requires a reform and a significant change, for the continuation of the activity of the Company and supply of the essential services”. According to the Letter of Appointment, the Steering Team was charged with, inter alia, examining the optimal structure of the electricity sector and the Electric Company while noting the models that are accepted worldwide, and those that have been discussed so far, including the model that was presented to the Company in recent years. The team will examine the various models, while emphasizing the 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 Electric Company and to propose, in view of the aforesaid, a comprehensive reform in the Electricity Sector and in the Company.
NOTE 1:- GENERAL (continued)

e. Structural Change (continued)

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 prevents 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. The Company is conducting a dialogue with the General Director on this subject.

On October 27, 2010, the head of the steering team announced that a team would be established, and it would hold discussions with the employee union and the management of the Company in order to reach agreements on topics that relate to rights of the Company employees and the implications of the structural change on them. This is at the same time as the discussions held by the steering team and according to the developments outlined there. Following this negotiations were held, but as of the date of the financial statements the agreements of the parties have not yet been received.

On March 23, 2014, the draft of recommendations of the steering team (hereinafter: the “Draft Report”) was published for comments by the public (until April 20, 2014). Below is a conclusion and summary of the recommendations of the steering team, as were detailed within the Draft Report:

1. System Management

   A. A separate government company will be established, to which the System Management Unit, the Design, Development and Technology Branch and the Statistics and Market Research Department of the Electric Company will be transferred (“System Management Company”).

   B. The System Management company will deal with the entirety of subjects related to designing the development and system management in the production sections and the delivery, including management and optimization of the electricity sector, including the loads for the power plants (the Dispatch), operating the electricity marketing mechanisms, management of the electrical grid system and the physical design (statutorily). In addition, the company will conduct research and development activities with emphasis on evaluating the technologies that may join the grid.

   C. Assets – The System Management Company will receive all the relevant assets for designing and operating the production and delivery system from the Electric Company.

      1. The Dania site will be transferred from the Electric Company to the system administration by the end of 2014, and will be used as the main site for the electrical system management.

      2. The Ramat Hasharon site will remain under the ownership of the Electric Company, but all the information that passes through this site and will be exposed to the Electric Company will be public for all the private electricity manufacturers. The site will be used by the System Management company for two purposes:

         a. As a backup site to be used by the System Management Company in emergencies, when the site at Denya cannot be operated or when two available sites are needed simultaneously. In addition, the site will also continue, in emergencies, to act in supervising the flow.

         b. The operating site where all the supervisory activities of the license holder for delivery are conducted. System Management Company representatives will be constantly present at the site and will give instructions to the delivery license holder according to the functions document.

      3. All assets, including special programs, computer equipment and other equipment needed for managing the system will be transferred to the System Management Company by the end of 2014.

      4. The System Management Company will not maintain production means.
NOTE 1: GENERAL (continued)
e. Structural Change (continued)

1. System Management (continued)

D. Human Resources and Organization
   1. The System Management Company will employ between 150 – 200 employees.
   2. At the establishment stage, most of the personnel will be based on Electric Company employees from the System Management Unit, the Design, Development and Technologies Branch and the Statistics and Market Research unit. The aspiration is to transfer the units of the electricity chain complete, except for employees or sub-units that do not deal in system topics.
   3. The company establishment, including appointment of the Board members, locating a CEO and appointing senior employees will be conducted during 2014 in an immediate manner.
   4. The target date for operating all the authorities of the company – January 1, 2015.
   5. According to need, up to 30 October, 2014 will be defined as a transition period for the purpose of completing the activities needed for the full operation of the separate company. This transition period will begin on the date of the company’s start of operations on January 1, 2015 and continue until full operation is achieved.
   6. A dedicated team will be established (Ministry of Finance, Ministry of Energy, Public Utilities Authority - Electricity, System Management Company) to evaluate the entirety of subjects related to the company’s financial strength, including capital structure, composition of liabilities, cash flow in the electricity chain, exposure to manufacturers by suppliers and administering the system. As necessary, the team will be supported by financial consultants and accountants.

2. Electricity Marketing Model

A. The team recommends a gradual transfer to an electricity marketing model based on the pool method as follows:
   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.

B. Combining the private plants under the existing regulations: private plants for which regulation has been approved will continue to operate in the framework of the specific regulation with each manufacturer. In the future combination will be provided with as much of an incentive as the Paul mechanism allows.

C. Israel Electric Company power plants: in principle, will be operated under the specific regulation in which the framework will give them the entire capital cost not depreciated (each plant according to the cost and its age) in the framework of availability payment and the energy cost so that IEC plants receive exactly the variable cost (Pass Through).

D. One Model F combined cycle plant (out of 11) incorporated in a separate company will participate in the Paul mechanism according to its rules. The scope of the IEC power plant that can take part in the competition will be evaluated from time to time according to the sector structure and the level of competition.

E. Private plants presently in the establishment process and that will reach financial closure up to 2019 will be gradually combined into the Paul forward transition model, and in the model, Paul supervises the transition period, until the gradual establishment of the accepted Paul sector, according to the sector’s development.

F. Private plants with financial closure from January 1, 2019 – will be entered into the Paul model according to its conditions.

G. Cogeneration plants – according to regulations presently practiced and as amended from time to time.

H. Until the full operation of the Paul, electricity manufacturers will be able to sign on bilateral transactions as a substitute for availability payments, but only for the transition period. With transition to the supervised Paul model and after establishing this model, the question of continuing bilateral sales will be reviewed, subject to market conditions.
3. Trade in Natural Gas

A. To allow trade in surplus natural gas between all the natural gas users in the market – electricity manufacturers, industry and gas marketers. This trade needs to be developed and to supply natural gas, if it wishes to sell gas in a spontaneous manner. It is important that the trade in natural gas be efficiently and objectively managed in the marketplace, so that the market can balance the surpluses and deficits in the fastest and best manner. It is also important that competitive interests not disrupt the trade in natural gas, so the trade needs to operate within the framework of an independent clearing house.

B. To expedite conducting sectors in order to prevent deficits.

C. Addition of a linepack and improving the ability of the conducting grid to support demand volatility of the consumers during the day.

D. A team from the Ministry of Finance and the Ministry of National Infrastructures, Energy and Water (hereinafter: "NIEW") will evaluate the development progress of the Leviathan reservoir in 2016. As far as can be seen, it seems 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 manufacturers.

E. To continue evaluating the options for storing gas in Sodom, at the Yam Tethys reservoir and at any other existing sites.

4. Production

A. Selling plants to private manufacturers – The following sites of the IEC will be sold:
   1. The Ramat Hovav site with a capacity of 1,140 MW will be sold by the end of 2014.
   2. The land and everything related to the fourth combined cycle in the emergency plan at Alon Tavor will be sold in its entirety to the State or directly to private entities, if the State decides so before the end of 2014.
   3. The existing plants at the Eshkol C and Eshkol D site (in Ashdod) with a capacity of 912 MW, including the relevant lands, will be sold to private entities in parallel and dependent on the decision to establish and meet all the necessary permits for the establishment of Power Plant Project D, which will be wholly owned by the IEC.

   The sale process will be managed by a team made up of personnel from the Companies Authority and the General Comptroller. The IEC will provide all the support needed to realize the process.

B. Incorporation – The following plants will be incorporated:
   1. All the sites where there are Model F Combined Cycle power plants, starting from 1 January, 2015, will become one subsidiary wholly owned by the IEC ("the subsidiary"). All the plants at these sites will be transferred to the subsidiary’s ownership, as well as commitments from the IEC will be transferred to the subsidiary, a process that will be managed by a team made up of personnel from the Companies Authority, the General Comptroller and the IEC.
   2. Power plants at the Reading D site will be incorporated as a subsidiary, starting from 1 January, 2014. The IEC will build a site with two combined cycle generators according to market needs.

C. Scrapping – The following plants will be dismantled:
   1. The Reading site with a capacity of 428 MW will be scrapped by 2021.
   2. The Haifa C site with a capacity of 282 MW will be scrapped by the end of 2018.
   3. The Eshkol plant with a capacity of 912 MW will be scrapped by 2018.

D. Future Development – the IEC will begin establishment of a nuclear power plant under its ownership in 2025, according to market needs.

E. Other than the above, no establishment, replacement or upgrade of power plants will be done by the IEC during the agreement period. All the steps described above will be brought to achievement of the committee’s objective, so that at the end of the period, private production will make up no less than 42%.

F. Every sale of assets or their transfer to subsidiaries will be conducted subject to all laws and with attention to the limitations included in the agreements for recruiting the debt of the IEC.
NOTE 1:-  GENERAL (continued)
   e. Structural Change (continued)
   4. Production (continued)

   G. Topics for re-evaluation – a special team will be established with the CEO of Ministry of National Infrastructures, Energy and Water and the participation of the Finance and Environmental Protection Ministries, the IEC and the System Management Company, which will evaluate the following topics:
   2. Installing scrubbers in units 1-4 at the Orot Rabin site – necessity and financial feasibility.
   3. Completion of the scrubber project at the Ruttenberg Site – timing.
   5. Evaluation and conclusions from application of advanced energy projects and submitting recommendations regarding the policy of issuing additional licenses.

Advancing the conversion of units 1-4 at the Orot Rabin site and completion of the scrubber project at the Ruttenberg site will be postponed until after the committee reaches its conclusions.

5. The Distribution Segment

   A. To allow the activities of private factors as sub-distributors up to the ceiling of 10% of the distribution grid consumption.
   B. The sub-distributors will provide electricity to the non-residential sector that is characterized by:
      1. Existing historical distributors or those who have the ability to choose whether to join or waive their historical distribution.
      2. Sites that provide services in a concentrated manner (for example, maintenance, cleaning, security, communication, etc.). These sites may include: office buildings, shopping malls, shopping centers, industrial buildings, industrial parks (with central management), industrial areas, airfields, hospitals, universities, student dormitories, etc.
      3. Settlements in the framework of cooperatives, where decision are reached by voting of the residents and that have a distribution system operated by the cooperative.
   C. Sub-distributor activities will be arranged according to law and will include, among other things, definition of the permitted operations, safety requirements, periodic inspections, relations with the distribution license holder and additional topics as needed.
   D. The IEC will continue to be the license holder as an essential service provider, and will sell the service at a supervised price.

6. Supply Segment

   A. The supply segment will be opened to competition according to the rules determined by 1 January, 2015.
   B. The IEC will continue to be the supply license holder, and will sell the service at a supervised price.
   C. Present and future private electricity manufacturers that meet the threshold conditions to be determined, will also be supply license holders and will be allowed to supply the electricity manufactured by them or by others, to consumers who own smart meters. To remove all doubt, manufacturers of electricity by advanced energy methods are not included in this layout.
   D. Market share of all the private suppliers will not exceed the market share of all the private manufacturers in the market.
   E. The activities of those companies operating in the field of demand response will be promoted, with the aim of encouraging their activities and guaranteeing financial optimization of electricity utilization in the market. As far as necessary, these will also be supply license holders.
   F. Sub-distributors will also be supply license holders.
   G. Supply license holders will have free access to the information issued by the analog electricity meters and from the smart metering of their customers. The information will be kept in the hands of the System Manager and its transfer is subject to the agreement of the consumers.
7. Smart Metering

A. The committee recommends advancing the deployment of smart metering in Israel, in a scope and on a schedule determined by the results of cost-benefit analysis.
B. The network will be built with an open architecture and will allow open access to users, service providers and others, according to authorizations by customers, who own the information.
C. Establishment of the project will be executed by the IEC, which will be assisted by subcontractors for the purpose of installing and maintaining the smart meters.
D. All the information will be transferred to the System Manager and to additional factors as decided by State factors and will be distributed according to the limitations of the law.
E. Schedule and scope of the project will be determined in the development plan by the Minister of National Infrastructures, Energy and Water approved by law, by 30 October, 2014.

8. Assets

A. Application of arranging the IEC assets will be determined by 30 October, 2014, in accordance with the principles specified in the committee’s report.
B. Assets used by IEC in the electricity chain – will continue to maintain the ownership or leasing arrangements in effect to date.
C. Assets required by IEC for future development of its sectors of operation – a team with personnel from the IEC, the Ministry of Natural Infrastructures, Energy and Water, Ministry of Finance and the Government Companies Authority (“the reserve team”) participating will examine and determine the assets answering this description by 30 October, 2014. These assets will be leased from the State to the IEC for a period of 49 years, without consideration, or arrangements such as are presently practiced will be determined, as the reserve team decides.
D. The assets that are not useful to the IEC and are not needed by it to develop the electricity chain will be sold by the IEC to the State.
E. The rights, properties and assets specified will be transferred by the company to the State when they are free of hazards, ground contamination, etc., without consideration.
F. The IEC is obligated to not claim ownership rights on properties and other assets that are not included in the attached book of rights and assets. The State will be allowed to receive these assets for no consideration on the date the IEC notified the State of them.

9. Structural Changes

A. The IEC 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 administration and services divisions, significant reduction in permanent human resource employment and reduction in the control and management roles.
B. The IEC will operate in conducting and distribution segments and in the management branches via monitored control centers that will permit full transparency and attribution of costs, in a model agreed upon between the Company, the Ministry of Finance, the Public Utilities Authority – Electricity and the Natural Infrastructures, Energy and Water Ministry by 30 October, 2014.
NOTE 1:- GENERAL (continued)
e. Structural Change (continued)

10. Reorganizing and Managerial Flexibility

A. The IEC will execute a comprehensive reorganization plan for reducing the Company’s employee ranks. It should be verified that this framework determine the table of employee organization for a period of ten years.

B. Reinforcing the management capability of the IEC management – Changes need to be made in employment agreements that allow the necessary flexibility for the Company’s activities as a commercial company and that will reduce the existing limitations in the existing collective agreements, in the following subjects, among others: temporary employees in the various segments (including project-based employees), establish a new disciplinary mechanism, a termination mechanism in the case of incompatibility, management authority in tender committees for bids on management positions, employee mobility, employee advancement, work attendance and utilization of the working day.

C. Personal Contracts – All managers in the IEC, from the level of Deputy Head of Branch and up will be employed through personal contracts. In addition, expanding employment through personal contracts in core expert positions (those with a specific expertise) in which there are gaps in knowledge or in salary with regard to the labor market (such as: high voltage, constructors, information and communications systems, Smartgrid, advanced energies, etc.). The team’s recommendation is that the quota of workers employed on personal contracts not fall below 3% of the number of tenured employees.

D. Salary Structure – The Company must act to change the salary structure so that it is more appropriate to the modern labor market and competitive environment. On this issue, the committee recommends that intake mechanisms for skilled workers in needed professions be determined and against that, to act towards cancelling the open salary ladder and institute more gradual advancement mechanisms as opposed to the method presently practiced, while significantly reducing the costs of employing workers in the company as opposed to now.

E. Free Electricity – Cessation of payment for the electricity component to Company employees and evaluation of conversion to a salary component equal to the average market consumption.

F. Trust Account – The Company will act to transfer an additional NIS 1 billion from the trust account to non-budgeted components to the central cashier for allocation by 1 January, 2015. The Company will finance this with the balance of sums in the trust account to pay the non-budgeted components in a regular manner.

G. Relevant State factors are evaluating the issue of capitalized interest for the actuarial liabilities. When it is determined that there is a deep market for high-quality corporate bonds in Israel, the IEC will be guided by the relevant factors to capitalize its pensioner liabilities according to market yields on high-quality corporate bonds.

11. The Capital Structure of the IEC

A. The IEC will make public issues of shares in 2015 and 2018.

B. The IEC will redeem its liabilities backed by government guarantee according to the original amortization table determined by them when the guarantees were made.

C. By 30 June, 2014, a roadmap for executing the issue of IEC shares or convertible bonds will be determined; control of the IEC will remain in the hands of the State. The share issue will be executed during 2015.

D. Equity capital of the IEC in relation to the Balance Sheet total will stand at 35% until 2025.

E. Implementation of the entirety of these recommendations should bring about the removal of sole borrower limitations in the electricity sector. The committee team will examine removal of the limitation and its conditions with the Banks Supervisor.

F. As of 1 January, 2014, the IEC will be able to engage in business initiatives abroad through a wholly-owned subsidiary. Every project that Electric Initiatives starts will be incorporated in a designated company for various activities in conjunction with private investors. The format for establishing the designated companies, their scope, exposure and the investment will be defined in a layout to be agreed upon between the Company and the Government Companies Authority by 1 January, 2015.
NOTE 1:- GENERAL (continued)

e. Structural Change (continued)

12. Additional Recommendations

A. The new company for electric power producing plants will be liquidated.

B. The Companies Authority will submit, by 30 June, 2014, a recommendation regarding decisions about the transition of the Company to conform to the IFRS standards, so that the Company’s financial strength is not harmed.

C. After the report’s approval by the government ministers, the committee will continue to operate for 18 months as a follow-up team monitoring the implementation of this report’s recommendations – and will also discuss and handle the main topics (obstacles) raised by the private electricity manufacturers. The committee will appoint an ad hoc team to conduct regular follow-up and warnings of failures in implementation.

In addition, the following are details of additional recommendations included in the Draft Report, and based on an initial examination of the report, the Company estimates that they may be very important for the Company:

1) The Arrangement Period
   The arrangement period is until the end of 2025.

2) Rate Outline
   The Electricity Authority will examine a determination of a rate outline which will be based on the following principles:

   a. The recognized salary cost of the base year will determined on the basis of normalized salary costs reflected in the Company’s financial statements (less/plus decrease/increase of one-time irregular expenses, including budgetary generation B employee pension costs, and without salary irregularities that were announced by the Commissioner of Wages), and less the retirees’ salary cost that relates to the retirement of permanent and temporary employees in accordance with the retirement expected in the base year, under the structural change and streamlining plan. As of the base year, the real salary will retain its value, without increase of the real salary.

   b. Over the years, the rate outline will decrease in accordance with the decrease in the salary cost that derives from the expected retirement of permanent and temporary employees and the supplemental payments to those who remain, under the organizational change and streamlining plan.

   c. The costs of retirement and payments to those who remain in accordance with the organizational change and streamlining plan will not surpass the saving derived from the outline stated in section (a) and (b) regarding the rate outline were it not for the organizational change and streamlining plan. The meaning of this section is that the saving deriving from the retirement that exceeds the cost of the plan will be expressed in the rate for consumers; and when the plan costs will be higher than the saving, to prevent the loading of this difference on the rate for consumers.

   d. The decrease rates of costs and their attribution among the segments and over the years will be determined by the Authority.

   e. The Company will not receive recognition of gaps existing in the past, between salary costs and actual pension and those that were recognized in the rate, and these will not be recognized.

   f. Other operating costs that are not salary will be determined by the Authority after costs control.

   g. Principles for determining capital costs and availability (CAPEX): in the generation segment - the Authority determined construction costs for the existing generation units. With regard to the stations that were operated from January 1, 2013 and onwards, the Authority determined a construction cost for each unit. The generation rate in the coming years will be based on the costs that were determined for each unit. The capital costs for existing units that were recognized as the rate base for the generation segment will be executed according to the reduced capital cost that was determined for each and every unit.
NOTE 1:- GENERAL (continued)

e. Structural Change (continued)

2) Rate Outline (continued)

h. In the grid segments - construction cost for an electrical installation was not determined. The capital costs are expected to be set within the framework of a base rate for the transmission and distribution segments that is expected in the coming months.

i. The normative cost of the investment plan that was approved by the Minister will be approved by the Authority according to the law.

j. Return on equity - the net average return on equity for all the Company will be approximately 6.5% based on normative equity 35% of the total recognized assets of the Company.

k. Allocating the return rate for the capital between the various segments will be determined by the Electricity Authority by determining a rate base for transmission, distribution and supply.

l. The method of payback of capital costs in the rate will be determined in the rate base for the generation segment, such that discriminating arrangements will not be created between the various producers.

m. In case generation units financed and paid for in advance by the consumers as part of the emergency plan will be sold to another entity, the balance of the investment that was financed by the consumers will be returned, and with the addition of a recognized return rate in a period of time of up to 5 years from the date of sale, dependent on the amount of the required payback.

n. The energy costs will be fully recognized for the Electric Company.

3) Assets

In addition to that stated in the summary and conclusion of the steering team with regard to the issue of assets, as detailed above, the Draft report includes additional recommendations with regard to the issue of assets, and the principal ones are as follows:

a. The Electric Company will present the Director of the Government Companies Authority with a full list of all the assets in its possession (hereinafter: the “Assets List”).

b. Financing the purchase of the power stations, system administration assets, the land and structures - the State will pay for the power stations, system administration assets and the land and structures that the State will purchase from the Company or that the system administration company will purchase from the Company, by offsetting the debt of the Electric Company to the State, including the debt secured by the perpetual debentures, up to the market value of the assets, in accordance with valuations, and in any case their value will not be less than their balance in the financial statements of the Electric Company that will be agreed upon between the State and the Company by October 30, 2014. The position of the team is that the outstanding balance as on December 31, 2013 is approximately NIS 3.1 billion and the perpetual debentures balance is approximately NIS 2.5 billion. If the market value of the stated assets will exceed the Electric Company’s debt to the State (the “Surplus Assets”), then all the decisions that are detailed in the committee’s report pertaining to the assets will not apply to the Surplus Assets and the State will formulate its position with regard to the Surplus Assets by October 30, 2014.

c. Assets regarded by the State as belonging to the State will be transferred to its ownership without consideration, as part of the implementation of the comprehensive settlement.

d. Decisions detailed in the committee’s report that pertain to the assets will not apply to assets that are supposed to be returned to the State in accordance with unique arrangements, including assets that the lease period with respect to them has ended and is not meant to be renewed or assets that are supposed to be expropriated in accordance with unique arrangements and the existing arrangements will apply to them.
NOTE 1:- GENERAL (continued)

e. Structural Change (continued)

3) Assets (continued)

e. Up to October 30, 2014, an umbrella agreement will be determined between the Israel Land Authority and the Electric 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 Israel Electric Company, promoting subjects that are the responsibility of the Electric 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.

f. By October 30, 2014, the State and the Electric Company will examine the various taxation aspects of the steps included in this document.

g. 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 Electric Company.

h. For removal of doubt, every sale or transfer of assets or liability by the Electric 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 Electric Company.

The issues included in the Draft Report may be of great importance to the Company, its financial position and its continued functioning as an essential service supplier. The Company is studying the Draft Report in detail and intends to present a detailed reaction to all the issues detailed in it within the hearing that will be held.

Approximately one week before the date of approval of these financial statements, the Company decided to take a number of administrative steps regarding various salary issues. As a result, the employee union decided to take a series of sanctions (without disrupting the electricity supply) whose aim is to disrupt and interfere with the orderly course of work of the Company. See note 34c. 11)

It should be noted that as of the date of this report, the implementation of the structural change in any outline has not yet commenced in practice, and despite the publication of the draft of recommendations of the steering team, there is still uncertainty with respect to the final form of a structural change, the time of its implementation and its consequences for the Company, its business affairs and outcomes.
Resolutions of the Government and Government Entities with Respect to the Structural Change

Following are details of the major resolutions adopted by the Government of Israel and Government entities concerning the structural change:

1) On March 25, 2003, the Government of Israel adopted a resolution with respect to the implementation of the Structural Change in the Electricity Sector (Resolution number 104). The main points of this resolution are: (1) Action is to be taken in order to regulate the Electricity Sector, including the amendment of the Electricity Sector Law in order to give expression to certain principles, inter alia, imposition of restrictions on the granting of a license to a person for more than one activity in the fields of generation, transmission and distribution, restrictions on the holding of means of control in a holder of a license for activity in the Electricity Sector and restrictions with respect to the scale of activity in which a license holder can hold, and setting of exceptions to these rules; (2) The amendment of the Electricity Sector Law such that the operations of the Electricity Administration in the Ministry of Energy and Water and the Electricity Authority will be consolidated; (3) Charging the Companies Authority, in coordination with the Ministry of Energy and Water, the Ministry of Finance and the Ministry of Justice, to take action to incorporate the operations of the Company in accordance with the principles that have been stipulated above, and conclusion of the incorporation as stated until March 4, 2006, including the conclusion of incorporation of the activities that may be performed in accordance with the existing licenses, prior to 2006, to the effect that at the end of the validity of the currently existing licenses in the Company, new licenses may be granted immediately in accordance with the principles as stated. In addition, the Companies Authority shall act as soon as possible to incorporate new power stations, which are included in the Development Plan of the Company, and if need be also existing stations, as subsidiaries, and issue them to the public; and (4) Charging the Minister, in consultation with the Electricity Authority, to prepare the principles and rules for the arrangements that are required in order to encourage the entry of private producers and additional distribution companies into the Electricity Sector, to establish the arrangements that will prevail in the Electricity Sector between the various companies and establish rules for uniform accounting reporting in the Electricity Sector with respect to each of the companies that are essential service supplier license holders, as this term is defined in the law.

2) At the same time, the Government adopted an additional resolution (number 94) concerning the promotion of privatization of the Government Companies by their floatation in the capital market, whereby the Companies Authority would establish a plan for the issue of shares of government companies on the Stock Exchange, in 2003-2005. Accordingly, the Companies Authority was charged with formulating and proposing to the Minister of Finance resolution proposals for submission to the Ministerial Committee on Privatization, for the purpose of the privatization of various government companies, among which was the Company, including by way of the sale of part of their shares via the capital market. With respect to the Company, it was decided that up to 49% of its shares would be sold, after the securing the application of the conclusions of the Electricity Sector Reform Committee and the resolution of the Ministerial Committee for Social and Economic Affairs (hereinafter: the “Socio-Economic Cabinet”) on this matter would be guaranteed.

3) In a resolution from August 15, 2004, (number 2429), concerning the implementation of the structural change in the Electricity Sector, the Government of Israel established that all of the measures that are required to implement the Structural Change in the Electricity Sector must be taken, which included charging the committee to implement the reform in the Electricity Sector, and for this purpose, a committee was formed by the Ministers, in order to submit recommendations on the issues and the steps that pertain to the implementation of the Electricity Sector Law in the various segments of the electricity chain; the Ministers and the Companies Authority were required to act in accordance with their lawful authority in order to raise the implementation of the recommendations of the committee to the agenda of the board of the Company, and impose on the Director General of the Companies Authority to raise on the agenda of the board of directors of the Company, immediately, the incorporation of new generation units at the Company within separate subsidiaries, and subject to the expert opinion of the Attorney General; the Company was required to act in order to implement the recommendations of the committee no later than March 30, 2005. The resolution further stated that if the Company did not act to implement the Structural Change in accordance with the recommendations of the committee until that date, the Ministers and the Companies Authority would take action, in accordance with their lawful authority, in order to ensure that these resolutions would be implemented, including the preparation of a resolution for the Ministerial committee for Privatization; it was decided to impose on the Minister, to publish by October 31, 2004, rules for the introduction of private generation into the Electricity Sector, in accordance with his lawful authority.
On September 12, 2006, the Government of Israel adopted a resolution (number 463), concerning a structural change in the Electric Company, whereby the Electricity Sector and the Company would undergo reorganization, and the Electricity Sector Law would be amended to the extent required, in order to allow for the implementation of this resolution. In general terms, this resolution determined as follows:

(a) The Company will become a government-owned holding company, which will hold a number of subsidiaries, each of which will engage in a different activity (the generation, distribution and transmission of electricity and the administration of the system and in companies in the fields of additional services as stated below).

(b) The management of the Company, and any field of activity of the Company that is not incorporated separately, shall remain part of the holding company.

(c) The Company will hold four (4) subsidiaries in the field of generation, all of which will be entitled to supply electricity to end consumers. These companies shall be incorporated as subsidiaries of the holding company, and the Company’s holdings in each of the subsidiaries in the field of generation will gradually be reduced to 51%, including by way of issue to the public, after which each such subsidiary will be entitled to engage in the desalination of water. It was further determined that the generation and supply segment, upon the establishment of competition, is to be gradually deregulated with regard to the charge rates of the Electricity Authority.

(d) From March 1, 2007, a transmission and system administration company shall operate with the function of operating and monitoring the electricity transmission grid. This company shall have a profit center established that is separate from the transmission activity, which will deal in the administration of the system, long term planning of the electricity system and management of trading of electricity. This profit center shall have powers vis-à-vis the companies operating in the Electricity Sector, in a manner that will ensure, inter alia, the level of development and holding that is required in the Electricity Sector, under the supervision of the Government.

(e) The Company will hold four (4) subsidiaries in the field of distribution that would be as similar to one another as possible in terms of cost structure and volume of activity. These holdings shall be incorporated as subsidiaries of the holding company by March 1, 2007, and the holdings of the Company in each of the subsidiaries in the distribution field will gradually be reduced to 51% by January 1, 2012. These companies shall act to operate and develop the regional electricity grid, and their activity shall be conducted under supervision, including the distribution service charge rate.

(f) Other services (such as planning, construction and performance, information technologies and logistics, which are currently carried out in the divisions of the Company) will be gradually incorporated in separate subsidiaries, and the holdings of the Company in each such subsidiary will be gradually reduced to 51%.

(g) The employees of the Company shall be entitled to benefits (from the Company or from the relevant subsidiary) as is common practice in the privatization process for a government company in accordance with the provisions of the Government Companies Law.

(h) The Ministers shall be authorized to establish in the regulations, despite the provisions of the Obligation for Tenders Law that the generation, distribution and transmission companies that have been split from the Company shall give priority to contracts with the utility companies, for a period and under conditions that the Ministers shall determine. In addition, these companies shall be allowed to contend in other tenders that are outside the field of electricity.

(i) Upon the sale of 49% of the holdings of the holdings company in the distribution and generation companies, the holding company shall be allowed to establish subsidiaries that will engage in other fields of activity.

5) The government resolution authorized the representatives of the Companies Authority, the Budgets Division in the Ministry of Finance and the Ministry of National Infrastructures, Energy and Water (then the Ministry of National Infrastructure), to confer with the Management of the Company and with the representative Employees' Organization of the Company about the process of the Structural Change and the reorganization of the Electricity Sector and the Company, with the goal of presenting the agreements that would be achieved for the approval of the Ministerial Committee for Social and Economic Affairs, to the extent that will be required for the purpose of the amendment of the Electricity Sector Law. It was further established in the government resolution that the known costs of the Structural Change will be reflected in future electricity charge rates.
6) In February 2007 (before Amendment No. 5 to the Electricity Sector Law became effective), pursuant to Government Decision No. 4 in September 2001, the Director of the Ministry of Energy and Water, the Budgets Commissioner in the Ministry of Finance and the Director of the Companies Authority published a policy document, that included their main recommendations for implementing the outline of the structural change in the Company ("The Policy Document"). According to The Policy Document, the Company will be restructured through a gradual process to be turned into a holding company that will have several subsidiaries:

(a) The Generation Segment – two (2) alternatives for implementing the structural change in the generation segment were outlined:

(1) Alternative 1: The generation activity in the current generation units of the Company will be transferred to four (4) up to six (6) subsidiaries, which will have a similar composition, as far as possible, of generation technologies and fuels mix used to operate the generation units, at similar generation costs, except the coal operated generation units. Each of the two (2) current coal generated power stations will be held jointly by two (2) the generation companies, and these companies will not sell electricity directly to consumers.

(2) Alternative 2: The generation activity in the current generation units of the Company will be transferred to four (4) subsidiaries, which will have a similar composition, as far as possible, of generation technologies and fuels mix used to operate the generation units, except the coal operated generation units. Each of the two (2) current coal generated power stations will be held by one of the generation companies, so that each of two (2) generation companies will have a coal operated power station in addition to the other units. The third and fourth generation companies will have agreements to purchase capacity and/or energy from the two (2) companies that hold the coal operated power stations. All for the purpose of creating a similar mix of electricity supply.

The structure and establishment of the generation companies will be determined in a manner that will prevent market failures or unfair utilization of the market power in the electricity market. In addition, clear rules will be prescribed for structural separation and non-dependence between the holding company and the generation companies and among the generation companies, to ensure the business independence of the generation companies and encourage competition in the electricity sector.

Holdings at the rate of 49% of the Company's holdings will be sold up to June 30, 2013 and after the sale at this rate is completed, each generation company will be allowed to deal in water desalination, subject to the directive of section 6(d) to the Electricity Sector Law, regarding an essential service supplier.

(b) System Management – a separate company will be established to manage the system, the commerce and the long term planning (which will not deal in electricity transmission). The system management company will be fully owned by the Government.

(c) The Transmission Segment – a separate company will be established in the field of electricity transmission (named in the policy document "delivery") and clear rules will be determined for structural separation and non-dependence between the Company and the transmission system, to ensure the business independence of the transmission system and development of competition in this segment. The Ministers will have to decide up to January 1, 2011, on the ownership of the transmission company, out of three (3) options: (a) a subsidiary of the Company; (b) a fully owned Government company; or (c) a subsidiary of the system management company.

(d) The distribution segment - will be split into four (4) or five (5) regional distribution companies with territorial continuity, which will be as similar as possible from aspects of costs structure and operation scope. The companies will be established and operated as subsidiaries of the Company and clear rules of structural separation and non-dependence will be prescribed between the Company and the newly established distribution companies and among the distribution companies, to ensure the business independence of the distribution companies and encourage the competition in the market. The distribution companies will operate under regulation, where criteria and rates charged by the distribution companies will be determined by the Electricity Authority and the distribution companies will be obliged to provide non-discriminating services to all parties in the electricity sector.

Holdings at the rate of 49% of the Company's holdings in each of the distribution companies will be sold up to June 30, 2013.
NOTE 1:- GENERAL (continued)

Structural Change (continued)

Resolutions of the Government and Government Entities with Respect to the Structural Change (continued)

(e) **The Supply Segment** – upon incorporation of the Company’s generation companies, all the consumers of the electricity sector will be initially attributed to these companies, according to predefined principles. Electricity will be supplied to consumers by the generation companies and also by independent parties that are not the distribution, the supply or the system management companies, according to supply licenses.

(f) **Service Companies** – divisions of planning, building and construction of power stations, information technology, logistics and the field of fuels and coal field will be established and operated as a company or separate subsidiaries of the Company and clear rules of structural separation and non-dependence will be prescribed between the subsidiaries and Company and among the subsidiaries, to ensure the business independence of the subsidiaries and encourage the competition in the segment. Holdings at the rate of 49% of the Company's holdings in each of the services companies will be sold up to June 30, 2013. Upon completion of the sale in the distribution and generation companies, the Company will be permitted to establish subsidiaries that will act in other fields, subject to the provisions of section 6(d) to the Electricity Sector Law.

(g) **Assets and Debts Transfer**

1. The Company will sell to the newly established companies, assets belonging to the operating segments that are transferred to the companies.
2. The Company will be responsible for loans it took and loans will not be transferred to the companies which will be established.
3. Assets that will serve more than one company will be transferred to the company which will be determined by the Ministers and suitable contracts will be entered to regulate the use of the assets by all other companies, under conditions that will enable early attainment of the competition goal.
4. The sale consideration will be determined according to the book value of the assets in the Company ledgers.
5. Part of the consideration, in an amount equaling the balance of the Company's loans just before the transfer date, will be paid gradually by the companies that will receive the transferred assets, at dates that will enable the Company to pay the amounts of its loans to its debtors.
6. The balance of the consideration will be paid immediately to the Company by the transferee companies. Funds deriving from the balance of the consideration that the Company will receive from subsidiaries will be used immediately by the Company for investing in the share capital of the subsidiaries.
7. Interest will be paid on the part of the consideration that will not be paid immediately, at the rate which will enable repayment of the interest which the Company is obliged to pay according to the terms of the loans.
8. The sale of the assets to the new companies will be performed in a manner that will ensure that the assets and the income of the Company after the restructuring, directly and indirectly, through its holding in the subsidiaries to be established, will enable repayment of the balance of the Company's debt to the debtors.

7) On February 18, 2007, the Government of Israel reached a decision (number 1210) regarding the Electricity Sector Law Draft (Amendment no. 5)-2007 – Authorization of the Ministerial Committee for Legislation and Law Enforcement, which adopted the outline of Amendment No. 5 to the Electricity Sector Law and defined the outline of its regulation process. The Policy Document also stated that clear rules should be regulated to ensure structural separation between the Company and its subsidiaries. The majority of the principles which were stated in the Policy Document were integrated shortly afterwards within Amendment No. 5 to the Electricity Sector Law in March 2007. However, the majority of the dates which were stated in Amendment No. 5 were cancelled in practice, or postponed under Amendment No. 8 of June 2008, and other dates were determined.

In practice, the licenses of the Company continue to be extended from time to time, and were lately extended up to January 1, 2015, without implementing a structural change in the Company.

In a letter to the Chairman of the Board of Directors of the Company on February 28, 2007, on the subject of regulating Amendment No. 5 to the Electricity Sector Law, the Director General of the Government Companies Authority clarified that the implementation of the reform in the Company according to the Electricity Sector Law, including Amendment No. 5 to the Law of that date, will be conducted while examining, inter alia, the implications.
NOTE 1:- GENERAL (continued)
e. Structural Change (continued)

Resolutions of the Government and Government Entities with Respect to the Structural Change (continued)

of the structural change for the Company's obligations, with the intent to allow repayment of loans received by the Company.

In the opinion of the Company's Board of Directors and Management, implementation of the structural change in the Company (in any outline) involves addressing issues related to creditors of the Company, in light of the agreements with some of them, to the extent that these issues will be affected by the implementation of the structural change, all subject to the effective laws.

As of the date of this report, the Company and the Government have not completed the actions related to these issues as yet.

8) On March 28, 2007, the Government of Israel reached a decision (number 1482), with respect to conducting negotiations concerning the implications of the structural change in the electricity sector on the rights of the employees of the Company, stating that continued negotiations should be conducted with the employees of the Company on their rights, in the context of the structural change. The decision stated that the Ministers will lead the negotiations and that significant decisions, requiring approval of the Ministers, will be made by the Ministers in a joint decision.

9) On June 30, 2008, the Government of Israel reached a decision (number 3704) with respect to the establishment of government companies in the electricity sector – approval by the Ministerial Committee for Social and Economic Affairs (the Socio-Economic Cabinet), within which the Government of Israel approved the formation of two (2) government companies owned by the State of Israel, which would operate in the Electricity Sector – the System Administration Company Ltd., which was supposed to carry out the activity relating to the administration of the system in the Electricity Sector, and the New Electricity Generation Stations Company Ltd., which was supposed to act to generate electricity in accordance with the provisions of the Electricity Sector Law. The two companies were incorporated and registered with the Registrar of Companies in October 2008. On May 12, 2009 an additional government resolution (number 129), with respect to the increase of competition in the electricity sector, was adopted, within which it was decided to charge the Ministers with advancing the activity of the founded government companies in accordance with their goals. Within the Draft Report, the steering team recommended that the New Electricity Generation Stations Company Ltd. will be liquidated.

In the opinion of the Company's Board of Directors and Management, implementation of the structural change in the Company (in any outline) involves addressing issues related to creditors of the Company, in light of the agreements with some of them, to the extent that these issues will be affected by the implementation of the structural change, all subject to the effective laws.

As of the date of this report, the Company and the Government have not completed the actions related to these issues as yet.
NOTE 1:- GENERAL (continued)
e. Structural Change (continued)

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 together: "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.

1) As a rule a license will not be granted to a person for more than one activity, however:
   a) 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.
   b) 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.

2) No generation license or distribution license shall be issued to a party holding means of control of a transmission license holder.

3) No transmission license shall be issued to a holder of means of control of a generation license holder or a distribution license holder.

4) No generation license shall be issued unless one of the following is fulfilled:
   a) The license applicant holds means of control of a distribution license that holds 10% or more of the distribution volume in the Electricity Sector;
   b) 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;
   c) 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;
   d) The license applicant is a holder of a transmission license.

5) No distribution license shall be issued if one of the following is fulfilled:
   a) 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;
   b) 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;
   c) 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 (4) and (5) 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.
Special transitional provisions and milestones for the Company in the Electricity Sector Law

1) 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, 2015.

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, and this until April 15, 2012 (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.

By virtue of Amendment 12 to the Electricity Sector Law, the licenses of the Company were extended until January 1, 2015. In accordance with section 60 (d11) to the Electricity Sector law, a further extension of the licenses until January 1, 2016 would require an order to be issued by the Ministers, after consultation with the Electricity Authority and the Companies Authority, and with the approval of the Economic Affairs Committee of the Knesset. This authority of the Ministers to provide an extension by an order is limited to one period only, which will not exceed one year, and therefore 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.

Additionally, in view of the position of the Electricity Authority with respect to its authority to extend the new production license as clarified above, and for the sake of caution, the Company has applied to the Electricity Authority and requested an extension for the new production licenses. On February 12, 2014, the Minister approved the decision of the Electricity Authority of January 23, 2014, within which the validity of the new production license was extended until January 1, 2015.

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, 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 implemented.

2) 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, 2015). An additional extension beyond this date will entail a legislation amendment. If and 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, and to the best of its knowledge, none have been granted to any other entity either.

3) 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, 2015. As stated, an additional extension of the Company’s licenses beyond the date of January 1, 2014, will entail the issue of an order by the Ministers as detailed above, and the additional extension beyond January 1, 2016 will entail a legislation amendment.
NOTE 1:- GENERAL (continued)
e. Structural Change (continued)

Special transition provisions and milestones for the Company in the Electricity Sector Law: (continued)

4) 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 subsection (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 1e4c and 1e5c above, as long as the following conditions are met:

a) 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.

b) 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.

c) 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.

d) 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.

5) 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, 2015) 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 of the Company’s licenses beyond this date will entail a legislation amendment. To the best of the knowledge of the Company, as of the date of the report, no such order has been given.

6) 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, 2015). An additional extension of the Company’s licenses beyond this date will require the issue of an order by the Ministers as detailed above, and an additional extension beyond January 1, 2016 will entail a legislation 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, 2015), but that time may be extended by an order, by the Ministers, after consultation with the Electricity Authority, if they find this to be crucial for the advancement of the goals of the Electricity Sector Law for a period that shall not exceed six (6) months only.

7) 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.
e. Structural Change (continued)

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, relying, inter alia, on the various Government resolutions that have been adopted with respect to the Structural Change in the Electricity Sector (and in particular Government resolution number 463 with respect to the structural change on the electricity sector, of September 12, 2006), the Policy Document and the explanations to the Electricity Sector Law and legislative amendments made thereto over the years, 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:

1) At least four (4) 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);

2) At least four (4) 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;

3) A company with a transmission license, unless the Ministers determine, by January 1, 2015, that a government company or a government subsidiary holding means of control of a generation or distribution license holder would not be able to hold means of control of a transmission license holder as well;

4) Beginning in July 2013, 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);

5) The system administration activity would be carried out within a separate corporation in which the Company would have no holdings.

6) 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);

7) The holding structure that has been described above is subject to the approval of the Minister. Notwithstanding that which has been described above, there is an option for one or more of the generation and distribution companies and for the transmission company to be detached completely from the group of the Company.

The provisions of the Electricity Sector Law are complex and may be construed or implemented in different outlines, and the Company has no certainty that its interpretation of the provisions of the Electricity Sector Law is the interpretation that will be accepted or be implemented. Although the Government related, in its decision dated September 12, 2006, to the implementation of the Structural Change in a manner that is similar to the interpretation of the Company, the Company has no certainty that the Law will be implemented in accordance with this resolution.
Outline of Understandings
Following discussions conducted in September 2010, between the Company and representatives of the Ministry of Finance, the Histadrut and the Company employees’ organization, the parties to these discussions reached an understanding on possible principles for an outline of a structural change in the Company which was recorded in writing. The outline does not conform to the instructions of the Electricity Sector Law, in its version on the date of the report and/or to the talks conducted within the Yogev Committee.

The detailed principles of this outline are as follows:
(1) The system management activity will be taken out of the Company and transferred to a separate Government company that will act as the system manager.
(2) In the generation segment:
   (a) The whole Ramat Hovav site will be sold and transferred to full private or Government ownership (a total generation capacity of about 1,150 MW).
   (b) The whole activity of CCGT 4 of the Alon Tavor emergency plan will be sold and transferred to full private or Government ownership. The Company will plan and build the generation unit (generation capacity of about 380 MW).
   (c) Project D – the coal operated power station, a project of future planning that is included in the development plan of the Company, will be established as a separate company. The Company will plan and build it and a private or Government ownership will be introduced with a shareholding of 51%. The Company will hold 49% of the project and will not be the controlling party of this company at any stage.
   (d) The Company will establish or build a nuclear power station, or power stations with an equivalent volume of generation capacity of 1,300 MW, that will be owned by the Company, starting from 2020, according to the needs of the development plan.
   (e) The Company will be allowed to upgrade and replace power stations that it owns according to its needs and upon the obsolescence of the existing equipment.
   (f) The prohibition, in principle, that prevents the Company from building and operating additional power stations it owns will be lifted.
(3) The Company will be allowed to plan and build power stations and also act in the fields of logistics, computerization and information, in Israel and abroad, and the current limitations on these fields of operation will be lifted.
(4) No Company activities, except the aforementioned in sub-sections 1 and 2 above will be incorporated into subsidiaries, including generation, transmission and distribution activities and also headquarters and service divisions of the Company. All these will remain in the Company and be performed as one united company.
(5) The Company will operate through profit centers that will enable full transparency and cost attribution according to a model that will be determined in line with the nature of the Company's operations, under the control of the external auditor of the Company. The power stations will be operated within a framework of regional stations as profit centers and will be audited by the external auditor of the Company, for the purpose of enabling maximum transparency and costs attribution for the system manager.
(6) The discussion of the subjects specified in section 7) below will not reopen the discussion on the structure in principle of the Electricity Sector, as stated in the outline of understanding.
(7) All the understandings and consents to this outline are subject to consent to all components of the agreement (structural change, organizational change, efficiency, financial strength and employee rights).

The Outline of Understandings has not yet been examined by the authorized government entities and has not yet been approved by them, and is not in line with the provisions of the Electricity Sector Law. The implementation of the structural change in the electricity sector in accordance with the outline of understandings, if an agreement is reached regarding its full or partial implementation, and providing legal validity to this outline, will require approvals of the competent agencies of the State, including Government approvals, making required legislative amendments and execution of additional actions, none of which has been agreed to or adopted as of the time of this report and whose fruition is unknown. As of the date of this report there is uncertainty as to whether and when these understandings will be implemented, if at all, and whether these or other understandings or other structural changes, including the recommendations of the Steering Committee, will be eventually implemented, all at the discretion of the competent entities and subject to any law. If all this does not take place, the Company may be required to implement the Structural Change as outlined in the Electricity Sector Law, whether in the manner in which the Company understands that the Electricity Sector Law can be implemented, or in another outline.
NOTE 1:- GENERAL (continued)
e. Structural Change (continued)

Steps and Measures Taken by the Company with Respect to the Structural Change
Implementation of the structural change in the company did not show real progress in the past, due to factors beyond the Company’s control, including among others, employees sanctions on the subject of the structural change and also because the negotiations conducted by the Company with the different Government parties on the issues of the structural change did not mature into agreements. The Company is acting and addressing related parties in the State, the employees organization and the Histadrut in order, to reach an agreed upon arrangement, inter alia, with Company employees on the implications that the structural change will have on employees’ rights, as described above, including within the steering team.

In December 2010, the Board of Directors decided to make progress in the implementation of the structural change during 2011, including the implementation of the Understandings Outline and a comprehensive efficiency plan. The Board of Directors called all the involved parties to cooperate closely and open intensive discussions immediately, to promote the agreed upon process.

In April 2011, the Board of Directors resolved to appoint a head for the structural change administration. Within the framework of his function, the Head of the Administration is responsible, inter alia, for the following issues: the planning, implementation and supervision of the measures required for executing the structural change in the Company, monitoring the schedules for implementation, milestones and execution of the changes and serving as the representative of the Management with respect to contacts with outside parties, the various authorities and Government ministries with which the connections will be managed through the Administration. The head of the Administration assumes the status of a division manager, serves as a member of Management and is subordinate directly to the CEO. Under the head of the Administration a number of subject matter teams operate, headed by team coordinators on the various issues of the structural change (economic, organizational, legal, regulatory, etc.).

This decision was adopted after a previous decision of February 2007 to form an administration for the purpose of implementing the structure change was not executed due to employees’ sanctions.

In November, 2011, the Board of Directors of the Company instructed the Management of the Company to promote the process of the structural change of the Company, even in the case that planned reform of the electricity sector will not be realized in full during the coming year, and to exhaust all the legal possibilities that exist in the budget and cash flow field of the Company, in order to decrease the need, as far as possible, of another debt raising.

In December 2011, the Board of Directors of the Company decided during discussions on the Company’s budget for 2012, to approve the early retirement outline for 400 employees as presented to the Board of Directors. The candidates will be according to Management’s lists, which will simultaneously approach to the Companies Authority and conduct negotiations with the employees’ organization and the National Labor Federation (Histadrut) regarding the conditions of the retirement operation and the rights of the retiring employees. The decision was not executed, and additionally, the Board of Directors of the Company reached a decision in December 2012 to decrease 200 positions from the service list in 2013.

The Company estimates that the costs of the retirement of employees, either under the implementation of the structural change, insofar as implemented or under the implementation of the multi-year plan for a structural change and efficiency, which according to the decision of the Board of Directors will be implemented in any case, may be material.

For details regarding the decision of the Commissioner of Wage and Labor Agreements in the Ministry of Finance of October 10, 2013, employee sanctions adopted regarding it, and the decision of the Court on this issue see Note 12 g. For details of labor disputes on issues that may be connected to the structural change, see Note 34 c.
NOTE 1:  GENERAL (continued)
e. Structural Change (continued)

The Position of the Board of Directors and the Company with Respect to the Implementation of the Structural Change

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 in the Company, and does not regulate in detail the manner of its execution. In their opinion, 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 operate, to the extent possible, to advance a structural change in the real outline, with the consent of the Employees' Organization.

The Company regards the implementation of the structural change as a milestone in fortifying and reinforcing the financial strength of the Company.

As of the approval date of these financial statements, an implementation of the structural change in any outline has not yet began, and the final format of the structural change, its implementation date or implications for the Company, its business and results are uncertain.

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 below) 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.

"The Plant" was defined in section 46 of the Concession as a business for generation, supply and distribution of electrical power, according to the Concession, and all assets of the Company related to that business, but not money or securities for money or debts in the books. Section 46 of the Concession also prescribes that if the Company established a laboratory, a science institute or a library and if the State received it, the State will be appropriate compensated. However, according to the directives of section 46 to the Concession, the Company will be entitled to claim appropriate compensation for installations and repairs under the conditions prescribed in section 44(c) to the addition to the Electricity Concessions Ordinance, as if the Government bought the plant at the date on which the plant was transferred to the holding of the Government. Section 46 of the Concession also states that if at the time of transferring the plant to the State, a debenture or borrowed capital of the Company (approved by the High Commissioner according to the Electricity Concessions Ordinance) were not repaid in full, the High Commissioner will assume all the liabilities of the Company deriving from it (but will be entitled to benefit from the available funds for reducing the liabilities).

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").
NOTE 1:-

f. Assets Arrangement (continued)

1) Electricity Sector Law Stipulations (continued)

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. If the parties do not arrive at the aforesaid arrangement within one year from the date that the concession expires (namely up to March 1997), the Ministers will determine provisions as to the acquisition of the aforesaid rights and assets.

In the first year following the date on which the concession expired no negotiations were held and therefore the parties did not reach an arrangement.

As of the date of this report, the Ministers had not determined which assets in use are non-compensable (assets "used" or "intended to be used" by the Company) and/or any provisions with respect to the acquisition of the aforesaid rights and assets.

Moreover, similar to the Electricity Concessions Ordinance, the Electricity Sector Law does not include classification and attribution of the assets of the Company on the Concession expiration date, namely, the law does not specify which assets and rights are compensable assets as mentioned in sub-section (a) above (and included in section 62(a) of the law, according to which they remain with the Company and it is not required to pay the State for them); and also does not specify which assets and rights are assets in use that are non-compensable, as stated in sub-section (b) above, for which an assets arrangement should be drawn (and which the Company will be required to buy from the State at their value on the transfer date of the rights and assets, on the arrangement execution date). 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 their acquisition cost 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.

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 (3) groups: (1) rights and assets mentioned in sub-section (a), namely, compensable assets; (2) rights and assets mentioned in sub-section (b) above, namely, assets in use that are non-compensable to which the assets arrangement will apply; and (3) 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 part of the "plant" within its meaning in the aforementioned section 46 of the Concession. 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 according to section 46 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".

The opinion of the State does not detail these implications and therefore what type of financial or other arrangement will be determined for these assets is also uncertain. However, since the policy of the Company was and still is to buy assets which are designated to be used for electricity generation and transmission operations, the Company believes that if such assets were held on the concession expiration date, then on the date of this report, their number is small and their depreciated cost in the financial statements is low.
NOTE 1:- GENERAL (continued)

f. Assets Arrangement (continued)

2) The Position of the Company Regarding the Assets and Rights Classification (continued)

As mentioned, as of the date of this report, the Ministers did not announce which assets are used or are intended to be used for the operation of the Company, therefore, even the assets included in the aforesaid third category cannot be actually classified, nor can their actual effect on the financial results of the Company be determined. There is no certainty that these assets will eventually remain with the Company.

The opinion of the legal advisors of the Company includes a claim that the Concession expires a day before the law became effective (the law became effective on March 4, 1996), therefore, the "plant" was not transferred to the Government. The State disputes this claim in its opinion.

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 in NIS of September 2013). 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.
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 September 2013).

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 total 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 2013).

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 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.

4) The Opinion 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.

On the basis of all of the above, the Company, based on the legal opinion it obtained, estimates that the implementation of the assets arrangement was not meant to have and does not have a material effect on the Company, its operating results or its financial position and that the Company will not be obliged to pay compensation to the State with respect to depreciable assets, even if these were fully or partially depreciated. Notwithstanding, since the assets arrangement is subject to the determination of the Ministers, it is possible that the Company will be eventually required to pay material amounts with respect to assets to which the assets arrangement will apply. Additionally, regarding some of the assets, it is uncertain which financial or other arrangement shall apply to them, or if they will be held by the Company or returned to the State.

In the month of May 2009, by virtue of Government Resolution number 129 regarding the increase of competition in the electricity sector, a team of regulators was established in order to, inter alia, increase the coordination and improve the efficiency of regulating on the Company. The team’s activity will focus on material issues in the Company’s activity, including in the field of pension, salary, actions permitted under the law, all in accordance with the authority of the regulating entities in the State.

On March 9, 2011, a draft of an interim report was delivered to the Company for its comments. The main points of the draft included a proposal to reexamine the significance of the assets arrangement, in accordance with section 62 of the Electricity Sector Law – 1996, including in light of the legal and economic opinions existing on this subject and its implications when implementing the structural change.

The Company delivered a reaction to the interim report draft (that did not include any reference to the assets arrangement, due to lack of any determinations in this issue in the interim report draft of the team of regulators). As of the date of the Report, the Company has yet to receive a summarizing report regarding all the issues that the team was required to examine, including the issue of the assets arrangement, the Company cannot estimate what effect, if any, the conclusions of the team of regulators will have on the assets arrangements and its implementation. For additional details regarding the team of regulators see Note 13 f below.
f. Assets Arrangement (continued)

In October, 2013, the Company raised the issue of the assets arrangement with the Yogev Committee as an issue that requires regulation. It is the Company’s understanding that the Government entities are formulating their position on the subject and are examining various possibilities of handling the issue within the handling of the financial strength of the Company, and it expects that the issue will be discussed and regulated during the discussions on the subject of the structural change.

Regarding the recommendation draft of the steering committee published on March 23, 2014, see Note 1 e above.

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 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. The Company has recently supplied the Ministry of Environmental protection with possible alternatives for dates of shutting down units of the project. In February 2014, the approval of the Ministry for Environmental Protection for postponing the dates of completion of the project until June 30, 2018 was received, subject to terms.

Regarding the recommendation draft of the steering committee published on March 23, 2014, see Note 1 e above.

3) As at the signing date of the financial statements, several proposed environmental bills and regulations are in various stages of enactment, including the Proposed Bill of Preventing Soil Pollution and Rehabilitating Polluted Soil, 2011, which determines a general prohibition on causing soil pollution and memorandums pertaining to the Non-ionizing Radiation Law, which may lead to material implications.

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.
**NOTE 1:- GENERAL (continued)**

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Related Parties</td>
<td>As defined under International Accounting Standard 24</td>
</tr>
<tr>
<td>Dollar</td>
<td>US dollar.</td>
</tr>
<tr>
<td>Subsidiary Companies</td>
<td>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.</td>
</tr>
<tr>
<td>Held Companies</td>
<td>Subsidiary companies and investee companies.</td>
</tr>
<tr>
<td>Associate Companies</td>
<td>Companies in which the Company has material influence.</td>
</tr>
<tr>
<td>Annual Financial Statements</td>
<td>The Company's Annual Financial Statements as of December 31, 2013, and for the year ended on that date and their accompanying notes.</td>
</tr>
<tr>
<td>Total Electricity Consumers</td>
<td>All the electricity consumers in Israel that are customers of the Company and that are customers of private producers.</td>
</tr>
<tr>
<td>IFRS</td>
<td>International Financial Reporting Standards</td>
</tr>
<tr>
<td>SFAS</td>
<td>Statement of Financial Accounting Standards</td>
</tr>
<tr>
<td>IAS</td>
<td>International Accounting Standards</td>
</tr>
</tbody>
</table>
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 amended in 2008, 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 and to 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 will be prepared in accordance with the International Financial Reporting Standards (IFRS), and their interpretations as published 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.

b) Notwithstanding any of the instructions of Section a) above:

(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.
NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)
a. The Basis of Financial Reporting (continued)
  1) Government Companies Regulations (continued)

(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 said 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 4) below.

c) The manner of applying International Financial Reporting Standards will be modified or adjusted as required for purposes of implementation.

d) The notes to the Company’s Financial Statements will include qualitative (rather than quantitative) disclosure to explain how the reporting principles applied in the Financial Statements of the Company differ from International Financial Reporting Standards (IFRS). See section 4 below.

e) The Report of the Board of Directors will provide an estimate of the financial effect of the difference between the effect of the Standard for Regulated Companies and the effect of the Accounting Opinion on items of equity and net income.

f) Should the Company fail to meet the reporting conditions listed in the directives of the Companies Authority the Company will not prepare its financial reports according to the exceptions detailed in section b, above.

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. Additionally, the position of the Government Companies authority is that, as from January 1, 2015, the Company should fully implement International Financial Reporting Standards (hereinafter: the “IFRS Standards”), see Note 3e below.

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.
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)

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 the said 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:
1. Anticipated coverage shortage with respect to certain costs.
2. It can be measured reliably.

The Company performs this test at every financial statements publication date.

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, not 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.
3) Principles of Adjusting the Financial Statements According to Changes in the General Purchasing Power of the NIS (continued)

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, prepayment on account of land leases, intangible assets and the amortization accumulated thereon, capital raising expenses, inventories, prepaid expenses, receipts and expenses in respect of work in progress, perpetual debentures, 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.

4) Qualitative Disclosure

The main differences between the financial reporting rules applied in the Financial Statements and the IFRS are listed below:

a) Asset Impairment

The international standards include no other standard which compares to the directives of SFAS 90 and when testing assets 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 International Accounting Standard No. 36 (hereinafter: “IAS 36”). According to the IFRS rules, the provision for assets impairment is calculated according to IAS 36 only.

b) Capitalized Financing Costs and Return on Capital

According to Chapter RE6 rules, the Company capitalizes financing and return on capital to assets costs. All this differs from International Accounting Standard number 23 that determines capitalization of financing costs to assets under construction, and does not allow capitalization of the return on investment and is based on the actual financing costs of assets under construction.

c) Investments in Operational Power Stations (including Renovations)

In accordance with the IFRS rules, the investment cost in operating power stations is capitalized to cost of the fixed assets.

The Electricity Authority determined that the cost of investments in operational power stations (including renovations), will not be recognized as an addition to fixed assets and will be recognized instead as operational expenses (except investments that increase the capacity and/or improve availability and/or prolong...
NOTE 2: REPORTING RULES AND ACCOUNTING POLICIES (continued)
a. The Basis of Financial Reporting (continued)
   4) Qualitative Disclosure (continued)
      c) Investments in Operational Power Stations (including Renovations) (continued)

operational life, or conform to environmental standards). Consequently, the recognized annual cost was determined according to the weighted average method for the years 2002-2006 and it is factored into the sales rate, less efficiency. In view of the decision of the Authority, as of the date of publication of the generation rate in February, 2010, the Company depreciates its investments in operational power stations (including renovations).

d) 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. At the same time, 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).

5) Transition to International Standardization on January 1, 2015

   a) On January 1, 2015, as stated in section a 1 above, the Company will transition to full implementation of the IFRS standards.

   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. In its reply, the Securities Authority granted the Company an exemption from the obligation to include comparison 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. The Securities Authority also set the date of transition to the IFRS standards as January 1, 2014.

   b) As stated in section z 4) below, in January, 2014, the International Accounting Standard number 14 was published, regarding regulatory assets liabilities. The standard enables to implement the existing practice in the Company on the subject of recognition of regulatory liability assets in the reports that will be prepared in accordance with IFRS standards.

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) 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 its Periodic Statements valuations that are highly material to the Company. Therefore, the Company applied a quantitative 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 annual profit of the last known year, neutralizing incidental effects (after tax), and the effect of the stated change constitutes at least 5% of the equity of the corporation.
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, 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:
      - 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.

e. Cash and Cash Equivalents and Short Term Investments
   Cash and cash equivalents include deposits for immediate withdrawal and fixed term deposits with no usage limitation, and maturity dates at the deposit date that do not exceed three months. Deposits which are restricted as to use and whose maturity date on the investment date exceeds three months and do not exceed one year are classified under the short term investments item.
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 and loss of the associates and in their comprehensive income and loss, after deducting impairment, if it occurred, in the value of the associate.

The value of the Company holding in an included 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. 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 section a. 4) c) above.

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.
### The useful lives and depreciation rates used in the calculation of depreciation are as follows:

<table>
<thead>
<tr>
<th>Asset Type</th>
<th>Useful Life (years)</th>
<th>Depreciation Rates (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Power stations</td>
<td>30 - 50 (mainly 30 years)</td>
<td>2.33 - 3.33</td>
</tr>
<tr>
<td>Industrial gas turbines</td>
<td>25</td>
<td>4</td>
</tr>
<tr>
<td>Jet gas turbines</td>
<td>15</td>
<td>6.67</td>
</tr>
<tr>
<td>Transmission system</td>
<td>30</td>
<td>3.33</td>
</tr>
<tr>
<td>Distribution system</td>
<td>20 - 30 (mainly 30 years)</td>
<td>3.33 - 5</td>
</tr>
<tr>
<td>Meters</td>
<td>9 - 14 (mainly 14 years)</td>
<td>7.1 - 11.1</td>
</tr>
<tr>
<td>Inventories (including office equipment), mobile</td>
<td></td>
<td></td>
</tr>
<tr>
<td>mechanical equipment and telecommunications</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Computers and auxiliary equipment</td>
<td>3 - 5</td>
<td>20 - 33.33</td>
</tr>
<tr>
<td>Motor vehicles</td>
<td>5 - 7</td>
<td>14.3 - 20</td>
</tr>
<tr>
<td>Buildings</td>
<td>30</td>
<td>3.33</td>
</tr>
</tbody>
</table>

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.
NOTE 2: REPORTING RULES AND ACCOUNTING POLICIES (continued)

j. 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:

<table>
<thead>
<tr>
<th>Useful life (years)</th>
<th>Amortization rates (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Software</td>
<td>5-15</td>
</tr>
<tr>
<td></td>
<td>6.67-20</td>
</tr>
</tbody>
</table>

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.

In the beginning of 2013, the Company examined the useful life of the software it uses, and following this the useful life of the software defined as strategic projects of the Company was changed. The influence of the change on the total depreciation and amortization this year is not material.

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, except inventory, 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 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 Section a4a above and Note 14 below.
NOTE 2: REPORTING RULES AND ACCOUNTING POLICIES (continued)

1. Fuel Inventory
Fuel 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 fuel inventory that is held for use in the electricity generation process is not written down if electricity sales amount to total cost or exceed cost.

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 during a period exceeding a year is presented within the section of Inventory fuel - 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 held for trading. Any resultant gain or loss arising from changes in fair value, including those originating from changes in exchange rates, is recognized in operations in the period in which the change occurred.

The financial assets of the Company that are included in this category include: swap transactions and forward transactions. See section o above.

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)
NOTE 2: REPORTING RULES AND ACCOUNTING POLICIES (continued)

m. Financial Assets (continued)

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 its 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.

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 or, according to the essence of the underlying contractual arrangements.

An equity instrument is any contract testifying to a residual right in the assets of the Company after deducting all liabilities. Equity instruments issued by the Company are recorded at the proceeds of the offering, less expenses directly related to issuing such instruments.

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.
NOTE 2: REPORTING RULES AND ACCOUNTING POLICIES (continued)

n. Financial Liabilities and Financial Instruments Issued by the Company (continued)

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
The Company enters into a variety of derivative financial instruments to manage its exposure to interest rate and foreign currency rate risks, including combined interest rate and currency swaps 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.

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
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.

2) Revenues from Interest
Interest revenue is accrued on a time basis, by reference to the principal outstanding and at by use of the effective interest method.

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 and 28 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 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
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 lessor 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).

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 lessor grants additional benefits, the Company recognizes the expenses on the straight line basis, over the lease term.

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.

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 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) Current Taxes
   Current tax expenses are computed based on the taxable income of the subsidiary during the reporting period. Taxable income differs from income before taxes on income, due to inclusion or exclusion of taxable income and expenses that are deductible in other reporting periods, and or are not taxable or deductible. Assets and liabilities of the Company for current taxes are calculated using tax rates and tax laws that have been enacted or substantially enacted by the statement of financial position date. Assets and liabilities of current taxes are presented as offset when the entity has an enforceable legal right to offset the recognized amounts and also an intention to pay off on a net basis or realize the asset and pay off the liability concurrently.

3) 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. The taxes that would apply in the event that the investments in investees were realized were not taken into account in the calculation of the deferred taxes, since the Company intends to hold these investments. In addition, the deferred taxes on distribution of earnings by investees as dividends were 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) Benefits after Termination of Employment
   Company benefits after termination of employment include: pension and grants. Benefits from the Company after termination of employment are in part defined contribution plans and in part defined benefits plans.

   Expenses for the liability of the Company to deposit funds in a defined contribution plan 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 are charged to operations, or capitalized to the cost of the assets, utilizing actuarial valuations carried out at every statement of financial position date, under the projected unit credit method. (According to the provisions of the International Accounting Standard No. 19, the discount rate for the calculation of pension actuarial liabilities is determined by using market returns at the end of the reported period on high quality corporate bonds. In countries where there is no deep market for such high quality bonds, the market returns on government bonds are used).

   The present value of the liability of the Company for the defined benefit plan is determined by capitalizing future cash flows anticipated for the plan at an interest rate determined according to market yields of CPI-linked government debentures, and having maturity periods matching the projected payoff dates under the plan as much as possible. In cases in which there is no market with high tradability of debentures with a period to maturity of all benefit payments, the capitalization rate will be estimated by extrapolating current market rates along the yield curve. Current employment cost and total liability as at the statement of financial position date are determined for every period by attributing the benefit to employees to the employment periods, based on accumulated rights in the plan.
NOTE 2: REPORTING RULES AND ACCOUNTING POLICIES (continued)

u. Benefits to Employees (continued)

1) Benefits after Termination of Employment (continued)

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 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 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 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 Y 3) below with respect to the IAS 19 amendment “Benefits for Employees”.

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 CPI-linked government debentures, linked to the CPI used to pay the benefits related to the grant, having maturity periods closely identical to the anticipated payoff dates of the grant. In a market without high tradability of debentures with a period to maturity of all benefit payments, the capitalization rate will be estimated by extrapolating current market rates along the yield curve. Actuarial gains and losses are charged to profit and loss upon their creation. Past service cost is recognized immediately in the Financial Statements of the Company.

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.
NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

u. Benefits to Employees (continued)

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.
   The benefits amount is determined in accordance with the capitalization rate of government debentures.

5) See section Y 3 and Note 37 below with respect to the influence of the initial implementation of IAS 19 amendment “Benefits for Employees” (amended 2011).

6) Funds in Trust (see Note 13 below)
   Funds held in trust are recorded in their fair value in accordance with the IFRS standards.

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. Exchange Rates and Linkage Basis
   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.

   3) The following are data of the CPI and exchange rates of the US dollar and the rates of their change:

<table>
<thead>
<tr>
<th>As of</th>
<th>Representative Exchange Rate</th>
<th>Consumer Price Index</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Of the US Dollar</td>
<td>Of the Euro</td>
</tr>
<tr>
<td>As of the Financial Statements date</td>
<td></td>
<td></td>
</tr>
<tr>
<td>December 31, 2013 .........................</td>
<td>3.471</td>
<td>4.782</td>
</tr>
<tr>
<td>December 31, 2011 .........................</td>
<td>3.821</td>
<td>4.938</td>
</tr>
</tbody>
</table>

   Rates of change in the year ended on
   | % | % | % | % |
   | For the year ended on December 31, 2013 | (7.02) | (2.80) | 1.82 | 1.91 |
   | For the year ended on December 31, 2012 | (2.30) | (0.36) | 1.63 | 1.44 |
   | For the year ended on December 31, 2011 | 7.66 | 4.22 | 2.17 | 2.55 |
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:

1) **IFRS 12 “Disclosure of Interests in Other Entities”**

   The standard sets disclosure requirements regarding the rights of an entity in subsidiaries, joint arrangements, associates and structured entities that are not consolidated. The purpose of the disclosures is to assist in assessing the accompanying nature and risks regarding rights in the said entities and the effect of the said rights on the financial statements of the reporting entity.

   For the effect of the implementation of the standard see Note 11 below.

2) **IFRS 13 “Fair Value Measurement”**

   This standard replaces the guidance on individual fair value measurement in different international financial reporting standards with guidance grouped in one standard, there is guidance guide for fair value measurement. Accordingly, it specifies guidance for fair value measurement of all the items measured at fair value in the statement of financial position or for disclosure purposes.

   The standard defines fair value as the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

   The standard sets out the various approaches that may be applied in measuring fair value and states that the valuation techniques that are applied should use the maximum observable market data available.

   The implementation of this standard on the Financial Statements of the Company is not material.

3) **IAS 19 (2011) “Employee Benefits”**

   The Company is implementing the guidelines of the International Accounting Standard No. 19 (2011) "Employee Benefits" commencing from January 1, 2013, by way of retrospective implementation from January 1, 2011 (except for the need to adjust the book value of assets whose cost includes employee benefits, such as fixed assets, for periods preceding January 1, 2011), in the following main aspects:

   a. Actuarial gains or losses, with respect to a defined benefit plan, are charged to other comprehensive income and are not classified later to profit or loss. As a result, the possibility of recognizing actuarial gains or losses immediately in profit or loss, or according to the “corridor method” prescribed by the previous standard, is eliminated.

   b. Interest income with respect to assets of a defined benefit plan is recognized on the basis of the capitalization rate used to measure the current value of the obligation and not according to the expected yield of the assets. This section had no effect on the financial statements of the Company since before this amendment the anticipated return rate of the assets was identical to the return rate used to calculate the interest cost are already identical. See Note 12 q below.

   c. The “cost of previous service” is recognized immediately for the period in which the plan was changed, regardless of the maturity conditions. On the other hand, according to the previous format of the standard, previous service cost was spread over the future service period, until it matures.

   d. Short term employee benefits include benefits that are expected to be fully paid off at the end of 12 months from the end of the year in which the service that entitles the employee was given. This change had no material effect on the Financial Statements.

   e. Termination benefits arising from the proposed encouragement of a voluntary retirement plan are recognized as a liability at a date when the reporting entity can no longer withdraw the offer. This change does not have any effect on the Financial Statements.

   For the impact of the retrospective implementation of the standard on the financial statements see Note 37 below.
NOTE 2: REPORTING RULES AND ACCOUNTING POLICIES (continued)

2. New Standards and Clarifications Published which are not in Force and were not Adopted by the Company in Early Adoption, Expected to, or May Affect Future Periods:

1) IFRS 9 "Financial Instruments"
The standard provides for the classification and measurement of financial instruments. And also offers a more updated model based on principles regarding hedging accounting.

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. The measurement model will be determined based on the entity'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, 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.
- Equity instruments will be measured at fair value through profit or loss.
- Equity instruments may be designated at fair value through profit or loss upon initial recognition, with any gains or losses being recognized in other comprehensive income. 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 from amortized cost to fair value and vice versa only if the entity 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 at fair value through profit or loss upon initial recognition, 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, 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.

Hedging
According to this standard, there is a choice of accounting policy with respect to implementation of the new hedging provisions as required under IFRS 9 as briefly detailed below, or alternatively those that exist 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 new standard, the three types of hedging accountancies will remain unchanged: cash flow, fair value and net investment hedging. However, material changes were conducted with regard to the transactions that are eligible for hedging accountancy, especially expansion of the risks eligible for hedging accountancy of non-financial items. Additionally, in accordance with the new standard, changes have occurred in the manner in which forward contracts and derivative options will be treated when they constitute hedging instruments.
2. New Standards and Clarifications Published which are not in Force and were not Adopted by the Company in Early Adoption, Expected to, or May Affect Future Periods: (continued)

1) IFRS 9 “Financial Instruments” (continued)

Hedging (continued)

Furthermore, some of the hedging effectiveness tests have been replaced with a more substantial test that is based on “financial relations”. 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.

1) IFRS 9 “Financial Instruments”

Date of commencement and possibilities of early adoption

Within the framework of the standard, the date of commencement that was originally set to January 1, 2015 has been removed. The commencement date will be determined when the overall IFRS 9 projects will near their completion. Additionally, it was temporarily decided that the obliging commencement date of the standard will not be before the annual reporting periods that begin on January 1, 2017.

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 orders 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.

Possible early implementation. Under the transitional orders, it is only possible to choose to implement by early implementation the provisions of the standard for financial assets, for financial liabilities, for financial assets and liabilities, or as a whole.

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.

2) Amendment of International Accounting Standard 36 with respect to impairment of assets, requirements to disclose recoverable amounts for non-financial assets (hereinafter: “amendment of IAS 36”).

In May 2013, the IASB published an amendment to IAS 36. The amendment of IAS 36 deals with disclosure requirements in situations where loss due to asset impairment, including goodwill (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.

Implementation of the standard has no effect on the Financial Statements of the Company.

3) 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 service related to 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.
NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)

2. New Standards and Clarifications Published which are not in Force and were not Adopted by the Company in Early Adoption, Expected to, or May Affect Future Periods (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 books thus far. During transition to complete international standardization, 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 the 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. An early implementation is possible, subject to disclosing this fact. As the Company already implements reporting principles of regulated companies, the implementation of the standard does not have implications on the financial statements of the Company - see Note 2 a 2).

5) Improvements project 2010-2012, 2011-2013

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 implementation of the standard does not have implications on the financial statements of the Company.

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 position net also to other contracts that are under the application of IAS 39 and IFRS 9.

The implementation of the standard does not have material 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 an early implementation.

The implementation of the standard has no implications on the financial statements of the Company.

All the amendments will be amended for annual reporting periods commencing on July 1, 2014 or later.
1) **General**

Implementation of the aforementioned accounting policies of the Company requires the Management of the Company, to apply, in certain cases, expansive accounting judgment regarding estimates and assumptions on the book value of assets and liabilities which may not be found in other sources. The estimates and the related assumptions are based on past experience and other factors considered relevant. The actual results may differ from these estimates.

The estimates and their basic assumptions are constantly reviewed by the Management. Changes in accounting estimates are recognized in the period on which the estimate was changed, when the change affects only that period, or recognized in that period and in future periods in cases where the change affects both the current period and the future periods.

2) **Principal Factors of Uncertainty in Estimates**

   a) **Fair Value of Financial Instruments**

The Company’s Management exercises discretion in choosing the appropriate evaluation techniques for financial instruments that do not have a quoted price in an active market. The evaluation techniques employed by the Company’s Management are those applied by market participants. The fair value of other financial instruments is determined on the basis of capitalizing cash flow expected from them, based on assumptions supported by expected market prices and rates. The assessed fair value of financial instruments that are not traded in an active market includes several assumptions that are not supported by expected market prices and rates. The book value of the financial instruments that are evaluated through valuation techniques as of December 31, 2013, amounts to approximately NIS 2,810 million (December 31, 2012 approximately NIS 786 million), for further details on assumptions used by the Company, see Note 27 below).

b) **Provisions for Legal Proceedings**

Legal claims against the Company, including class actions, are pending. See Note 34 b below.

The Management of the Company relies on the opinions of legal and professional consultants for reviewing the legal aspects of the claims and also for assessing the probability of decisions against the Company. After the advisors of the Company form their legal opinion and the chances that the Company will have to incur the results of the claim or will be able to reject the claim, the Management of the Company estimates the sum which should be recorded in the Financial Statements, if any. An interpretation of a certain legal status that differs from that of the legal advisors of the Company, a different understanding by the Management of the Company of agreements and changes originating from related court decision or new facts, may affect the value of the total provision for legal proceedings filed against the Company and consequently affect the Company’s financial position and results of its operations.

c) **Provision for Municipal Tax, Fees and Levies**

The Company received demands with respect to municipal tax for periods preceding the report date. These demands derive mainly from a changed classification of land held by the Company, a demand to increase billing area and demands related to municipal tax rates.

The Company prepares an estimate at each cut-off period of the reasonableness of the demand for payments, of changes in the legal environment, court decisions and new facts, which may affect the value of the provision in the books and affect the financial position and results of operations of the Company. (See Note 34b(7) below).
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)

d) Employees Benefits
The present value of the Company’s liability for payment of grants for termination of employee-employer relations, pension plan and benefits for its employees is based on numerous data, determined on the basis of an actuarial estimate, which uses many assumptions, including capitalization rate. Changes in actuarial assumptions may affect the book value of the Company’s liability for payments of grants for termination of employee-employer relations, pension and benefits. The Company estimates the capitalization rate once every quarter, based on market yields of Government debentures. Other main assumptions are made in light of prevailing market conditions, and the acquired experience of the Company. See Note 12 below for further details on assumptions made by the Company.

e) Fixed Assets and Intangible Assets Lifespan
As mentioned in sections h and j above, the Management of the Company reviews the estimated useful life of fixed assets and other asset items, during every reporting year. The Management stated that there is no significant change in the useful lives of fixed assets and intangible assets during 2013.

f) Standards for Regulated Companies (SFAS 71)
The Company applies accounting principles of the American Financial Accounting Standard Board SFAS 71 and SFAS 90 (see also section a2 above), the standard requires the regulated entity to reassess the coverage probability of the regulatory assets on every publication date of the financial statements.

In addition, within the estimations 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 that regulates the electricity rates) will approve them in future.

Upon reaching a conclusion that the Company does not fulfill the aforementioned conditions for applying the standard and only part of the regulated assets are covered by the rates, or if turns out that the rate update in practice is different from the assessment taken into account when calculating the regulatory assets, then all or part of the regulated assets should be deleted from the statement of financial position.

g) Impairment of Tangible and Intangible Assets
1) The Company tests for impairment recently completed assets, in accordance with the provisions of SFAS 90. For this purpose, the Company estimates the cost recognized in the rate in relation to the estimated setting up costs. Changes in the estimate of the recognized cost, the projected anticipated costs and the projected cash flows may affect the amount of the provision for the impairment of assets.

2) The Company tests its assets for impairment in accordance with IAS 36. Changes in assumptions and estimates vs actual may affect the operating results of the Company. For additional information, see Note 14 b below.

h) Income Receivable
The Company uses statistical models to assess the revenues from sale of electricity for the proportionate share of revenues included in bills issued subsequent to the date of the statement of financial position that were created in practice according to an estimate, related to the reporting period. The statistical models are based on statistical simulation that creates several scenarios that are based upon, inter alia, electricity generation in practice both by the Company and by private producers, loss rate assessment and average price assessment.

The estimate of income receivable in the accounts of the Company as of December 31, 2013 amounts to approximately NIS 1,759 million (2012 – NIS 1,608 million).
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.

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. These costs consist mainly of costs of fuel, costs of operations and maintenance and costs of capital (depreciation, financing and return on capital).

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 will retrospectively apply from April 1, 2012, the Company has received 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 March 22, 2012, it was determined that the rates will be updated in practice according to the earliest of the following:
(1) A change in the recognized cost of the input basket of the whole system of at least 3.5%, provided that 4 months have passed since the last update.
(2) The date of the annual update, as of 2013.
3) Rate Updates in 2013

On May 6, 2013, the Authority reached decisions on the subject of updating the electricity rates for the years 2012-2013 and updating the spread of the electricity rates increase. The update of the electricity rates spread results from an increase in the fuel costs in 2012 in comparison to estimates according to which the Authority’s decision of March 22, 2012 was determined, wherein the Authority determined an outline for spreading the increase in the electricity rates for the years 2012-2014.

According to the decision of the Authority, the electricity rates rose on May 16, 2013 at an average rate of 5.5% for 2013. The Authority will update the rate, as required, in 2014 until payment of all the addition to the fuels cost with respect to the gas crisis.

The following are the main points of the aforesaid Authority decisions:

a) Update of the recognized costs and spreading the addition to the fuels costs

The Authority updated the debt balance of the electricity consumers to the Electric Company with respect to the addition to the fuels cost for 2012 to the sum of NIS 6.84 billion (as of the end of 2012).

The addition will be spread in the following manner:
- In 2013 – NIS 3.07 billion
- In 2014 – NIS 3.77 billion

Interest and linkage differentials will be added to these sums.

b) An addition to the recognized cost of the transmission and distribution segments

The rate increase in 2013 includes an advance of approximately NIS 100 million per annum as an addition to the recognized cost of the transmission and distribution rates. This advance is added to the advance of approximately NIS 300 million that was provided in the decision of March 2012, so that the total advance included in the recognized cost in accordance with the decision is approximately NIS 400 million per annum.

The Management of the Company is of the opinion that these advance payments do not provide full cover for the costs of the above mentioned segments (see Note 9 j below).

c) Shortening the period of repaying the debt to the consumers

On May 6, 2013, the Authority has decided to update its decision of March 7, 2011, so that the return period of the loan given to the Company in the amount of NIS 2 billion for financing the emergency plan stage B shall be shortened to 7 years instead of 15 years as determined in the original decision.

According to this update, the principal and interest payments in 2013 were approximately NIS 500 million instead of NIS 200 million. The significance of shortening the period of repaying the debt to the Company is the increase of the scope of the loan return in the years 2013-2017 in the amount of approximately NIS 300 million a year (see Note 9 i).

On October 24, 2013, the Company sent a letter to the Electricity Authority, appealing its decisions regarding the annual update for the years 2012-2013 and the update of the spread of the electricity rates increase. The letter includes a detailed list of the issues that require reexamination by the Authority. Among the Company’s arguments: retrospective change of the Authority’s decisions, delay of the update of the cost recognized for the Company in the rate, previous Company applications to the Authority in the past that were refused or that have not yet been addressed in the Authority’s decisions, mistakes discovered in the Authority’s calculations. As of the date of signing the Financial Statements, the response of the Electricity Authority to the letter has not been received.
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).

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 exposure of the Company due to the aforesaid fine mechanism, as of the date of the Statement of Financial Position, is approximately NIS 50 million, as follows:
• In its decision pertaining to the annual update for the years 2012-2013, the Authority updated the normative operation date of the Haifa Unit 3 to February 15, 2012, when the actual operation date was March 14, 2012. Following this, an exposure to a fine of NIS 20 million is created. In light of the fact that the unit was not synchronized on the normative date due to exogenous and systemic constraints that are not under the control of the Company, and due to the fact that a fine was not activated in the decision of the Authority pertaining to the annual update for the years 2012-2013, 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 normative operation date of the Eshkol steam addition is set to December 1, 2013. The actual operation date was March 14, 2014, and an exposure to a fine assessed at NIS 30 million is therefore created. On May 19, 2013, the Company approached the Ministry of National Infrastructures, Energy and Water for approval of the development plan update and on May 23, 2013 received a reply that the stated postponement seems reasonable. However, the dates of operation of the development plan have not yet been updated. In view of the fact that this is an exogenous event and in view of past experience, the Company estimates at a likelihood level of more likely than not that the authority will refrain from imposing these fines on the Company.

Moreover, under the decision of the Authority of May 6, 2013, pertaining to the annual update for 2012-2013, emergency Alon Tavor CCGT was removed from the Company’s total recognized assets, with respect to which the Company has no exposure to a fine due to allegedly not meeting the normative operation date.

The Management reviews this estimate quarterly and updates it accordingly.
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 basket from a hedged financing) was determined or 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. 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 its decision of May 6, 2013, regarding the annual update for the years 2012 and 2013, the Authority noted that the outline of cancelling the hedging mechanism determined in the Authority's decision on the basis of the current rates for the generation segment will be frozen, the composition of the financing basket will be according to the composition of April 2012, and the amount of hedged capital will remain in effect up to November 1, 2013, for the Authority's examination with respect to the asset hedging ability of the Company. In its decision of September 16, 2013, the Authority determined that the hedging mechanism, in its present format, will remain in effect until the next annual update.

   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.
      - The cost of capital services with respect to spare parts inventory was only partially recognized under operating costs. The Company estimates that these costs will be recognized within the 2014 annual update and, therefore, has not recorded any provision for impairment with respect to this item in its Financial Statements.
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) Fuel 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.

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. According to the decision of the Authority with respect to the annual update for 2012-2013, the Authority recognized an addition of costs of conversion to gas at the Gezer site, but not in full, costs of converting two of the four units that were converted at Ramat Hovav, and partial costs of conversion to gas at the Haifa site. According to this decision, the conversion costs that have not yet been recognized at Haifa and Ramat Hovav will be examined within the annual update for 2014. The Company approached the Authority requesting full recognition of the conversion costs that have not yet been recognized and estimates that the conversion costs at Haifa and Ramat Hovav will be fully recognized. Regarding the conversion costs at the Gezer site, on January 23, 2014, the Authority held a meeting, noting that the Authority will examine the arguments of the Company with respect to attribution of the conversion costs.

The Company estimates that there is no level of reasonability above probable that the costs 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.

The Company has asked on numerous occasions for a discussion before the plenum of the Electricity Authority on its main contentions against the decision of the Authority on this subject. To the best of the Company's knowledge, as part of its current activity, the professional team of the Electricity Authority is studying the reservations of the Company regarding certain components as mentioned above.

In this context, in October, 2010, Authority delivered to the Company the minutes the Authority used to base the determination of the rate base, and this following the petition filed by the Company with the District Court, in 2010, on the subject of freedom of information, in an application to instruct the Electricity Authority to deliver to the Company all the minutes and documents the Authority used to base its determination on the rate base.

As of the date of signing the financial statements, additional specific documents requested by the Company in view of the compromise agreement have not yet been delivered to it by the Electricity Authority.
NOTE 3: THE ELECTRICITY RATE (continued)

c. The Transmission and Distribution Segments

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.

Within the framework of the decisions of the Authority of March 2012 and of May 2013, advances were set for the Company as an addition to the recognized cost for the transmission and distribution rates in a total amount of approximately NIS 300 million with respect to 2012 and approximately NIS 400 million with respect to 2013, until a new rate base will be determined for these segments, to be retroactively effective from April 1, 2012. Since the rate base will be retroactively applied from April 1, 2012, the Company created, to the best of its estimate, a regulatory asset that will reflect the costs that will be recognized for the Company when updating the base of the transmission and distribution rates beyond the advance received as aforesaid. It was also determined that the recognized costs for the transmission and distribution segments, including the increment according to this decision, will remain effective without an amortization factor until a new rate base is determined for these segments. 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 9j below).

Since the transmission and distribution rate base will be retroactively applied from April 1, 2012, and since the Company has no information about the scope of the expected non-recognition, if any, of the costs of fixed assets, the Company estimates that, in accordance with the Electricity Sector Law, the costs will be fully recognized.

Given the aforesaid, the Company did not made a provision for impairment with respect to fixed assets in the transmission and distribution segments in its Financial Statements.

As of August 2013, discussions are being held and correspondence is carried out between the Company and the Authority’s representatives and its counselors for the rates for the transmission and distribution.

d. Main costs incurred by the Company which are not covered by rates as granted by the Electricity Authority for Previous Years and General Disputes

The Company disputes numerous decisions of the Electricity Authority in previous years. Additionally, there are a number of open subjects on which the Electricity Authority did not yet reach a decision, including the liability for pension and general disputes.

The Company is conducting correspondence with the Electricity Authority and as of the signing date of these financial statements, there are subjects that are still under discussion and no decision was reached regarding them.

The Company's Management and Board of Directors are conducting an ongoing dialogue with the Electricity Authority, in an attempt to advance the discussions regarding issues in dispute regarding the electricity rate.

e. Adjustment of the Rate to the Implications of the Adoption of International Financial Reporting Standards

The International Financial Reporting Standards (“IFRS”) were adopted in Israel on January 1, 2008. These standards do not allow the Company to prepare its Financial Statements according to changes in the relevant purchasing power of the currency unless high inflationary conditions alone exist (in Israel, up to December 31, 2003).

The Minister of Finance decided that during the years 2007 – 2011, the Company will adopt reporting rules in accordance with the Government Companies Regulations (according to which the Company continues, inter alia, to implement reporting rules adjusted for the CPI).

On May 22, 2012, the Companies Regulations for preparing financial statements were extended by the Minister of Finance up to December 31, 2014. From January 1, 2015, the Company will fully implement the International Financial Reporting Standards (IFRS).
NOTE 3:- THE ELECTRICITY RATE (continued)
e. **Adjustment of the Rate to the Implications of the Adoption of International Financial Reporting Standards (continued)**

Pursuant to the aforesaid, the Company announced that the implications of transition to implementation of full IFRS in the Company are:
1) Cancelling the preparation of financial statements adjusted to the CPI.
2) Non-application of American standardization to regulated companies.

The IFRS 14 was published in January 2014, dealing with regulatory assets and liabilities. The standard makes it possible to implement the existing practice in the Company pertaining to recognition of regulatory liability assets in the reports that are prepared according to the IFRS, as the Company has done thus far. The application of this intermediate standard is from 2016, and early implementation is possible during transition to international standardization.

According to the Company’s estimates which were presented to the Companies authority and the Electricity Authority, the ceasing of the adjustment of the financial statements to the CPI, without finding a suitable solution, will erode profitability of the Company, so that with respect to each percent increase in inflation, the equity of the Company will be eroded by approximately NIS 490 million, net, after tax effect (compared to a report adjusted to the CPI).

The Company is conducting ongoing discussions with the professional team of the Electricity Authority in order to solve the issue.

In light of all the aforesaid, the Company believes that the transition to full implementation of the IFRS should be accompanied by an appropriate rate or accounting solution that will reflect the nominal financing costs and ensure the appropriate yield for the capital and also by updates of the rate, to prevent a significant delay between amounts due to the Company or to electricity consumers and the collection date, in order to prevent severe damage in the future which will eventually erode the equity of the Company and impair its ability to raise funds.

On August 21, 2013, the Securities Authority provided its reply to the preliminary application of the Company regarding the manner of transition to international standards. See Note 2 a above.

f. **Dedicated Account for fuels**

According to the decision of the Electricity Authority from March 22, 2012, the Company designated a dedicated bank account that was used for managing the fuels funds only and has informed the Electricity Authority on the details of the account.

On June 17, 2012, the Company and the Electricity Authority reached an agreement on the management and supervision of the dedicated account for fuels and principles were established for the management of the dedicated account for fuels.

In 2012, the Company deposited approximately NIS 6.9 billion into the dedicated account with respect to the debt issuances secured by State guarantee. The monies were released from the account for purchasing fuel close to the deposit date.
g. 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 4) below.

In view of non-compliance with the above mentioned condition, an application has recently been received from private producers, which contests 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.

The exposure due to financial reimbursement to private electricity producers and/or to all the consumers is very small in 2013, 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.

h. 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 private producers. Until lately, because the scope of the private production was limited, the Company's customers were the ones who paid the complete costs of the available stations which functioned as a reserve for back up purposes.

However, as of July 2013, when the private producer OPC began operating and later on due to the massive entrance of further private electricity producers, a significant decrease of the scope of production by the Company is expected. Despite this, it will need to continue maintaining its production units and keeping them available as a reserve for back up for all the customers, including the private producers which began and will begin operations. In order to avoid cross subsidy between the Company's customers and the private producers' customers, the Company demands that the costs of these units which serve as backup will apply to all the customers and not just the Company's customers.

Because 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.

Up to the date of signing the Financial Statements, the Electricity Authority has not yet determined rates for backup and auxiliary services.

During a meeting held on January 23, 2014, with the professional team of the Authority, it was clarified that the Company is expected to receive an addition to the recognized cost of the fixed operational costs in the production segment, so that the revenues recognized for the Company will not be harmed as a result of the entry of private producers. Accordingly the Company created a regulatory asset to cover the fixed operational costs (see Note 9 k below).
i. 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 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 Electric Company).

The Company has approached the Electricity Authority many times since the beginning of execution of the project, for recognition of all the costs. In January, 2014, the letter of the professional team of the Electricity Authority was received, noting that the professional team intends to recommend that at the first stage, until all the costs of the project are examined, 70% of the comprehensive investments budget for 2013 for units 5-6 at the Orot Rabin power station and units 1-4 at the Rutenberg power station will be recognized, starting from the dates of activation of each of these units. In any case, exceptions of the recognized costs beyond this budget will not be approved. Additionally, from now onwards the control company on behalf of the Authority together with the professional team of the Authority will accompany the project within the framework of a costs control process.

On February 16, 2014, the Company submitted to the Electricity Authority extensive comments on the recognition outline proposed by the professional team of the Authority including its opposition to this outline.

As to the conversion to gas and installing installations for emission reduction in units 1 - 4 at the Orot Rabin power station, a letter was received from the Electricity Authority in February 2014, under which the Authority requests to wait for the decision regarding units 1 - 4 at the Orot Rabin power station that will be made within the framework of the Government Steering Committee for reform in the Electric Company and the electricity sector, before continuing the discussion of the subject of recognizing these conversion costs.

Regarding the recommendation draft of the steering team that was published on March 23, 2014, see Note 1 e. above.
NOTE 4: CASH AND CASH EQUIVALENTS

<table>
<thead>
<tr>
<th>December 31</th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>NIS in millions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and balances in banks</td>
<td>16</td>
<td>35</td>
</tr>
<tr>
<td>Short-term deposits*</td>
<td>3,385</td>
<td>4,191</td>
</tr>
<tr>
<td><strong>Total cash and cash equivalents</strong></td>
<td><strong>3,401</strong></td>
<td><strong>4,226</strong></td>
</tr>
</tbody>
</table>

* Interest rate as of December 31, 2013 and 2012 was 0.96% and 2.27%, respectively.

NOTE 5: SHORT TERM INVESTMENTS

See Note 14 j below for funds that are held in a dedicated account and using them is limited, to finance investments of the Company in developing the electricity sector.

NOTE 6: TRADE RECEIVABLES FOR SALES OF ELECTRICITY

a. Composition

<table>
<thead>
<tr>
<th>December 31</th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>NIS in millions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customer debts for electricity bills that were issued</td>
<td>3,283</td>
<td>2,691</td>
</tr>
<tr>
<td>Allowance for doubtful accounts</td>
<td>(310)</td>
<td>(172)</td>
</tr>
<tr>
<td><strong>Income receivable (1)</strong></td>
<td>2,973</td>
<td>2,519</td>
</tr>
<tr>
<td></td>
<td>1,759</td>
<td>1,608</td>
</tr>
<tr>
<td><strong>Less debts included in long term receivables (see section d below)</strong></td>
<td><strong>4,732</strong></td>
<td><strong>4,127</strong></td>
</tr>
<tr>
<td></td>
<td>387</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total customer debts with respect to electricity sales</strong></td>
<td><strong>4,345</strong></td>
<td><strong>4,127</strong></td>
</tr>
</tbody>
</table>

(1)Income with respect to the relative portion of the electricity bills issued after the statement of financial position date that, according to an estimate, are attributable to the related reported period.

The last date for paying electricity bills without interest charges ranges from 11 to 14 days from the bill issue date, according to the type of customer, as detailed in the criteria. After this period, customers are charged with annual interest, at the rate of about 9% on the balance of their debt.
NOTE 6: TRADE RECEIVABLES FOR SALES OF ELECTRICITY (continued)

b. Aging of all customer receivables in excess of credit days (with respect to invoices sent up to November 30, 2013) on the report date:

<table>
<thead>
<tr>
<th></th>
<th>December 31</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013</td>
<td>2012</td>
</tr>
<tr>
<td>From 2 months to 3 months</td>
<td>616</td>
<td>593</td>
</tr>
<tr>
<td>From 3 months to 6 months</td>
<td>411</td>
<td>113</td>
</tr>
<tr>
<td>Over 6 months</td>
<td>591</td>
<td>239</td>
</tr>
<tr>
<td>Total</td>
<td>1,618</td>
<td>945</td>
</tr>
</tbody>
</table>

c. For credit risk management, see Note 27 below.

d. The customers balance includes, among others, the debts of the customers of the Palestinian Authority and the East Jerusalem Electricity Company (hereinafter: “EJC”).

Below are details of the balances after provision for doubtful debts:

<table>
<thead>
<tr>
<th></th>
<th>December 31</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013</td>
<td>2012</td>
</tr>
<tr>
<td>East Jerusalem Electricity Company debt balance</td>
<td>712</td>
<td>380</td>
</tr>
<tr>
<td>Palestinian Authority customers’ debt balance</td>
<td>395</td>
<td>134</td>
</tr>
<tr>
<td>Total debts</td>
<td>1,107</td>
<td>514</td>
</tr>
</tbody>
</table>

Presented in item of trade receivables for sales of electricity

<table>
<thead>
<tr>
<th>Present</th>
<th>December 31</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013</td>
<td>2012</td>
</tr>
<tr>
<td>Presented in item of trade receivables for sales of electricity</td>
<td>720</td>
<td>514</td>
</tr>
<tr>
<td>Presented in long-term receivables item</td>
<td>387</td>
<td>-</td>
</tr>
<tr>
<td>Total</td>
<td>1,107</td>
<td>514</td>
</tr>
</tbody>
</table>

As of the date of signing of the Financial Statements, the balance with respect to electricity invoices issued and before provision for doubtful debts is approximately NIS 1.4 billion.

The Company is holding advanced negotiations, aided by various State entities, regarding the spread and collection of these debts. In accordance with the formulating consents, an appropriate provision for doubtful debts was included in these financial statements and part of the debt balance was classified as long term.
NOTE 7:-  OTHER CURRENT ASSETS

<table>
<thead>
<tr>
<th>December 31</th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>NIS in millions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current maturities (loans to employees, chartering tug boats and currency exchange transactions)</td>
<td>36</td>
<td>78</td>
</tr>
<tr>
<td>Deposits for securing swap transactions</td>
<td>-</td>
<td>23</td>
</tr>
<tr>
<td>Prepaid expenses</td>
<td>51</td>
<td>133</td>
</tr>
<tr>
<td>Income receivable</td>
<td>52</td>
<td>92</td>
</tr>
<tr>
<td>Other receivables (1)</td>
<td>238</td>
<td>213</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>377</strong></td>
<td><strong>539</strong></td>
</tr>
</tbody>
</table>

(1) Including indemnification receivable from the insurance companies with respect to legal charges for the year 2012, and approximately NIS 19 million with respect to additional indemnities that were approved after the balance date. See Note 36 l below.

NOTE 8:-  INVENTORY - FUEL

<table>
<thead>
<tr>
<th>December 31</th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>NIS in millions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fuel oil</td>
<td>650</td>
<td>436</td>
</tr>
<tr>
<td>Diesel oil</td>
<td>1,298</td>
<td>1,054</td>
</tr>
<tr>
<td>Liquid natural gas (hereinafter: “LNG”)</td>
<td>24</td>
<td>131</td>
</tr>
<tr>
<td>Coal</td>
<td>514</td>
<td>355</td>
</tr>
<tr>
<td>Coal in transit</td>
<td>317</td>
<td>705</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>2,803</strong></td>
<td><strong>2,681</strong></td>
</tr>
<tr>
<td>Presented in Current Assets</td>
<td><strong>1,067</strong></td>
<td><strong>2,681</strong></td>
</tr>
<tr>
<td>Presented in Non-Current Assets(*)</td>
<td><strong>1,736</strong></td>
<td>-</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>2,803</strong></td>
<td><strong>2,681</strong></td>
</tr>
</tbody>
</table>

(*) In view of the commencement of gas supply from the “Tamar” reserve in March 2013, there is a significant decrease in the Company forecast for use of liquid fuels (diesel oil and fuel oil), and the inventory is therefore mainly maintained for backup and electricity system availability needs in case of failure to supply gas.

In addition, part of the Diesel oil inventory is held in accordance with the requirement of the Fuels Administration of the Ministry of National Infrastructures, Energy and Water.
NOTE 9: REGULATORY ASSETS/LIABILITIES

a. The Company applies the accounting principles of the US Financial Accounting Standards Board (FASB) as listed in Chapter 26 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

<table>
<thead>
<tr>
<th>Details of the amounts of the regulatory liabilities, net</th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>With respect to the erosion of the Company’s liabilities in foreign currency, passed on to the electricity consumers (see section c. below)</td>
<td>(624)</td>
<td>(916)</td>
</tr>
<tr>
<td>With respect to the gap between dates for actual updating rates and the theoretical rate (see section d below)</td>
<td>371</td>
<td>258</td>
</tr>
<tr>
<td>With respect to social rate (see section e below)</td>
<td>306</td>
<td>207</td>
</tr>
<tr>
<td>With respect to electricity purchases from private producers and photovoltaic facilities and load management arrangements (see section f below)</td>
<td>468</td>
<td>770</td>
</tr>
<tr>
<td>With respect to provision for fines - Electricity Authority (see section g below)</td>
<td>(20)</td>
<td>(20)</td>
</tr>
<tr>
<td>With respect to consecutive non-update of the fuel component in the rate (see section h below)</td>
<td>3,335</td>
<td>7,577</td>
</tr>
<tr>
<td>With respect to consumers participation in financing emergency plan stage B (see section i below)</td>
<td>(1,758)</td>
<td>(2,110)</td>
</tr>
<tr>
<td>With respect to not updating the electricity rate for the transmission and distribution segment (see section j below)</td>
<td>148</td>
<td>112</td>
</tr>
<tr>
<td>With respect to cover of recognized operational costs following entry of private producers (see section k below)</td>
<td>90</td>
<td>-</td>
</tr>
<tr>
<td>With respect to other regulatory liability/ assets (see section l below)</td>
<td>(45)</td>
<td>(62)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>2,271</strong></td>
<td><strong>5,816</strong></td>
</tr>
</tbody>
</table>

Presented in current assets | 2,972 | 3,325 |
Presented in non-current assets | 696 | 4,875 |
Presented in non-current liabilities | (1,397) | (2,384) |
**Total** | **2,271** | **5,816**

c. Liabilities 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 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 of approximately NIS 442 million, will be refunded to the consumers over the period remaining until December 2015.

The New Hedging Mechanism

At the same time, within the framework of the publication of the rate in February 2010, a new hedging mechanism was defined, to be completely decreased by March 31, 2013. In its decision of September 16, 2013, the Authority determined that the hedging mechanism in its present format will remain in effect until the next annual update, for the purpose of the Authority’s examination as regards the Company’s ability to hedge its liabilities.
NOTE 9:- REGULATORY ASSETS/LIABILITIES (continued)
c. Liabilities with Respect to the Hedging Mechanism (continued)

The New Hedging Mechanism (continued)

The balance of the regulatory liability as of the statement of financial position date is approximately NIS 182 million. In the reporting period, 2013 the Company transferred financing income to regulatory liabilities with respect to real linkage differentials in the amount of NIS 254 million. See Note 32a below.

d. Asset with Respect to a Gap between Rate Updating Dates

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 amount accumulated with respect to the consecutive failure to update the electricity rates and the theoretical collection of the said component, net (excluding fuel) as of December 31, 2013 is NIS 371 million. The change in the assets for the period starting January 1, 2013 to December 31, 2013 is calculated as the difference between the total theoretical cost recognized and the actual recognized cost less the theoretical collection. This calculation is executed based on decisions from May 6, 2013 pertaining to the annual update for the years 2012 and 2013, and also based on estimates of the Management of the Company.

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:

a. Disabled holocaust survivors.
b. Disabled who receive old age pensions for the disabled.
c. Six additional groups that 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, provided 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 306 million. According to the decision of the Electricity Authority, this cost will be charged to all electricity consumers.

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. These advances do not reflect the full extent of electricity purchases in the reporting period. The Company recorded in its books a regulatory asset with a balance of NIS 468 million as of December 31, 2013, 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 in the books.
NOTE 9:- REGULATORY ASSETS/LIABILITIES (continued)

g. With Respect to Provision for Fines
As of the statement of financial position date, the Company recorded a regulatory liability amounting to approximately NIS 20 million with respect to failure to meet the timetables of operating the Haifa 4 stage A generation units.

h. 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 professional 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, 2013, the balance of the regulatory asset with respect to a consecutive non-update of the fuel component is NIS 3,335 million. The balance includes the following components:

- Debt asset with respect to 2012 in the amount of NIS 4,711 million was calculated in accordance with the Electricity Authority’s decision of May 6, 2013 pertaining to an update of the electricity rates for the years 2012-2013, while the recognized fuel basket for 2012 was determined and the outline of the 2012 fuel debt spread was updated, as determined in the decision of the Authority of March 22, 2012. According to this decision of the Authority of March 2012, it was determined that these costs will be spread for 3 years commencing from April 2012 and this fuel debt for 2012 shall be administered as a separate debt and shall therefore not be included as part of the compensation mechanism for a delay in the update.

Since part of the balance is expected to be collected in 2015, the balance of the regulatory asset is partly classified as long term receivable balance.

- Compensation liability with respect to the delayed updating of the fuel component in the rate in the amount of NIS 771 million. This balance reflects the difference between the actual rate in 2013 and the theoretical rate that is based on existing valid decisions of the Authority.

- Regulatory liability in the amount of NIS 813 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 in 2013. The calculation of the liability is based on the fuel mix published by the Authority in its decision of May 6, 2013 with respect to the update of the rate of 2012-2013, as well as on new information held by the Company as of December 31, 2013, that according to the Company is expected to influence the recognized fuels basket.

- A regulatory liability in the amount of approximately NIS 78 million with respect to the overcharging of gas costs.

- Regulatory assets in the amount of approximately NIS 286 million with respect to the Company’s assessment concerning the recognition by the Authority of auxiliary costs with respect to use of LNG, costs of losses and costs of self- consumption by the boat and losses that derived from the delay in the construction of the LNG buoy. The Authority has not yet recognized all the surplus costs of the Company that derived from the delay in the Construction of the buoy. In the Authority’s decision of May 6, 2013, pertaining to the 2012-2013 annual update, it was determined that these costs will be reexamined by the Authority. The Company is of the opinion that there is a level of likelihood of “virtually certain” that these costs will be recognized.

i. 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 decision of the Electricity Authority also 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.

Within the Authority’s decision of May 6, 2013, pertaining to the updating of the rate increase, the Authority decided to shorten this debt return period by half, so that the debt will already end in 2017 instead of 2025. As of December 31, 2013, the liability balance (including current maturities) is NIS 1,758 million, and the Company is expected to return to the consumers, approximately NIS 511 million in the coming year.
NOTE 9:- REGULATORY ASSETS/LIABILITIES (continued)

j. Asset With Respect to not updating the Electricity Rate in the Transmission and Distribution Segments
According to the decision of the Authority of March 28, 2012, the Authority recognized, for the Company, a supplement to the recognized cost of 2012 for the transmission and distribution segments in an amount of approximately NIS 300 million (in current terms) as an advance until the determination of new rate bases for these segments, that will apply retroactively from April 1, 2012. In the decision of the Authority of May 6, 2013, with respect to annual updates for 2012-2013, the Authority updated the advance with respect to update of the rate bases for the transmission and distribution segments recognized for 2013 to an amount of approximately NIS 400 million (in current terms). 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 advance) for the recognized costs of the transmission and distribution segments for the period between April 2012 and December 2013. Considering this, the Company recorded in its books, as of December 31, 2013, a regulatory asset in the amount of approximately NIS 148 million.

k. Asset with Respect to Cover of Recognized Operating Costs Due to Entry of Private Producers
In accordance with the decision of the Authority of May 6, 2013 on the subject of determining a date of incidence for backup rates and auxiliary services, the Authority is expected to determine backup rates that will apply retroactively from June 1, 2013, to all the consumers in the economy. The Company estimates that it will receive an addition to the fixed operating costs recognized for the generation segment so that the recognized revenues for the Company with respect to these costs will not be harmed as a result of entry of private producers. In the financial statements of December 31, 2013 the Company has charged in its books, for the first time, regulatory assets in the amount of NIS 90 million at the sum of the addition that is expected to be recognized for the period of June - December 2013.

l. Other Regulatory Assets/Liabilities
The balance of the liability is composed of the following components:

- Asset/liability in respect of coal price differences
  The Company records a regulatory asset 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.

- Asset with respect to refund to the East Jerusalem Company (EJC)
  The resolution of the Electricity Authority from August 6, 2012 provides for a retroactive rate update with respect to the reclassification of EJC consumers from consumers who pay a high-voltage bulk sale rate to consumers who pay a cumulative rate.
  The Company estimates with high probability that with respect to these amounts, a refund would be received from the Electricity Authority, since the Company uses the rates in collecting all of the income that is approved for it by the Authority.

NOTE 10:- LONG-TERM RECEIVABLES

<table>
<thead>
<tr>
<th></th>
<th>December 31</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013</td>
<td>2012</td>
</tr>
<tr>
<td>Natural Gas Lines - gas transmission project (see Note 33b1)a) below)</td>
<td>647</td>
<td>861</td>
</tr>
<tr>
<td>Receivables for currency swap transactions</td>
<td>-</td>
<td>97</td>
</tr>
<tr>
<td>Customers with respect to electricity sales (see Note 6 d above)</td>
<td>387</td>
<td>-</td>
</tr>
<tr>
<td>Other *</td>
<td>180</td>
<td>169</td>
</tr>
<tr>
<td>Total long-term receivables</td>
<td>1,214</td>
<td>1,127</td>
</tr>
<tr>
<td>Less – current maturities (see Note 7 above)</td>
<td>36</td>
<td>78</td>
</tr>
<tr>
<td></td>
<td>1,178</td>
<td>1,049</td>
</tr>
</tbody>
</table>

* 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.
NOTE 11:-- INVESTMENT IN HELD AND ASSOCIATED COMPANIES

a. Held Companies:

1) Details of the Consolidated Companies of the Company

<table>
<thead>
<tr>
<th>Subsidiary Name</th>
<th>Company Operation</th>
<th>Place of Incorporation</th>
<th>Holding rate of capital rights as of December 31</th>
<th>Investment in the Company as of December 31</th>
</tr>
</thead>
<tbody>
<tr>
<td>National Coal Supply Corporation Ltd.</td>
<td>The company purchases coal for the coal power stations of the Electric Company</td>
<td>Israel</td>
<td>100% 100%</td>
<td>55% 55%</td>
</tr>
</tbody>
</table>

* Presented by deemed cost which is the total investment account as it was on the date of transition of the Company to standardization under IFRS, on January 1, 2008, as detailed in Note 2 above.

1) 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.

On January 24, 2011, an amendment to the agreement with the Company was entered, effective from January 1, 2011, 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.

2) 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 2013 and 2012 are approximately NIS 1.6 million and NIS 0.3 million, respectively.

3) In the years 2013 and 2012, the Company acquired coal from the Coal Company at a cost of approximately NIS 4,817 million, and NIS 6,636 million respectively.

4) 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 net lease fees as of December 31, 2013 are approximately NIS 26 million.

5) Dividends from the Coal Company - In December, 2013, a dividend in the amount of NIS 7 million were received from the Coal Company with respect to 2012. A dividend in the amount of NIS 7 million was proposed after the balance date with respect to 2013.

6) Regarding the contractual engagements with the Coal Company, see Note 34 a 7) below.
NOTE 11:- INVESTMENT IN HELD AND ASSOCIATED COMPANIES (continued)

a. Held Companies (continued)

2) Details of Held Companies

<table>
<thead>
<tr>
<th>Investee Company Name</th>
<th>Residence</th>
<th>Status</th>
<th>Holding rate of Ordinary Shares</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>December 31</td>
<td>2013</td>
</tr>
<tr>
<td></td>
<td></td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>PAMA Ltd.</td>
<td>Israel</td>
<td>Inactive since 2000</td>
<td>49.99</td>
</tr>
<tr>
<td>Migrashei Kablanim Ltd.</td>
<td>Israel</td>
<td>Inactive</td>
<td>76.00</td>
</tr>
<tr>
<td>Jordan Properties Company</td>
<td>Israel</td>
<td>Active</td>
<td>99.98</td>
</tr>
</tbody>
</table>

The Company holds 99.98% of Jordan Properties Ltd. 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.

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 (except 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:

| For the year ended on December 31, 2013 | 79 |
| For the Year ended on December 31, 2012 | 76 |

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.

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 loans 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 employee union have reached agreements with respect to arranging the rights for employees of the Company with respect to the communications enterprise. Receiving the required approvals from the relevant entities is a condition for the parties to sign the agreement. The Electric Company will act to receive the stated approvals. At present, the required approvals have not yet been received and the agreement as stated has not yet been signed.

5) The Company examined the transaction 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.
### NOTE 11: INVESTMENT IN HELD AND ASSOCIATED COMPANIES (continued)

#### b. Investment in Associate Company (continued)

On the Transaction Date, the Company examined the transaction in accordance with the provisions of IFRIC 4 (determination of 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 services agreement as it is defined in IAS 18. Therefore, the Company recognized the value of the shares as deferred income within other liabilities, which will be recognized across the period of providing services under the agreement, by the straight line method.

<table>
<thead>
<tr>
<th>Name of associate</th>
<th>Operation of the Company</th>
<th>Country of incorporation</th>
<th>Holding rate of rights in capital %</th>
<th>Scope of investment in the associate (in NIS millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>IBC company (hereinafter: “IBC”)</td>
<td>Providing stationary Bezeq services to communication operators and business customers through an optical fiber communications infrastructure</td>
<td>Israel</td>
<td>40</td>
<td>98</td>
</tr>
</tbody>
</table>

(*) The scope of investment in IBC is the book value of the investment handled according to the book value method.

The reporting date of IBC is December 31, 2013.

#### Presentation in the Statement of Financial Position

<table>
<thead>
<tr>
<th>as of December 31</th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment in associate</td>
<td>100</td>
<td>-</td>
</tr>
<tr>
<td>Company’s share of the loss of IBC</td>
<td>(2)</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>98</strong></td>
<td><strong>-</strong></td>
</tr>
</tbody>
</table>

IBC prepares its financial statements in accordance with IFRS standards.

The financial statements of IBC were not attached to the reports of the Company, as they are insignificant in relation to the reports of the Company according to regulation 23 (b).
NOTE 12:- EMPLOYEE BENEFITS AFTER EMPLOYMENT TERMINATION

a. Excess of amounts of pension plan assets over the pension obligation

<table>
<thead>
<tr>
<th></th>
<th>December 31</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013</td>
<td>2012*</td>
<td></td>
</tr>
<tr>
<td>NIS in millions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fair value of plan assets (see section l) 2) below</td>
<td>25,038</td>
<td>24,151</td>
<td></td>
</tr>
<tr>
<td>Present value of pension obligations (see section k) 1) below</td>
<td>(22,899)</td>
<td>(22,801)</td>
<td></td>
</tr>
<tr>
<td>Present value of pension obligations with respect to special agreements on early retirement (see section k) 3) below</td>
<td>(119)</td>
<td>(171)</td>
<td></td>
</tr>
<tr>
<td>Excess of pension plan assets over pension obligations</td>
<td>2,020</td>
<td>1,179</td>
<td></td>
</tr>
</tbody>
</table>

b. Funds in Trust (*)

<table>
<thead>
<tr>
<th></th>
<th>December 31</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013</td>
<td>2012</td>
<td></td>
</tr>
<tr>
<td>NIS in millions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fair value of funds in trust</td>
<td>1,728</td>
<td>1,976</td>
<td></td>
</tr>
</tbody>
</table>

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 benefits after employment termination

<table>
<thead>
<tr>
<th></th>
<th>December 31</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013</td>
<td>2012*</td>
<td></td>
</tr>
<tr>
<td>NIS in millions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Present value of obligation with respect to other benefits after employment termination, (see section k) 2) below</td>
<td>2,924</td>
<td>3,050</td>
<td></td>
</tr>
</tbody>
</table>

Composition according to types of the other benefits:

<table>
<thead>
<tr>
<th></th>
<th>December 31</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013</td>
<td>2012</td>
<td></td>
</tr>
<tr>
<td>NIS in millions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Discounted electricity</td>
<td>1,057</td>
<td>1,157</td>
<td></td>
</tr>
<tr>
<td>V.A.T. and grossed up tax with respect to discounted electricity</td>
<td>381</td>
<td>438</td>
<td></td>
</tr>
<tr>
<td>Retirement benefits</td>
<td>1,083</td>
<td>1,037</td>
<td></td>
</tr>
<tr>
<td>Pensioners' Welfare Fund</td>
<td>48</td>
<td>46</td>
<td></td>
</tr>
<tr>
<td>Holiday gifts including grossed up tax</td>
<td>355</td>
<td>372</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>2,924</td>
<td>3,050</td>
<td></td>
</tr>
</tbody>
</table>

* The impact of retrospective application of IAS 19 (2011) - see Note 37 below.
d. The Pension Plan of the Company and Other Benefits after Termination of Employment

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 l(1) below). On March 5, 2012, the “Change of Method of Updating the Budgetary Pension, 2012 Law” was published in the Official Gazette, regarding the change of method of updating the pension of the insured under the Budgetary Pension Arrangement to linkage to the Consumer Price Index. The effect of this law on the financial statements was expressed in the first quarter of 2012, and included an increase in the actuarial liability of the Company of approximately NIS 2.8 billion against an increase in pension expenses and compensation of approximately NIS 1.5 billion and NIS 1.3 billion against an increase in the salary cost.

Following is a summary of the budgetary pension arrangement under the code 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) 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.
NOTE 12: EMPLOYEE BENEFITS AFTER EMPLOYMENT TERMINATION (continued)

d. The Pension Plan of the Company and Other Benefits after Termination of Employment (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, 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 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. The discount rates used to calculate the actuarial liability conform to market yields on government debentures as of December 31, 2013, according to a quote by the “Mirvach Hogen” Company.
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 continuously makes deposits in respect of its liabilities to the said 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 k2) below).

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 k2) below).

As stated, the actuarial liability in respect of 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 a basket of benefits and additional rights that are not included in the actuarial liability due to their being non material.

f. Collective Agreements

On July 18, 2013, a new collective (salary agreement) agreement was signed between the Electric Company and the employee organization and the New National Employee Labor Federation. The Company salary agreement is 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”).

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 new salary 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 will only apply from January 1, 2015. According to this salary agreement, the actuarial liability increased by approximately 0.5% with respect to 2012, compared to the liability as it appeared in the Financial Statements as of December 31, 2012. This change increased the liability for pension by approximately NIS 52 million and was recorded in the reporting period (in the second quarter) against other comprehensive income and fixed assets. 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, and a commitment to industrial peace in this matter was determined 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 determined by the Minister of Finance (to this date, the stated execution provisions have not yet been received), this sum is estimated at approximately NIS 30 million a year. An adequate provision was included in these financial statements. 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, 2013, at a rate of approximately 1% per year, This assessment was determined considering past experience. This accounting assumption constitutes the best assessment for an expected salary raise in 2013 in a future agreement.

g. Examinations by the Supervisor of Wages

In 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 (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 demand return of the payments paid to employees 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 entitled 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, i.e. – at rates lower than those received at present by some of the employees of various command levels. 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.

4) Global pension overtime – members of the management of the Company (at a level of division and 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 in the pension salary of management members who were appointed after 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 employees’ and pensioners’ right to a hearing within 60 days.
g. Examinations by the Supervisor of Wages (Continued)

5) Increased compensation to temporary employees in an emergent plant – the Supervisor of Wages has decided not to intervene in this component.

It is the position of the Supervisor of Wages that, 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 Note 34 c 9) the possible effect of the Supervisor’s decision on the current wages of the Company employees is a decrease of approximately NIS 150 million per year in the salary cost, and approximately NIS 450 million one-time decrease of 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 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, inter alia, by taking into account legal opinions the Company has received, and hence on the scope of the possible effect of the decision on the wages and the actuarial liability.

On October 22, 2013, the Court granted validity of a decision to the 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 a hearing that was held on March 10, 2014, it was ruled that these agreements will continue to be in effect until a decision is reached in the application of this case itself, and that later on the parties will deliver an update to the Court in all that pertains to the recommendations of the Steering Committee headed by Mr. Uri Yogev or the discussions regarding the implementations, and accordingly a continuation of the hearing of the application will be scheduled.

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.

It should be noted that in accordance with the stated letter of the Supervisor of Wages, he intends to conduct a hearing proceeding concerning other wage and pension terms paid to the Company employees and its pensioners.

The Supervisor of Wages intends 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.

Regarding the draft of recommendations of the steering team that was published on March 23, 2014, see Note 1 e above.
NOTE 12: EMPLOYEE BENEFITS AFTER EMPLOYMENT TERMINATION (continued)

h. Change of the actuarial liability in 2013:

1) During the reporting period, International Accounting Standard 19 (2011) was implemented by way of retrospective implementation. See Note 37 below for the major changes and their impact.

2) Following a survey conducted on the basis of electricity consumption in the years 2005-2012 among pensioners/survivors, the Company decided to update the electricity consumption assumption according to average consumption by pensioners/survivors over several years and according to the age of the pensioner/survivor and his family status. The update of this assumption reduced the actuarial liability by approximately NIS 81 million.

3) An update was performed in the work assumptions that were used to calculate the assessment of the forecasted electricity rate, which constitutes a part of the estimate of liability with respect to the reduced price electricity benefit. This change decreased the actuarial liability as on December 31, 2013 by approximately NIS 10 million.

4) Following an examination of the assumptions of age differences between married partners and marriage rates, it was decided to update the assumptions, so that they were mainly adjusted to the tables of the treasury. The effect of the change is a decrease in actuarial liability as on December 31, 2013 of approximately NIS 98 million.

5) Following an examination that was conducted of historical early retirement rates, which are not part of “retirement campaigns”, based on the data of 2002 - 2013, it was decided to update the early retirements assumption. The effect of the change is a decrease in actuarial liability as on December 31, 2013 of approximately NIS 78 million.

i. The aforementioned reserve sections, with respect to employee benefits after termination of employment as of December 31, 2013 and December 31, 2012, amount to a total of NIS 25,942 million, NIS 26,022 million respectively.

j. In October, 2012, the State Comptroller published a report relating to the years between 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

<table>
<thead>
<tr>
<th>For the Year ended December 31</th>
<th>2013</th>
<th>2012*</th>
<th>2011*</th>
</tr>
</thead>
<tbody>
<tr>
<td>NIS in millions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Present value of the obligation for pensions as of the beginning of the year</td>
<td>22,801</td>
<td>17,000</td>
<td>16,282</td>
</tr>
<tr>
<td>Cost of interest</td>
<td>520</td>
<td>534</td>
<td>465</td>
</tr>
<tr>
<td>Current service cost</td>
<td>307</td>
<td>258</td>
<td>207</td>
</tr>
<tr>
<td>Previous service cost - changes in the plan terms recognized due to pension linkage to the CPI</td>
<td>-</td>
<td>2,816</td>
<td>-</td>
</tr>
<tr>
<td>Changes in the plan terms due to the decisions of the Supervisor</td>
<td>-</td>
<td>-</td>
<td>80</td>
</tr>
<tr>
<td>Benefits paid</td>
<td>(637)</td>
<td>(617)</td>
<td>(554)</td>
</tr>
<tr>
<td>Total</td>
<td>22,991</td>
<td>19,991</td>
<td>16,480</td>
</tr>
</tbody>
</table>

**Losses (gains) with respect to remeasurement:**

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012*</th>
<th>2011*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actuarial gains deriving from changes in demographic assumptions</td>
<td>(151)</td>
<td>(6)</td>
<td>-</td>
</tr>
<tr>
<td>Actuarial losses (gains) deriving from changes in financial assumptions</td>
<td>(108)</td>
<td>2,366</td>
<td>325</td>
</tr>
<tr>
<td>Adjustments based on past experience</td>
<td>167</td>
<td>450</td>
<td>195</td>
</tr>
<tr>
<td>Total</td>
<td>(92)</td>
<td>2,810</td>
<td>520</td>
</tr>
</tbody>
</table>

Present value of the obligation for pensions as of the end of the period | 22,899 | 22,801 | 17,000 |
### NOTE 12: EMPLOYEE BENEFITS AFTER EMPLOYMENT TERMINATION (continued)

#### k. Reserves (continued)

2) **Changes in the present value of the obligation for other benefits after employment termination**

<table>
<thead>
<tr>
<th>For the Year ended December 31</th>
<th>2013</th>
<th>2012*</th>
<th>2011*</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>NIS in millions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Present value of the obligation for other benefits after employment termination as of the beginning of the year</td>
<td>3,050</td>
<td>2,638</td>
<td>2,377</td>
</tr>
<tr>
<td>Cost of interest</td>
<td>70</td>
<td>72</td>
<td>67</td>
</tr>
<tr>
<td>Current service cost</td>
<td>61</td>
<td>50</td>
<td>47</td>
</tr>
<tr>
<td>Previous service cost - changes in the plan terms recognized due to pension linkage to the CPI</td>
<td>-</td>
<td>42</td>
<td>-</td>
</tr>
<tr>
<td>Benefits paid</td>
<td>(66)</td>
<td>(63)</td>
<td>(53)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>3,115</strong></td>
<td><strong>2,739</strong></td>
<td><strong>2,438</strong></td>
</tr>
<tr>
<td><strong>Losses (gains) with respect to remeasurement:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Actuarial gains deriving from changes in demographic assumptions</td>
<td>(24)</td>
<td>(1)</td>
<td>-</td>
</tr>
<tr>
<td>Actuarial losses (gains) deriving from changes in financial assumptions</td>
<td>(160)</td>
<td>508</td>
<td>20</td>
</tr>
<tr>
<td>Adjustments based on past experience</td>
<td>(7)</td>
<td>(196)</td>
<td>180</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>(191)</td>
<td>311</td>
<td>200</td>
</tr>
<tr>
<td>Present value of the obligation for other benefits after employment termination as of the end of the period</td>
<td><strong>2,924</strong></td>
<td><strong>3,050</strong></td>
<td><strong>2,638</strong></td>
</tr>
</tbody>
</table>

*For the impact of the retrospective implementation of IAS 19 (2011) see Note 37 below.

3) **Changes in present value of the obligation with respect to special agreements on early retirement**

<table>
<thead>
<tr>
<th>For the Year ended December 31</th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>NIS in millions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Present value of the obligation as of the beginning of the year</td>
<td>171</td>
<td>217</td>
<td>287</td>
</tr>
<tr>
<td>Cost of interest</td>
<td>3</td>
<td>5</td>
<td>7</td>
</tr>
<tr>
<td>Additional provision for employee retirement due to employment termination</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Previous service cost - changes in the plan terms recognized due to pension linkage to the CPI</td>
<td>-</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Changes in the plan terms due to the decisions of the Supervisor</td>
<td>-</td>
<td>17</td>
<td>-</td>
</tr>
<tr>
<td>Benefits paid</td>
<td>(68)</td>
<td>(76)</td>
<td>(86)</td>
</tr>
<tr>
<td>Actuarial losses with respect to the obligation charged to the Profit and Loss</td>
<td>13</td>
<td>6</td>
<td>1</td>
</tr>
<tr>
<td>Present value of the obligation as of the period end</td>
<td><strong>119</strong></td>
<td><strong>171</strong></td>
<td><strong>217</strong></td>
</tr>
</tbody>
</table>
NOTE 12:-  EMPLOYEE BENEFITS AFTER EMPLOYMENT TERMINATION (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 its employees insured 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 (“income tax regulations”). The fund was managed by the managing company accordingly. As of May 1, 2010, Infinity – Administrating the Main Pension Fund Ltd., manages the fund.

      b) According to the Financial Statements of the Fund, the actuarial liability as of December 31, 2013 is NIS 25,360 million and the debt of the Company on that date is approximately NIS 322 million. According to the Financial Statements of the Company, its actuarial liability for the pension obligations as of December 31, 2013 is NIS 23,018 million.

      c) The difference between the actuarial liability in the financial statements of the “Fund” as of December 31, 2013, and the actuarial liability in the financial statements of the Company as of December 31, 2013, 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), 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 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 2.3 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 Officer, 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 its response and to settle the manner of handling the subject. On December 4, 2013, its response 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 is maintained between the Fund management and the Company management so that the actuarial assumptions will be as similar as possible in accordance with all the above mentioned.
NOTE 12:- EMPLOYEE BENEFITS AFTER EMPLOYMENT TERMINATION (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. In order to implement the stated changes, 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 Managing Company is currently working towards receiving the approval of the Capital Market, Insurance and Savings Division of the Ministry of Finance to the proposed change. As of the date of publication of the Financial Statements, a change in the articles of the fund in this context has not yet occurred. The following is the payment arrangement between the Company and the Fund according to the articles in effect:

(1) Supplements with respect to debt from an increase in liability to pensioners
   (a) Completion of the debt arising from an increase that is not an exception as it is defined in the articles of the Fund (detailed in section b below) will be completed within 3 months in equal payments which in any case will not exceed that tax year.
   (b) Completion of a debt arising from an increase in liability that is an exception as it is defined in the articles of the Fund: an increase that is an exception in the actuarial liability approved by the Supervisor, or that derives from an irregular increase in actuarial liability that was caused not under the sole control of the Electric Company as a result of one of these: change in life tables, new labor agreements, change in yield from Fund assets, change in the imputed interest, change in the method of calculating the actuarial liability due to an accounting change or a change deriving from the instructions of the Supervisor will be completed within 12 months in equal payments.

(2) Supplements with respect to debt from an increase in liability to active employees
   (a) Completion of debt deriving from an increase that is not an exception as it is defined in the articles of the Fund will be completed within 3 months in equal payments.
   (b) Completion of a debt arising from an increase in liability that is an exception as it is defined in the articles of the Fund as detailed in section 1 b above will be completed within 120 equal monthly payments.

The monthly supplement will not be less than NIS 50 million, provided that there is a comprehensive debt that exceeds NIS 50 million.

f) The Company deposited in the pension fund NIS 797 million during 2013, of which NIS 254 million is from a transfer from funds in trust. (See Note 13 below).

g) The Fund approved its financial statements as of December 31, 2013, on March 18, 2014.

h) The Fund presents the value of its assets at fair value according to international standard principles (IFRS).

i) According to the forecast of the Company, the expected transfers to the Central Pension Fund (Infinity) will amount to approximately NIS 760 million for the coming year, according to the article in effect as of the date of publication of the reports.
NOTE 12:- EMPLOYEE BENEFITS AFTER EMPLOYMENT TERMINATION (continued)

I. Funds (continued)

2) Changes in the fair value of the assets of the plan

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of plan assets as of the beginning of the year</td>
<td>24,151</td>
<td>21,992</td>
<td>21,767</td>
</tr>
<tr>
<td>Interest income on plan assets</td>
<td>553</td>
<td>608</td>
<td>626</td>
</tr>
<tr>
<td>Deposits</td>
<td>797</td>
<td>614</td>
<td>686</td>
</tr>
<tr>
<td>Benefits paid</td>
<td>(687)</td>
<td>(676)</td>
<td>(722)</td>
</tr>
<tr>
<td>Gains (losses) with respect to remeasurements on plan assets:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yield on plan assets (except for sums included in the net interest cost)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fair value of plan assets as of the period end</td>
<td>224</td>
<td>1,613</td>
<td>(365)</td>
</tr>
</tbody>
</table>

For the Year ended December 31

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest income on plan assets</td>
<td>553</td>
<td>608</td>
<td>626</td>
</tr>
<tr>
<td>Gains (losses) with respect to remeasurements on plan assets</td>
<td>224</td>
<td>1,613</td>
<td>(365)</td>
</tr>
<tr>
<td>Actual yield on plan assets</td>
<td>777</td>
<td>2,221</td>
<td>261</td>
</tr>
</tbody>
</table>

For the Year ended December 31

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employees participation in the plan</td>
<td>27</td>
<td>26</td>
<td>25</td>
</tr>
</tbody>
</table>

3) Composition of the asset portfolio of the funds of those insured by the Fund:

<table>
<thead>
<tr>
<th></th>
<th>2013 (in NIS million)</th>
<th>2012 (in NIS million)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Quoted in active market</td>
<td>Not quoted in active market</td>
</tr>
<tr>
<td>Negotiable government debentures</td>
<td>14,176</td>
<td>-</td>
</tr>
<tr>
<td>Corporate, negotiable debentures,</td>
<td>1,324</td>
<td>-</td>
</tr>
<tr>
<td>Deposits and loans</td>
<td>-</td>
<td>4,827</td>
</tr>
<tr>
<td>Shares</td>
<td>3,769</td>
<td>-</td>
</tr>
<tr>
<td>Other investments</td>
<td>-</td>
<td>336</td>
</tr>
<tr>
<td>Cash</td>
<td>-</td>
<td>606</td>
</tr>
<tr>
<td></td>
<td>19,269</td>
<td>5,769</td>
</tr>
</tbody>
</table>
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 which are invested in Government 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 Mizrachi 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 Central Pension Fund, and/or to execute a reimbursement to the Company (subject to the application to the Court). A response on the matter has not yet been received.

   c) Regarding the release of funds from the Trust Account, see Note 13 below, and regarding the draft of recommendations of the steering committee which was published on March 23, 2014, see Note 1 e above.

2) Changes in fair value of funds in trust designated to cover actuarial liabilities (assets according to section 116 A):

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of funds in trust as of the beginning of the year</td>
<td>1,976</td>
<td>2,118</td>
<td>2,049</td>
</tr>
<tr>
<td>Interest income from funds in trust</td>
<td>40</td>
<td>55</td>
<td>59</td>
</tr>
<tr>
<td>Transfer to Central Pension Fund (see section l)(1)f</td>
<td>(254)</td>
<td>(356)</td>
<td>-</td>
</tr>
<tr>
<td>Gains (losses) with respect to remeasurement:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yield on plan assets (except for sums included in the net interest cost)</td>
<td>(34)</td>
<td>159</td>
<td>10</td>
</tr>
<tr>
<td>Fair value of funds in trust as of the period end</td>
<td>1,728</td>
<td>1,976</td>
<td>2,118</td>
</tr>
</tbody>
</table>

3) Yield of funds in trust:

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest income from funds in trust</td>
<td>40</td>
<td>55</td>
<td>59</td>
</tr>
<tr>
<td>Gains (losses) with respect to remeasurement on funds in trust</td>
<td>(34)</td>
<td>159</td>
<td>10</td>
</tr>
<tr>
<td>Actual yield on funds in trust</td>
<td>6</td>
<td>214</td>
<td>69</td>
</tr>
<tr>
<td>Anticipated annual yield rate of funds in trust as of the beginning of the period</td>
<td>2.28%</td>
<td>2.77%</td>
<td>2.88%</td>
</tr>
</tbody>
</table>
n. **Capital Reserves With Respect to Remeasurements of the Liability (asset), net (Before Tax Effect)**

<table>
<thead>
<tr>
<th></th>
<th>For the Year ended December 31</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013</td>
</tr>
<tr>
<td>Balance as at the beginning of the year</td>
<td>1,738</td>
</tr>
<tr>
<td>Yield on the plan assets less sums included in the net interest cost*</td>
<td>(345)</td>
</tr>
<tr>
<td>Balance as at the end of the period</td>
<td>1,393</td>
</tr>
</tbody>
</table>

* Less reserve administration fees.

o. **Amounts Present in Cost of Salaries and in Expenses with respect to Liabilities to Pensioners**

<table>
<thead>
<tr>
<th></th>
<th>For the Year ended December 31</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013</td>
</tr>
<tr>
<td>Cost of Salaries and Expenses with respect to Liabilities to Pensioners</td>
<td></td>
</tr>
<tr>
<td>Current service cost after deducting employees participation in the pension plan</td>
<td>341</td>
</tr>
<tr>
<td>Cost of interest</td>
<td>590</td>
</tr>
<tr>
<td>Interest revenues</td>
<td>(593)</td>
</tr>
<tr>
<td>Costs due to early retirement</td>
<td>19</td>
</tr>
<tr>
<td>Cost of previous service – changes in the plan terms that were recognized due to the linkage of the pension to the CPI</td>
<td>-</td>
</tr>
<tr>
<td>Change in plan of exception cancellation and cancellation of 0.3% salary agreement</td>
<td>-</td>
</tr>
<tr>
<td>Total cost recognized in salaries cost and expenses with respect to liabilities to pensioners</td>
<td>357</td>
</tr>
</tbody>
</table>

p. **Remeasurements that were capitalized to assets cost (fixed assets):**

<table>
<thead>
<tr>
<th></th>
<th>For the Year ended Dec 31</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013</td>
</tr>
<tr>
<td>Increase (decrease) in fixed assets</td>
<td>(109)</td>
</tr>
</tbody>
</table>
q. Main Actuarial Assumptions Applied to the Actuarial Liability and Plan Assets

<table>
<thead>
<tr>
<th>Actuarial assumptions</th>
<th>December 31</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013</td>
<td>2012</td>
<td>2011</td>
</tr>
<tr>
<td>Weighted annual real interest rate grossed in the present</td>
<td>2.29%</td>
<td>2.28%</td>
<td>2.77%</td>
</tr>
<tr>
<td>value of the obligation at the end of the year</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rate of return used to calculate the interest cost</td>
<td>2.28%</td>
<td>2.77%</td>
<td>2.88%</td>
</tr>
<tr>
<td>Anticipated annual real rate of return grossed in the fair</td>
<td>2.28%</td>
<td>2.77%</td>
<td>2.88%</td>
</tr>
<tr>
<td>value of plan assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average liability lifetime</td>
<td>16.9 years</td>
<td>16.5 years</td>
<td>15.9 years</td>
</tr>
<tr>
<td>Real update of salaries during the work period</td>
<td>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 is eroded at a rate of 1.38% compared to the CPI*) and also inclusion of salary increments with respect to current salary agreements.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Real update of pension amounts after employment termination</td>
<td>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.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pensioners and next of kin mortality, including updated mortality data</td>
<td>According to the Ministry of Finance draft circular dated July 11, 2012, and mortality study regarding employees, pensioners and survivors.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* 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), is 1.38% per year (an erosion of 1.38% in real terms). The Company advised the actuary about this actuarial assumption after using long term statistics to examine the annual price increase data with respect to general salary agreements and cost of living increment compared to the increase of the CPI. After the Company examined the data, it is of the opinion that this assumption is reasonable.

r. Analysis of sensitivity of main actuarial assumptions as of December 31, 2013

<table>
<thead>
<tr>
<th>Actuarial assumptions</th>
<th>Change %</th>
<th>Increase (decrease) in liability</th>
<th>Change %</th>
<th>Increase (decrease) in liability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate of interest for capitalization</td>
<td>(0.1)</td>
<td>436</td>
<td>0.1</td>
<td>(425)</td>
</tr>
<tr>
<td>Future salary increase rate with respect to general salary</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>agreements and cost of living increment less the CPI</td>
<td>0.5</td>
<td>722</td>
<td>(0.5)</td>
<td>(674)</td>
</tr>
</tbody>
</table>

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.
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 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. 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.

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 the cash flow problem of the Company. 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, the Company transferred every month, during 2012-2013, NIS 600 million 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. 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.
NOTE 13:- FUNDS IN TRUST (continued)

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 arrangement 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 the said 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 the implementation of this decision. This proceeding is still pending at the Center District Court.

d. The funds of the trust account are invested in Government 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 above.
NOTE 14:- FIXED ASSETS

a. 1) Composition and changes in 2013

<table>
<thead>
<tr>
<th>Fixed Assets Under Construction</th>
<th>Cost</th>
<th>Accumulated Depreciation</th>
<th>Depreciated balance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013</td>
<td>2012</td>
<td>2013</td>
</tr>
<tr>
<td></td>
<td>Classification</td>
<td>Deduction</td>
<td>Net addition</td>
</tr>
<tr>
<td>Power plants (including land, buildings and machinery)</td>
<td>67,735</td>
<td>1,931</td>
<td>(36)</td>
</tr>
<tr>
<td>Sub-stations</td>
<td>13,710</td>
<td>29</td>
<td>(20)</td>
</tr>
<tr>
<td>Overloading control center</td>
<td>993</td>
<td>1</td>
<td>-</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>1,588</td>
<td>3</td>
<td>-</td>
</tr>
<tr>
<td>Switching stations and 400 KV voltage lines</td>
<td>8,279</td>
<td>75</td>
<td>-</td>
</tr>
<tr>
<td>High voltage transmission lines</td>
<td>6,380</td>
<td>310</td>
<td>(63)</td>
</tr>
<tr>
<td>Distribution networks</td>
<td>42,265</td>
<td>346</td>
<td>(160)</td>
</tr>
<tr>
<td>Installations, etc. - East Jerusalem district</td>
<td>138</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Meters</td>
<td>1,834</td>
<td>20</td>
<td>(40)</td>
</tr>
<tr>
<td>Land, office buildings</td>
<td>3,141</td>
<td>66</td>
<td>(3)</td>
</tr>
<tr>
<td>Office equipment and tools</td>
<td>1,561</td>
<td>3</td>
<td>-</td>
</tr>
<tr>
<td>Computers</td>
<td>1,592</td>
<td>-</td>
<td>(15)</td>
</tr>
<tr>
<td>Motor vehicles</td>
<td>725</td>
<td>-</td>
<td>(80)</td>
</tr>
<tr>
<td>Mobile mechanical equipment</td>
<td>660</td>
<td>-</td>
<td>(69)</td>
</tr>
<tr>
<td>Emergency equipment</td>
<td>63</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Consumers participation in fixed assets not yet attributed to projects</td>
<td>688</td>
<td>10</td>
<td>-</td>
</tr>
<tr>
<td>Less: receipts for extension of the electricity network</td>
<td>151,352</td>
<td>2,794</td>
<td>(486)</td>
</tr>
<tr>
<td>Total fixed assets in use</td>
<td>143,494</td>
<td>2,711</td>
<td>(585)</td>
</tr>
</tbody>
</table>

(*) 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.
### FIXED ASSETS IN USE

<table>
<thead>
<tr>
<th>Classification (a)</th>
<th>Deduction (*)</th>
<th>Net addition (**)</th>
<th>Classification (a)</th>
<th>Deduction</th>
<th>Addition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Power plants (including land, buildings and machinery)</td>
<td>65,322</td>
<td>1,885</td>
<td>61</td>
<td>589</td>
<td>67,735</td>
</tr>
<tr>
<td>Sub-stations</td>
<td>13,464</td>
<td>46</td>
<td>(40)</td>
<td>240</td>
<td>13,710</td>
</tr>
<tr>
<td>Overloading control center</td>
<td>954</td>
<td>1</td>
<td>-</td>
<td>38</td>
<td>993</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>1,529</td>
<td>4</td>
<td>-</td>
<td>55</td>
<td>1,588</td>
</tr>
<tr>
<td>Switching stations and 400 KV voltage lines</td>
<td>8,062</td>
<td>216</td>
<td>(1)</td>
<td>2</td>
<td>8,279</td>
</tr>
<tr>
<td>High voltage transmission lines</td>
<td>6,264</td>
<td>134</td>
<td>(1)</td>
<td>(17)</td>
<td>6,380</td>
</tr>
<tr>
<td>Distribution networks</td>
<td>40,971</td>
<td>371</td>
<td>(151)</td>
<td>1,074</td>
<td>42,265</td>
</tr>
<tr>
<td>Installations, etc. - East Jerusalem district</td>
<td>138</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>138</td>
</tr>
<tr>
<td>Meters</td>
<td>1,768</td>
<td>16</td>
<td>(42)</td>
<td>92</td>
<td>1,834</td>
</tr>
<tr>
<td>Land, office buildings</td>
<td>3,123</td>
<td>2</td>
<td>-</td>
<td>16</td>
<td>3,141</td>
</tr>
<tr>
<td>Office equipment and tools</td>
<td>1,527</td>
<td>2</td>
<td>-</td>
<td>32</td>
<td>1,561</td>
</tr>
<tr>
<td>Computers</td>
<td>1,577</td>
<td>-</td>
<td>(12)</td>
<td>27</td>
<td>1,592</td>
</tr>
<tr>
<td>Motor vehicles</td>
<td>712</td>
<td>-</td>
<td>(81)</td>
<td>94</td>
<td>725</td>
</tr>
<tr>
<td>Mobile mechanical equipment</td>
<td>577</td>
<td>-</td>
<td>(23)</td>
<td>106</td>
<td>660</td>
</tr>
<tr>
<td>Emergency equipment</td>
<td>62</td>
<td>-</td>
<td>-</td>
<td>1</td>
<td>63</td>
</tr>
<tr>
<td>Various projects</td>
<td>658</td>
<td>6</td>
<td>-</td>
<td>24</td>
<td>688</td>
</tr>
<tr>
<td>Consumers participation in fixed assets not yet attributed to projects</td>
<td>(55)</td>
<td>52</td>
<td>(7)</td>
<td>(4)</td>
<td>-</td>
</tr>
<tr>
<td>Total fixed assets in use</td>
<td>146,653</td>
<td>2,735</td>
<td>(405)</td>
<td>2,369</td>
<td>151,352</td>
</tr>
<tr>
<td>Less: receipts for extension of the electricity network</td>
<td>(9,335)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>(9,334)</td>
</tr>
<tr>
<td>Spare parts for power plants and substations</td>
<td>137,318</td>
<td>2,735</td>
<td>(405)</td>
<td>2,370</td>
<td>142,018</td>
</tr>
<tr>
<td>Total fixed assets in use</td>
<td>138,940</td>
<td>2,697</td>
<td>(626)</td>
<td>2,483</td>
<td>134,494</td>
</tr>
</tbody>
</table>

### FIXED ASSETS UNDER CONSTRUCTION

<table>
<thead>
<tr>
<th>Classification (a)</th>
<th>Deduction (*)</th>
<th>Net addition (**)</th>
<th>Classification (a)</th>
<th>Deduction</th>
<th>Addition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Power plants, buildings and other installations</td>
<td>2,895</td>
<td>(1,563)</td>
<td>(6)</td>
<td>2,599</td>
<td>3,925</td>
</tr>
<tr>
<td>Sub-stations and high voltage lines</td>
<td>798</td>
<td>(124)</td>
<td>(3)</td>
<td>362</td>
<td>1,033</td>
</tr>
<tr>
<td>Switching stations and 400 KV voltage lines</td>
<td>272</td>
<td>(167)</td>
<td>-</td>
<td>100</td>
<td>205</td>
</tr>
<tr>
<td>Payments on account of equipment</td>
<td>442</td>
<td>(254)</td>
<td>-</td>
<td>86</td>
<td>274</td>
</tr>
<tr>
<td>Materials and payments on account of materials designated for investments in fixed assets</td>
<td>626</td>
<td>(589)</td>
<td>(9)</td>
<td>555</td>
<td>583</td>
</tr>
<tr>
<td>Total fixed assets under construction</td>
<td>5,053</td>
<td>(2,697)</td>
<td>(18)</td>
<td>3,702</td>
<td>6,020</td>
</tr>
<tr>
<td>Total fixed assets</td>
<td>143,973</td>
<td>-</td>
<td>(644)</td>
<td>6,185</td>
<td>149,514</td>
</tr>
</tbody>
</table>

(*) Including cancellation of the deduction according to FAS 90 in the amount of NIS 6 million (included in depreciation and amortization section).

(**) Less receipts from development works orders.
b. **Fixed Assets Impairment Test according to IAS 36**

The Company reviewed, based on the estimation of external consultants, 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).

In forming its position regarding the number of cash-generating units according to the standard, the Company heard the position of the Electricity Authority and the Government Companies Authority.

The Electricity Authority stated that in the case where IAS 36 applies to the Company, it is of the opinion (backed by a professional opinion which it commissioned), that the generation, transmission and distribution of the Company are one cash-generating unit as defined by that standard.

The Deputy Director General of the Government Companies Authority expressed a similar opinion on the number of cash-generating units.

The forecast of future cash flow expected to be derived from the cash-generating unit 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. The main economic conditions are:

1) In reviewing the cash-generating units, the Company identified the three operating segments of the Company as one cash-generating unit.
2) The current rate base for the generation segment, as determined in February 2010, will end at the end of 2014 and a new rate that will become effective at the middle of 2015.
3) The new rate base for the transmission and distribution sectors (see Note 3 c above), will become retroactively effective from April 1, 2012, based on the Decision of the Electricity Authority on March 22, 2012.
4) Based on past experience, work principles of the Electricity Authority and the directives of the 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 will also include 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) Fuel expenses incurred by the Company will be covered by the electricity rate throughout the periods of the forecast.

6) Weighted Average Capital Cost (WACC) - 4.7% 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 assets is not lower than their value in these Financial Statements.
c. Investments in land (before amortization), which are included under fixed assets include NIS 982 million for long term land leases and NIS 686 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 (March 5, 1996), the Company had fully written off the cost of acquiring land in the amount of NIS 578 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 354 million, as to which the Company received confirmation 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 8 for fixed asset investment commitments.

g. Accumulated financial costs, net, capitalized as part of the cost of fixed assets (before depreciation) were NIS 5,378 million and NIS 4,964 million as of December 31, 2013 and as of December 31, 2012, 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 1,020 million as of December 31, 2013. 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 on December 31, 2013. 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, 2013, 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 Company's costs, according to the updated valuation of the forecast completion of the projects. In 2013, the reduction increased by NIS 341 million. The accumulated reduction as of December 31, 2013 is approximately NIS 1,260 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.
NOTE 14:  FIXED ASSETS (continued)

i. Reduction with respect to Non-Recognition of Building Costs of Generation Units According to the American SFAS 90 Standard (continued)

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.

In 2012, significant gaps were not found in relation to this provision.

j. Emergency plan for the Electricity sector and its Financing

The Company constructs a major part of its power stations in recent years according to an emergency plan, approved by the Minister. In this framework, the Company began constructing the emergency plan stage A in 2007 which ended in 2011, and the emergency plan stage B in 2009.

Financing the emergency plan stage B:

In order to finance the construction of three steam turbine add-ons within the framework of Stage B of the Emergency Plan and in accordance with the decision of the Electricity Authority as of March 7, 2011, the Company’s debt to consumers in the amount of NIS 2 billion was spread up to 2025. On May 6, 2013, the Authority updated its decision of March 7, 2011, such that the period of returning the loan that was provided to the Company in the amount of NIS 2 billion will be shortened to 7 years instead of 15 years as was determined in the original decision. (See Note 9 i below).

The funds are deposited in a dedicated account and are withdrawn in accordance with the progress of the projects.

As of the date of the financial statements, it has a balance of approximately half a billion NIS (see Note 3 a 3c above).

k. 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.

In addition, the Company does not currently possess all of the required information due to various problems in registering the many assets that have been accumulated by the Company over tens of years and due to the considerable costs and duration required to issue assessments. 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.

l. Regarding the draft of recommendations of the steering committee published on March 23, 2014, see Note 1 e above.
NOTE 15:  INTANGIBLE ASSETS, NET

<table>
<thead>
<tr>
<th></th>
<th>Balance as of January 1, 2013</th>
<th>Additions in 2013</th>
<th>Balance as of December 31, 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>NIS in millions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost of software</td>
<td>3,856</td>
<td>172</td>
<td>4,028</td>
</tr>
<tr>
<td>Accumulated amortization of software</td>
<td>(2,935)</td>
<td>(145)</td>
<td>(3,080)</td>
</tr>
<tr>
<td>Intangible assets, net</td>
<td>921</td>
<td>27</td>
<td>948</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Balance as of January 1, 2012</th>
<th>Additions in 2012</th>
<th>Balance as of December 31, 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>NIS in millions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost of software</td>
<td>3,641</td>
<td>215</td>
<td>3,856</td>
</tr>
<tr>
<td>Accumulated amortization of software</td>
<td>(2,751)</td>
<td>(184)</td>
<td>(2,935)</td>
</tr>
<tr>
<td>Intangible assets, net</td>
<td>890</td>
<td>31</td>
<td>921</td>
</tr>
</tbody>
</table>

At the beginning of 2013, the Company examined the useful lifespan of the software it uses and following this the useful lifespan of the software defined as strategic projects of the Company has been changed (see Note 2 j above).

NOTE 16:  CREDIT FROM BANKS AND OTHERS

<table>
<thead>
<tr>
<th></th>
<th>As on December 31</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013</td>
</tr>
<tr>
<td></td>
<td>NIS in millions</td>
</tr>
<tr>
<td>Short term loans*</td>
<td>187</td>
</tr>
<tr>
<td>Current maturities of loans and debentures (**, ***)</td>
<td>6,652</td>
</tr>
<tr>
<td>Current maturity of a liability to the State of Israel</td>
<td>251</td>
</tr>
<tr>
<td>Maturities for forward and swap transactions</td>
<td>28</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>7,118</td>
</tr>
</tbody>
</table>

(*) As on December 31, 2013, the interest rate was Libor + 2.82%.

(**) With respect to interest rates for current maturities, see Note 20.

NOTE 17:-  OTHER CURRENT LIABILITIES

<table>
<thead>
<tr>
<th></th>
<th>As on December 31</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013</td>
</tr>
<tr>
<td></td>
<td>NIS in millions</td>
</tr>
<tr>
<td>Employees</td>
<td>198</td>
</tr>
<tr>
<td>Institutions</td>
<td>315</td>
</tr>
<tr>
<td>Interest and accrued expenses</td>
<td>1,136</td>
</tr>
<tr>
<td>Other payables</td>
<td>93</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1,742</td>
</tr>
</tbody>
</table>
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 and Note 28 below).

<table>
<thead>
<tr>
<th>Connections to buildings</th>
<th>Work paid for by others</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>As on December 31</td>
<td>As on December 31</td>
<td>As on December 31</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td>2012</td>
<td>2013</td>
</tr>
<tr>
<td>NIS in millions</td>
<td>NIS in millions</td>
<td>NIS in millions</td>
</tr>
<tr>
<td>Receipts from customers</td>
<td>417</td>
<td>362</td>
</tr>
<tr>
<td>Less: expenses with respect to work in progress</td>
<td>(175)</td>
<td>(206)</td>
</tr>
<tr>
<td></td>
<td>242</td>
<td>156</td>
</tr>
</tbody>
</table>

NOTE 19: PROVISIONS

<table>
<thead>
<tr>
<th>Provision for legal claims (1)</th>
<th>Provision for vacation pay</th>
<th>Municipal tax</th>
<th>Advance payments from customers less works in process</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>NIS in millions</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balance as of January 1, 2013</td>
<td>379</td>
<td>270</td>
<td>74</td>
<td>9</td>
</tr>
<tr>
<td>Additional recognized provisions</td>
<td>29</td>
<td>-</td>
<td>9</td>
<td>-</td>
</tr>
<tr>
<td>Updated current provisions</td>
<td>(4)</td>
<td>261</td>
<td>19</td>
<td>-</td>
</tr>
<tr>
<td>Amounts used during the year</td>
<td>-</td>
<td>(229)</td>
<td>(38)</td>
<td>(1)</td>
</tr>
<tr>
<td>Amounts canceled during the year</td>
<td>(48)</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Balance as of December 31, 2013</td>
<td>356</td>
<td>302</td>
<td>64</td>
<td>8</td>
</tr>
</tbody>
</table>

(1) In 2013, the Company recorded net revenues of approximately NIS 15 million resulting from the settlement of legal claims as existed on December 31, 2012 in amounts smaller than the provisions recorded for them.

<table>
<thead>
<tr>
<th>Provision for legal claims (1)</th>
<th>Provision for vacation pay</th>
<th>Municipal tax</th>
<th>Advance payments from customers less works in process</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>NIS in millions</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balance as of January 1, 2012</td>
<td>459</td>
<td>260</td>
<td>87</td>
<td>10</td>
</tr>
<tr>
<td>Additional recognized provisions</td>
<td>30</td>
<td>-</td>
<td>6</td>
<td>-</td>
</tr>
<tr>
<td>Updated current provisions</td>
<td>(39)</td>
<td>230</td>
<td>21</td>
<td>-</td>
</tr>
<tr>
<td>Amounts used during the year</td>
<td>-</td>
<td>(220)</td>
<td>(40)</td>
<td>(1)</td>
</tr>
<tr>
<td>Amounts canceled during the year</td>
<td>(71)</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Balance as of December 31, 2012</td>
<td>379</td>
<td>270</td>
<td>74</td>
<td>9</td>
</tr>
</tbody>
</table>
NOTE 20:- DEBENTURES AND LIABILITIES TO BANKING CORPORATIONS AND OTHERS

a. Composition of the long-term debentures and liabilities and hedging transactions, net

<table>
<thead>
<tr>
<th>Linkage Basis:</th>
<th>December 31, 2013</th>
<th>December 31, 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Unlinked NIS</td>
<td>Linked to the CPI</td>
</tr>
<tr>
<td>(1) Debentures:</td>
<td>NIS in millions</td>
<td>NIS in millions</td>
</tr>
<tr>
<td>Interest rates (%)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8.5</td>
<td>6.0-6.9</td>
<td>0.7-1.2</td>
</tr>
<tr>
<td>Debentures traded on the Israel Stock Exchange</td>
<td>-</td>
<td>3,146</td>
</tr>
<tr>
<td>Debentures not traded in Israel</td>
<td>657</td>
<td>10,871</td>
</tr>
<tr>
<td>Debentures issued abroad</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total</td>
<td>657</td>
<td>14,017</td>
</tr>
<tr>
<td>Less: deferred charges</td>
<td>-</td>
<td>(7)</td>
</tr>
<tr>
<td>(Discount)/premium</td>
<td>22</td>
<td>618</td>
</tr>
<tr>
<td>Current maturities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debentures</td>
<td>-</td>
<td>2,978</td>
</tr>
<tr>
<td>Deferred charges</td>
<td>-</td>
<td>(3)</td>
</tr>
<tr>
<td>(Discount)/premium</td>
<td>6</td>
<td>154</td>
</tr>
<tr>
<td>Total current maturities</td>
<td>6</td>
<td>3,129</td>
</tr>
<tr>
<td>Total debentures, net.</td>
<td>673</td>
<td>11,499</td>
</tr>
</tbody>
</table>
### Linkage Basis:

#### (2) Liabilities to banks:

<table>
<thead>
<tr>
<th>Interest rates (%)</th>
<th>Unlinked NIS</th>
<th>Linked to the CPI</th>
<th>Denominated in U.S. Dollars</th>
<th>Denominated in Euro</th>
<th>Denominated in Japanese Yen</th>
<th>Total</th>
<th>December 31, 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1.5 – 2.6</td>
<td>3.7 - 5.4</td>
<td>0.1</td>
<td>0.5 – 2.8</td>
<td>0.7 – 2.9</td>
<td>Total</td>
<td></td>
</tr>
<tr>
<td>Loans from banks</td>
<td>4,650</td>
<td>1,342</td>
<td>143</td>
<td>-</td>
<td>1,053</td>
<td>2,359</td>
<td>9,547</td>
</tr>
<tr>
<td>Less: Deferred charges</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>(45)</td>
<td>(178)</td>
<td>-</td>
<td>(223)</td>
</tr>
<tr>
<td>Total</td>
<td>4,650</td>
<td>1,342</td>
<td>143</td>
<td>-</td>
<td>1,008</td>
<td>2,181</td>
<td>9,324</td>
</tr>
</tbody>
</table>

#### Current maturities:

| Loans from banks     | 2,000        | 1,057             | 48                         | -                 | 71                          | 400   | -                | 858   |
| Deferred charges     | -            | -                 | -                          | (7)               | (35)                        | -     | (42)             |
| Total current maturities | 2,000    | 1,057             | 48                         | -                 | 64                          | 365   | -                | 833   |

#### Liabilities to banks, net

| Total current maturities | 2,650 | 285       | 95                          | -                 | 944                         | 1,816 | -                | 5,790 | 6,157 |

#### Hedging transactions:

| Deposits              | -       | -         | -                           | -                 | (12,483)                    | (973) | (2,376)         | (15,832) |
| Loans                 | 820     | 17,819    | -                           | -                 | (12,483)                    | (973) | (2,376)         | 18,639 |
| Total swap transactions | 820  | 17,819    | -                           | -                 | (12,483)                    | (973) | (2,376)         | 2,807 |
| Forward transactions  | 67      | -         | -                           | (64)              | -                           | -     | 3               |
| Total hedging transactions | 887 | 17,819    | -                           | -                 | (12,547)                    | (973) | (2,376)         | 2,810 |
| Current maturities of swap transactions | -       | 1,157    | -                           | -                 | (622)                       | (476) | (34)            | 25    |
| Current maturities of forward transactions | 67      | -         | -                           | (64)              | -                           | -     | 3               |
| Total current maturities | 67    | 1,157    | -                           | -                 | (686)                       | (476) | (34)            | 28    |

#### Total hedging transactions, net

| Total hedging transactions, net | 820 | 16,662 | - | - | (11,861) | (497) | (2,342) | 2,782 |

#### Transfer of hedge transactions to long-term receivables, net

| Payables balance with respect to long term hedging transactions | 820 | 16,662 | - | - | (11,861) | (497) | (2,342) | 2,782 |

#### Total liabilities to banking corporations (including hedge transactions)

| Total liabilities to banking corporations (including hedge transactions) | 3,470 | 16,947 | 95 | - | (10,917) | 1,319 | (2,342) | 8,572 | 6,945 |
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)

<table>
<thead>
<tr>
<th>Linkage Basis:</th>
<th>December 31, 2013</th>
<th>December 31, 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Unlinked NIS</td>
<td>Linked to the CPI</td>
</tr>
<tr>
<td>Interest rates (%)</td>
<td>5 – 5.75</td>
<td></td>
</tr>
<tr>
<td>(3) Debentures to the State of Israel</td>
<td>-</td>
<td>2,536</td>
</tr>
<tr>
<td>(see Note 23 below)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest rates (%)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans from the State of Israel</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Less deferred expenses</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>total current maturities</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Loans from the State of Israel</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest rates (%)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(4) Liabilities to the State of Israel</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Loans from the State of Israel</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Deferred expenses</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans from the State of Israel</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Loans from the State of Israel</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest rates (%)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Liabilities for finance leases</td>
<td>-</td>
<td>20</td>
</tr>
<tr>
<td>Long-term payables</td>
<td>114</td>
<td>443</td>
</tr>
<tr>
<td></td>
<td>208</td>
<td>917</td>
</tr>
<tr>
<td>Total other liabilities, net</td>
<td>114</td>
<td>462</td>
</tr>
<tr>
<td>Total debentures, liabilities to banks and other liabilities</td>
<td>4,257</td>
<td>31,444</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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b. Composition of the long-term debentures
1) Negotiable debenture Series 22 which was issued in 2002 and listed for trade on the Tel-Aviv Stock Exchange, is linked (principal and interest) to the known CPI, due for redemption through the years 2014 until 2015. (See section c.3 a) below).

2) Negotiable debenture Series 24, which was issued in 2012 and listed for trade on the Tel-Aviv Stock Exchange, is linked (principal and interest) to the known CPI, is due for redemption in 2015.

3) Negotiable debenture Series 25, which was issued in 2012 and listed for trade on the Tel-Aviv Stock Exchange, is linked (principal and interest) to the known CPI, is due for redemption in 2017.

4) Non-negotiable debentures Series listed for trade on the Tel-Aviv Stock Exchange at the institutional continuous floor in the country XI, XII, XIII "2018 Linked Electric", "2018 NIS Electric", "2015 Linked Electric" and "2014 Linked Electric", "2020 Linked Electric" and "2022 Linked Electric", which were issued on the Tel-Aviv Stock Exchange, are due for redemption in 2014-2023. (See section c.3 b) below).

5) Non-negotiable debentures Series not listed for trade on the Tel-Aviv Stock Exchange Series X, private debentures that were issued in 1991, 1996, 1999 and 2002, which were issued to institutional bodies, will be redeemed in 2014-2020 (see section c.3) b) below.

6) Non-negotiable debentures series registered on the Singapore stock exchange are due for redemption during 2017-2023.

7) Non-negotiable debentures series issued in Japan and Europe are due for redemption during 2027-2032.

8) Non-negotiable debentures series issued in the U.S.A. are due for redemption during 2018-2027 and in 2096.

c. Foreign Capital Raising and Substantial Payments in the Reporting Period
1) Foreign Capital Raising in the Reporting Period
a) On April 24, 2013, a loan of USD 500 million was received within the framework of the loan agreement signed between the Company and the Barclays Bank Plc. and Citibank N.A. The loan was intended to serve as a bridging loan until the raising of alternative debt by the Company. The loan was repaid in full on June 24, 2013. See section 2) e below.

b) On May 30, 2013, loans in the amount of approximately EUR 95.6 million and approximately USD 125.1 million were received within the framework of a loan agreement with a consortium of 4 Banks led by HSBC, to finance Stage B of the emergency project.

c) On June 21, 2013, the Company issued debentures which were distributed by the investment banks Barclays and Citi to institutional purchasers in and outside the United States of America, in a total amount of USD 1.1 billion par value, from a comprehensive plan (Global Medium Term Notes hereinafter: "GMTN") to issue debentures in the total amount of up to USD 5 billion par value. The accumulated amount issued within the comprehensive plan up to that date is USD 3.1 billion par value.

Debentures issued as stated within the comprehensive plan were listed on the Singapore stock exchange.

Raising the debentures was executed through two different series:

- The first series is USD 600 million par value for consideration of an identical sum (price 100) and it bears nominal interest of 5.625% (5.625% yield to maturity on the raising date). The debenture principal will be paid in one payment on June 21, 2018.
- The second series is USD 500 million par value for consideration of an identical sum (price 100) and it bears nominal interest of 6.875% (6.875% yield to maturity on the raising date). The debenture principal will be paid in one payment on June 21, 2023.
d) On July 9, 2013, the Company issued debentures which were distributed by the investment banks Barclays and Citi to institutional purchasers in the U.S.A. and outside the U.S.A., in a total amount of USD 300 million par value, out of a comprehensive plan ("GMTN") to issue debentures in a total amount of up to USD 5 billion par value. The accumulated sum issued within the comprehensive plan is USD 3.4 billion par value.

Debentures issued within the comprehensive plan as stated were listed on the Singapore Stock Exchange. The debenture raising was executed by expanding two debenture series issued on June 21, 2013.

- The expansion of the first series is USD 150 million par value for consideration of approximately USD 153 million (price 101.75) and a nominal interest rate of 5.625% (yield to maturity 5.219% on the raising date). The debenture principal will be paid in one payment on June 21, 2018.
- The expansion of the second series is USD 150 million par value for consideration of approximately USD 151 million (price 100.375) and annual nominal interest rate of 6.875% (yield to maturity 6.822% on the raising date). The debenture principal will be paid in one payment on June 21, 2023.

e) On July 1, 2013, loans in the amount of NIS 2.4 billion were received from four Israeli banks that are not linked to the CPI and are backed by State guarantee.

2) Substantial Payments in the Reporting Period

a) On February 13, 2013, private (non-negotiable) debentures in the amount of NIS 154.5 million par value (a total of approximately NIS 186.6 million including linkage differentials), issued to institutional bodies on February 13, 2003, were paid.

b) On February 20, 2013, negotiable debentures of series 22 in the amount of NIS 500 million par value (a total of approximately NIS 617.6 million including linkage differentials), issued by the Company on the TASE within the public prospectus of May 2002, were paid.

c) On April 10, 2013, private (non-negotiable) debentures not linked to the CPI of series “Electric NIS 2013”, secured by State guarantee, in the amount of NIS 1.5 billion par value, and issued to institutional bodies on April 10, 2012, were paid.

d) On May 20, 2013, additional negotiable debentures of series 22 in the amount of NIS 500 million par value (a total of approximately NIS 621.3 million including linkage differentials), were paid.

e) On June 24, 2013, after execution of the issue as stated in section 1)c, the bridging loan in the amount of USD 500 million received within the loan agreement signed by the Company and the Barclays Bank Plc and Citibank N.A. as stated in section 1)a above, was fully repaid.

f) On July 9, 2013, public debentures not linked to the CPI of series 23, backed by State guarantee, were paid, in the amount of approximately NIS 2.4 billion par value, which were issued to the public within a prospectus published in June 2012.

g) On August 20, 2013, additional negotiable debentures of series 22 were paid, in the amount of approximately NIS 500 million par value (a total of approximately NIS 628.7 million including linkage differentials).

h) On October 25, 2013, private (non-negotiable) debentures in the amount of NIS 282.9 million par value (a total of approximately NIS 346.2 million including linkage differentials), issued to institutional bodies on October 25, 2002, were paid.

i) On November 20, 2013, negotiable debentures of series 22 in the amount of NIS 500 million par value (a total of approximately NIS 631.8 million including linkage differentials), were paid.
c. Foreign Capital Raising and Substantial Payments in the Reporting Period (continued)

2) Substantial Payments in the Reporting Period (continued)

j) On November 25, 2013, private (non-negotiable) debentures not linked to the CPI of series “Electric NIS 1113” in the amount of NIS 783.5 million par value, and issued to institutional bodies on November 25, 2012, were paid.

k) On December 12, 2013, a loan in the amount of approximately USD 59 million which was received under a loan agreement signed on April 22, 2004 with the ABN AMRO Bank, and assigned on September 24 to RSB Bank, was paid.

l) On December 26, 2013, private (non-negotiable) debentures in the amount of NIS 116.3 million par value (a total of approximately NIS 142.5 including linkage differentials), and issued to institutional bodies on December 26, 2002, were paid.

3) Material Payments after the Balance Sheet Date

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), issued by the Company at the Tel Aviv Stock Exchange as part of the new public prospectus of May 2002, were paid.

b) On March 19, 2014, private (non-negotiable) debentures of series “Electric Linked 2014” in the amount of approximately NIS 169.7 million par value (a total of approximately NIS 197.5 million including linkage differentials), and issued to institutional bodies on March 19, 2008, were paid.

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, 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 21,165 million, as of December 31, 2013. 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, 2013 to approximately NIS 4,618 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.

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, 2013, to approximately NIS 21,556 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 the signed trust deeds in connection with the debentures (Series 22) that the Company issued to the public and institutional investors in Israel, it was determined that the trustee will be entitled to require immediate
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)

repayment of the entire unpaid balance of the debentures and will be obligated to do so if so requested by a special decision made in a general meeting of the holders of the debentures, or by the written demand of holders of debentures owning at least 20% of the aggregate par value of the outstanding debentures, inter alia, on the occurrence of one or more of the events listed below:

a) if the holders of the charges on the Company's assets will realize the charges that they have on the Company's assets, in whole or in part;

b) if a court shall grant a final order or if a valid decision will be made to liquidate the Company (excluding liquidation for objectives of a merger with another company or a change in the Company's structure). It was determined in the trust deed, with respect to the debentures that the end of the validity of the generation and/or generation licenses held by the Company (on the signing date of the prospectus of May 2002, which served as the basis for floating the debentures) does not constitute a cause for immediate repayment.

12) 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.

13) 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.

14) Under the terms of debentures issued through Goldman Sachs and Dexia investment banks in the amount of NIS 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.

15) 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.

16) According to the general terms of the debentures (series 2022) issued by the Company in January 2011, holders of debentures are entitled to demand immediate repayment of the principal and interest of the debentures, inter alia when:

a) 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)

b) Insofar as the debentures will be listed for trading on the stock exchange, if the stock exchange suspends the trading in the debentures and the suspension was not lifted within 90 days (except a suspension when non-clarity is created according to the articles of the stock exchange).

17) 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.
d. Terms of the Company’s financing agreements that might result in immediate repayment (continued)

18) 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.

19) 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.

20) 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).

21) 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.

22) Under the terms of the debentures issued by the Company abroad in the months of June and July 2013 (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 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.

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 8.2 billion as on December 31, 2013.
f) **Credit Rating**

1) On April 11, 2013, the international rating company Standard and Poor’s and the local rating company Standard and Poor’s Ma’alot announced that they were changing the Company’s local credit rating outlook (ilAA-) and the international credit rating outlook (BB+) to stable, and removing the rating from the CreditWatch Negative list it was inserted into on November 14, 2012.

2) On May 9, 2013, the S&P rating companies (international and local) announced that they were ratifying the international (BB+) and the local (ilAA-) credit rating of the Company.

3) On December 5, 2013, the local rating company Midroog announced that it was keeping the Company’s local credit rating outlook (Aa3) and changing the rating manner from negative to stable, for debenture series 22 and Electric Linked 2022, and removing the rating from the CreditWatch Negative list it was inserted into on May 24, 2012.

4) On December 5, 2013, the local rating company Midroog announced that it was keeping the rating for the State guaranteed debenture series 24 and 25 at Aaa, i.e. Aaa with a stable outlook.

5) On December 11, 2013, the international rating company Moody’s announced that it was changing the Company’s international credit rating outlook (Baa3) from negative to stable, and removing the rating from the CreditWatch Negative list it was inserted into on November 2, 2011.

g) **Securities and Liens**

To ensure full repayment of part of the payments with respect to the above mentioned debentures and loans (principal, interest and linkage differentials) and to ensure the fulfillment of the remainder of the debenture terms, the Company has pledged all its property (including property under construction) 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.

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 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.”

Additionally, the lenders were given the right of setoff or placing a lien over all the funds, deeds, securities and other negotiable instruments that the Company delivers to them for collection, security, safeguarding or other activities.

h) **Fair Value of Negotiable Debentures**

The fair value of the debentures traded in the Tel Aviv Stock Exchange is approximately NIS 6,448 million. The fair value of the negotiable debentures is the Stock Exchange value. Also see Note 27 h below.

i) Regarding the draft of recommendations of the steering committee that was published on March 23, 2014, see Note 1 e above.
NOTE 21:- PROVISIONS FOR REFUNDING SUMS TO CONSUMERS

Based on a legal opinion, the Financial Statements include provisions amounting to NIS 2,565 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.

Regarding the draft of recommendations of the steering committee that was published on March 23, 2014, see Note 1 e above.
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 14,599 million. The Company recorded a deferred tax asset with regard to the loss carry-forward in the aggregate amount of NIS 3,869 million as of December 31, 2013 and NIS 3,590 million as of December 31, 2012 (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
   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.
   Since the legislation process was completed in the last quarter of 2011, the Company updated the balance of its deferred taxes as of December 31, 2011, as a result of the said changes in the tax rates in the years on which the temporary differences for which the Company recognized the deferred taxes are expected to reverse. Accordingly, the 2011 Amendment caused an increase in the deferred taxes liability of the Company as of December 31, 2011 of approximately NIS 1,248 million charged as an expense in the statement of operations and comprehensive income for the year ended on December 31, 2011.

   On August 5, 2013, the Change in National Priorities (Legislation Amendments for Achieving Budgetary Goals) 5773-2013 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%).
   As a result of the aforesaid legislation, an increase occurred in the deferred taxes provision of the Company as of December 31, 2013 in the amount of NIS 302 million which was recorded against tax expenses in the amount of approximately NIS 29 million and against other comprehensive income for the nine and three months of approximately NIS 26 million.

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.
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:

<table>
<thead>
<tr>
<th>For the Year ended December 31</th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>NIS in millions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income (loss) before income taxes</td>
<td>(808)</td>
<td>(1,298)</td>
<td>566</td>
</tr>
<tr>
<td>Statutory tax rate</td>
<td>26.5%</td>
<td>25%</td>
<td>24%</td>
</tr>
<tr>
<td>Computed tax per statutory rate</td>
<td>(214)</td>
<td>(325)</td>
<td>135</td>
</tr>
<tr>
<td>Expenses disallowed net (including depreciation)</td>
<td>12</td>
<td>8</td>
<td>7</td>
</tr>
<tr>
<td>Effect of tax law compared to adjusted statements</td>
<td>(1)</td>
<td>23</td>
<td>4</td>
</tr>
<tr>
<td>Expenses (income) arising from change in the tax rate</td>
<td>329</td>
<td>-</td>
<td>1,248</td>
</tr>
<tr>
<td>Effect of the difference between the statutory tax rate and the tax rate according to which the deferred taxes were calculated</td>
<td>-</td>
<td>-</td>
<td>5</td>
</tr>
<tr>
<td>Total income tax as presented in profit or loss</td>
<td>126</td>
<td>(294)</td>
<td>1,399</td>
</tr>
</tbody>
</table>

   g. Tax expenses (income) for income that were recognized in the statement or operations:

<table>
<thead>
<tr>
<th>As on December 31</th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>NIS in millions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase in deferred tax assets</td>
<td>(370)</td>
<td>(271)</td>
<td>(1,598)</td>
</tr>
<tr>
<td>Increase in deferred tax liabilities</td>
<td>492</td>
<td>(26)</td>
<td>2,992</td>
</tr>
<tr>
<td>Current taxes of subsidiary</td>
<td>4</td>
<td>3</td>
<td>5</td>
</tr>
<tr>
<td>Total</td>
<td>126</td>
<td>(294)</td>
<td>1,399</td>
</tr>
</tbody>
</table>

   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:

<table>
<thead>
<tr>
<th>Amount before tax</th>
<th>Tax influence</th>
<th>Amount less tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>For year ended December 31, 2011</td>
<td>(836)</td>
<td>209</td>
</tr>
<tr>
<td>For year ended December 31, 2012</td>
<td>(1,048)</td>
<td>262</td>
</tr>
<tr>
<td>For year ended December 31, 2013</td>
<td>346</td>
<td>(66)</td>
</tr>
</tbody>
</table>
NOTE 22:- INCOME TAXES (continued)

i. Deferred taxes

1) Composition of deferred tax assets:

<table>
<thead>
<tr>
<th></th>
<th>Loss carry-forward</th>
<th>Accrued vacation pay</th>
<th>Allowance for doubtful accounts and legal</th>
<th>Debt to Consumers</th>
<th>Accrued pension pay, net</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long term balance as of January 1, 2012</td>
<td>4,022</td>
<td>39</td>
<td>76</td>
<td>583</td>
<td>1,884</td>
<td>6,604</td>
</tr>
<tr>
<td>Changes during 2012</td>
<td>(432)</td>
<td>3</td>
<td>(13)</td>
<td>30</td>
<td>945</td>
<td>533</td>
</tr>
<tr>
<td>Long term balance as of December 31, 2012</td>
<td>3,590</td>
<td>42</td>
<td>63</td>
<td>613</td>
<td>2,829</td>
<td>7,137</td>
</tr>
<tr>
<td>Changes during 2013</td>
<td>297</td>
<td>7</td>
<td>58</td>
<td>95</td>
<td>(135)</td>
<td>304</td>
</tr>
<tr>
<td>Long term balance as of December 31, 2013</td>
<td>3,869</td>
<td>49</td>
<td>121</td>
<td>708</td>
<td>2,694</td>
<td>7,441</td>
</tr>
</tbody>
</table>

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:

<table>
<thead>
<tr>
<th>Adjustment of depreciable fixed assets, depreciation and other assets</th>
<th>Fuel and other inventories</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>NIS in millions</td>
<td>NIS in millions</td>
<td>NIS in millions</td>
</tr>
<tr>
<td>Balance as of December 31, 2011</td>
<td>12,037</td>
<td>170</td>
</tr>
<tr>
<td>Changes during 2012</td>
<td>121</td>
<td>(147)</td>
</tr>
<tr>
<td>Long term balance as of December 31, 2012</td>
<td>12,158</td>
<td>23</td>
</tr>
<tr>
<td>Changes during 2013</td>
<td>522</td>
<td>(30)</td>
</tr>
<tr>
<td>Long term balance as of December 31, 2013</td>
<td>12,680</td>
<td>(7)</td>
</tr>
</tbody>
</table>

3) Composition of deferred taxes balance presented in the statement of financial position:

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>NIS in millions</td>
<td></td>
</tr>
<tr>
<td>Long-term</td>
<td>12,673</td>
<td>12,181</td>
</tr>
<tr>
<td>Deferred tax reserves</td>
<td>12,673</td>
<td>12,181</td>
</tr>
<tr>
<td>Less:</td>
<td>7,441</td>
<td>7,137</td>
</tr>
<tr>
<td>Deferred tax assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advances: for disallowable deductions</td>
<td>144</td>
<td>135</td>
</tr>
<tr>
<td></td>
<td>5,088</td>
<td>4,909</td>
</tr>
</tbody>
</table>
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 2,536 million) were issued in previous years. 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.

Regarding the draft of recommendations of the steering committee that was published on March 23, 2014, see Note 1 e above.

NOTE 24: INFORMATION IN NOMINAL VALUES

a. Share Capital

Composed as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>December 31</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013</td>
</tr>
<tr>
<td></td>
<td>Authorized</td>
</tr>
<tr>
<td></td>
<td>NIS</td>
</tr>
<tr>
<td>80,167,387 Ordinary shares of NIS 0.1 par value each</td>
<td>8,016,499</td>
</tr>
<tr>
<td>(issued and paid-up - 80,164,986 Ordinary shares).............................</td>
<td></td>
</tr>
<tr>
<td>40,053,252 Ordinary &quot;B&quot; shares of NIS 0.1 par value each...</td>
<td>4,005,325</td>
</tr>
<tr>
<td>39,531 unclassified shares of NIS 0.1 par value each...</td>
<td>-</td>
</tr>
<tr>
<td>Total</td>
<td>12,021,824</td>
</tr>
</tbody>
</table>

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.

In the Company's opinion, shareholders' rights to dividends relate to the par value of the adjusted share capital.

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 shares, which represent 99.85% of the paid-up capital of the Company.
NOTE 25: CAPITAL RESERVES

<table>
<thead>
<tr>
<th>For the year ended December 31</th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>NIS in millions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital reserve according to the Securities Regulations - transactions with controlling shareholders:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>From the sale of land to the Ports and Railway Authority</td>
<td>(2)</td>
<td>(2)</td>
</tr>
<tr>
<td>From the purchase of the Coal Company</td>
<td>843</td>
<td>843</td>
</tr>
<tr>
<td>Company's assets renewal reserve (1)</td>
<td>52</td>
<td>52</td>
</tr>
<tr>
<td>Capital redemption reserve fund</td>
<td>30</td>
<td>30</td>
</tr>
<tr>
<td>Premium on shares</td>
<td>36</td>
<td>36</td>
</tr>
<tr>
<td>Reserves from disposal of assets</td>
<td>1,030</td>
<td>1,030</td>
</tr>
<tr>
<td>Remeasurement fund</td>
<td>(1,025)</td>
<td>(1,305)</td>
</tr>
</tbody>
</table>

(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.

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.
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 371 million (after an update with respect to the restatements, the calculated sum would have amounted to approximately NIS 567 million). The amount of dividends for 2009 is NIS 806 million (after an update with respect to the restatements, the calculated sum would have amounted to approximately NIS 872 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. The Company did not distribute a dividend since 2004. See details in section f below.
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 financial 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 it does not intend to require the Company to appropriate dividends with respect to 2009, in 2012.

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 833 million, in 2012 the Company recorded a loss of NIS 1,004 million, and in 2013 the Company recorded a loss of NIS 936 million.

g. Regarding the draft of recommendations of the steering committee that was published on March 23, 2014, see Note 1 e above.
### NOTE 27:  FINANCIAL INSTRUMENTS

#### a. Groups of Financial Instruments

<table>
<thead>
<tr>
<th>Financial Instruments</th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financial Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>3,401</td>
<td>4,226</td>
</tr>
<tr>
<td>Short term investments</td>
<td>493</td>
<td>-</td>
</tr>
<tr>
<td>Trade receivables for sales of electricity</td>
<td>4,732</td>
<td>4,127</td>
</tr>
<tr>
<td>Hedge transactions</td>
<td>-</td>
<td>98</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>326</td>
<td>393</td>
</tr>
<tr>
<td>Long term receivables</td>
<td>790</td>
<td>982</td>
</tr>
<tr>
<td><strong>Total Financial Assets</strong></td>
<td>9,742</td>
<td>9,826</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Financial Liabilities</strong></th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade and other accounts payable</td>
<td>3,468</td>
<td>3,589</td>
</tr>
<tr>
<td>Hedge transactions</td>
<td>2,810</td>
<td>884</td>
</tr>
<tr>
<td>Financial liabilities</td>
<td>45,523</td>
<td>48,908</td>
</tr>
<tr>
<td>Debentures to the State of Israel</td>
<td>2,536</td>
<td>2,534</td>
</tr>
<tr>
<td>Liabilities to the State of Israel</td>
<td>2,878</td>
<td>3,432</td>
</tr>
<tr>
<td><strong>Total Financial Liabilities</strong></td>
<td>57,215</td>
<td>59,347</td>
</tr>
</tbody>
</table>


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.
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 with respect to its financial liabilities and accounts payable, including payments to fuel suppliers.
       The Company's policies in executing hedging transactions up to the end of 2013 were as follows:
       1) The swap transactions will be undertaken for a period of at least one year. As a rule, transactions will be entered into to cover at least 85% of the remaining exposure so that the exposure amount for each currency will not exceed a cumulative 15% of the balance of loans in same currency.
       2) As for the balance of the Company's exposure for liabilities in foreign currency (after the adoption of section (a) above), the Company will enter hedging transactions (mainly swap and forward transactions) and, should the market conditions justify it, in order to reduce its foreign currency exposure.
       3) The swap transactions will be performed for a period of at least one year while taking into consideration the inflation rates in Israel and the Western countries and the interest rates in the capital markets.
       4) The Company will consider executing hedging transactions to decentralize the exposure to interest in foreign currency on the unprotected part (variable/fixed interest) aiming to reduce exposure to increase in interest rates, if market conditions indicate it is worthwhile to execute them.

At the end of 2013, the Company updated the policies of handling the currency risk and the variable interest. Within the update, it was determined that:

(1) The Company will execute hedging transactions in foreign currency in order to reduce the 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.

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 foreign currency sensitivity

(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)

e) Analysis of foreign currency sensitivity (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 Bond that corresponds to the life span of that debenture, and the risk-free interest according to the return on Treasury Bond 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, which are built according to their liability channels and guarantees given to the lenders.

(b) Loans in Foreign Currency

Loans in U.S. Dollar are revalued on the basis of the interest on U.S.A. Treasury Bond 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. Dollar through the SWPM function in Bloomberg system.

Fair Value

The change in the capitalization rates for obligations in NIS derives mainly from the use of individual price quotes of the non-negotiable debentures of the Company according to the model of Mirvach Hogen Ltd. which is based on dividing the negotiable market to tenths according to the yield to maturity on the loan and determining the place of the non-negotiable loan in those tenths according to the risk premium derived from the price of transactions/issuances in the non-negotiable market. This model expresses in a more up to date way the changes in the risk premium of the debt as reflected in the negotiable market, according to changes in the related tenth. These individual quotes come instead of the interest vector according to the Company rating, previously used by the Company, provided by Shaarey Ribit Ltd., which provided these quotes to institutional organizations up to the transition date, with the addition of the increment according to the results gained by the Company in the last issue.

The change in the discount rates for liabilities in foreign currency derives mainly from the use of individual price quotes provided by Bloomberg system of debentures issued by the Company abroad. These individual quotes come instead of rates of return on debentures issued by the Company with the addition of the initial issuance premium, previously used by the Company.
### FINANCIAL INSTRUMENTS (continued)

#### 1) Currency risk (continued)

**e) Analysis of foreign currency sensitivity**

#### Fair Value (continued)

(3) As of December 31, 2013

<table>
<thead>
<tr>
<th>Market factor: Dollar</th>
<th>Loss (profit) from increase in market factor</th>
<th>Fair value</th>
<th>Loss (profit) from decrease in market factor</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>-5%</td>
<td>-10%</td>
<td></td>
</tr>
<tr>
<td><strong>Financial assets:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Receivables</td>
<td>(20)</td>
<td>(10)</td>
<td>197</td>
</tr>
<tr>
<td></td>
<td>(75)</td>
<td>(37)</td>
<td>746</td>
</tr>
<tr>
<td>Long term receivables</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(75)</td>
<td>(37)</td>
<td>746</td>
</tr>
<tr>
<td><strong>Financial liabilities:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short term loans</td>
<td>17</td>
<td>9</td>
<td>170</td>
</tr>
<tr>
<td></td>
<td>(9)</td>
<td>(17)</td>
<td></td>
</tr>
<tr>
<td>Payables</td>
<td>81</td>
<td>41</td>
<td>810</td>
</tr>
<tr>
<td></td>
<td>(41)</td>
<td>(81)</td>
<td></td>
</tr>
<tr>
<td>Loans and debentures</td>
<td>2,158</td>
<td>1,079</td>
<td>21,583</td>
</tr>
<tr>
<td></td>
<td>(1,079)</td>
<td>(2,158)</td>
<td></td>
</tr>
<tr>
<td><strong>Swap transactions:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NIS - Dollar swap</td>
<td>(51)</td>
<td>(25)</td>
<td>311*</td>
</tr>
<tr>
<td></td>
<td>(1,197)</td>
<td>(599)</td>
<td>1,408*</td>
</tr>
<tr>
<td>NIS linked - Dollar swap</td>
<td>(1,197)</td>
<td>(599)</td>
<td>1,408*</td>
</tr>
<tr>
<td><strong>Forward transactions:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NIS - Dollar forward</td>
<td>(6)</td>
<td>(3)</td>
<td>3*</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>3</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>907</td>
<td>455</td>
<td>23,342</td>
</tr>
<tr>
<td></td>
<td>(455)</td>
<td>(907)</td>
<td></td>
</tr>
</tbody>
</table>

* The sensitivity calculation is only performed for the Dollar denominated leg.

<table>
<thead>
<tr>
<th>Market factor: Euro</th>
<th>Loss (profit) from increase in market factor</th>
<th>Fair value</th>
<th>Loss (profit) from decrease in market factor</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>-5%</td>
<td>-10%</td>
<td></td>
</tr>
<tr>
<td><strong>Financial liabilities:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payables</td>
<td>16</td>
<td>8</td>
<td>159</td>
</tr>
<tr>
<td></td>
<td>(8)</td>
<td>(16)</td>
<td></td>
</tr>
<tr>
<td>Loans and debentures</td>
<td>236</td>
<td>118</td>
<td>2,359</td>
</tr>
<tr>
<td></td>
<td>(118)</td>
<td>(236)</td>
<td></td>
</tr>
<tr>
<td><strong>Swap transactions:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NIS linked - Euro swap</td>
<td>(97)</td>
<td>(49)</td>
<td>85*</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>49</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>97</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>155</td>
<td>77</td>
<td>2,603</td>
</tr>
<tr>
<td></td>
<td>(77)</td>
<td>(155)</td>
<td></td>
</tr>
</tbody>
</table>

* The sensitivity calculation is only performed for the Euro leg.
NOTE 27:- FINANCIAL INSTRUMENTS (continued)

c. Market Risk (continued)

1) Currency risk (continued)

e) Analysis of foreign currency sensitivity (continued)

Fair Value (continued)

(3) As of December 31, 2013 (continued)

<table>
<thead>
<tr>
<th>Market factor: Yen</th>
<th>Loss (profit) from increase in market factor</th>
<th>Fair value</th>
<th>Loss (profit) from decrease in market factor</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>+10%</td>
<td>+5%</td>
<td>-5%</td>
</tr>
<tr>
<td>Financial assets:</td>
<td>NIS in millions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payables</td>
<td>2</td>
<td>1</td>
<td>21</td>
</tr>
<tr>
<td>Loans and debentures</td>
<td>228</td>
<td>114</td>
<td>2,277</td>
</tr>
<tr>
<td>Swap transactions:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NIS linked - Yen swap</td>
<td>(238)</td>
<td>(119)</td>
<td>1,003*</td>
</tr>
<tr>
<td>Total</td>
<td>(8)</td>
<td>(4)</td>
<td>3,301</td>
</tr>
</tbody>
</table>

* The sensitivity calculation is only performed for the Yen leg.

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 on 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 above).

3. The disclosure does not take into account the possible change in the risk coefficient due to change of rate of exchange.
NOTE 2:

FINANCIAL INSTRUMENTS (continued)

c. Market Risk (continued)

1) Currency risk (continued)

e) Analysis of foreign currency sensitivity (continued)

Fair Value (continued)

(4) As of December 31, 2012

<table>
<thead>
<tr>
<th>Market factor: Dollar</th>
<th>Loss (profit) from increase in market factor</th>
<th>Fair value</th>
<th>Loss (profit) from decrease in market factor</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>NIS in millions</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>+10%</td>
<td>+5%</td>
<td>-5%</td>
</tr>
<tr>
<td>Financial assets:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Receivables</td>
<td>(2)</td>
<td>(1)</td>
<td>(24)</td>
</tr>
<tr>
<td>Long term receivables</td>
<td>(87)</td>
<td>(44)</td>
<td>(875)</td>
</tr>
<tr>
<td>Financial liabilities:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short term loans</td>
<td>61</td>
<td>30</td>
<td>609</td>
</tr>
<tr>
<td>Payables</td>
<td>120</td>
<td>60</td>
<td>1,201</td>
</tr>
<tr>
<td>Loans and debentures</td>
<td>1,788</td>
<td>894</td>
<td>17,876</td>
</tr>
<tr>
<td>Swap transactions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Euro-Dollar swap</td>
<td>4</td>
<td>2</td>
<td>20*</td>
</tr>
<tr>
<td>NIS - Dollar swap</td>
<td>(71)</td>
<td>(35)</td>
<td>146*</td>
</tr>
<tr>
<td>NIS linked - Dollar swap</td>
<td>(1,064)</td>
<td>(532)</td>
<td>163*</td>
</tr>
<tr>
<td>Pound Sterling - Dollar swap</td>
<td>(15)</td>
<td>(8)</td>
<td>(1)</td>
</tr>
<tr>
<td>Financial liabilities:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payables</td>
<td>9</td>
<td>4</td>
<td>89</td>
</tr>
<tr>
<td>Loans and debentures</td>
<td>226</td>
<td>113</td>
<td>2,261</td>
</tr>
<tr>
<td>Swap transactions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dollar - Euro swap</td>
<td>(2)</td>
<td>(1)</td>
<td>20*</td>
</tr>
<tr>
<td>NIS linked - Dollar swap</td>
<td>(133)</td>
<td>(66)</td>
<td>37*</td>
</tr>
<tr>
<td>Forward transactions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NIS - Dollar</td>
<td>(29)</td>
<td>(15)</td>
<td>8*</td>
</tr>
<tr>
<td>Yen - Dollar</td>
<td>12</td>
<td>6</td>
<td>9*</td>
</tr>
<tr>
<td>Total</td>
<td>717</td>
<td>357</td>
<td>19,132</td>
</tr>
</tbody>
</table>

* The sensitivity calculation is only performed for the Dollar denominated leg.

<table>
<thead>
<tr>
<th>Market factor: Euro</th>
<th>Loss (profit) from increase in market factor</th>
<th>Fair value</th>
<th>Loss (profit) from decrease in market factor</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>NIS in millions</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>+10%</td>
<td>+5%</td>
<td>-5%</td>
</tr>
<tr>
<td>Financial assets:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Receivables</td>
<td>(3)</td>
<td>(2)</td>
<td>(31)</td>
</tr>
<tr>
<td>Financial liabilities:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payables</td>
<td>9</td>
<td>4</td>
<td>89</td>
</tr>
<tr>
<td>Loans and debentures</td>
<td>226</td>
<td>113</td>
<td>2,261</td>
</tr>
<tr>
<td>Swap transactions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dollar - Euro swap</td>
<td>(2)</td>
<td>(1)</td>
<td>20*</td>
</tr>
<tr>
<td>NIS linked - Dollar swap</td>
<td>(133)</td>
<td>(66)</td>
<td>37*</td>
</tr>
<tr>
<td>Forward transactions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NIS - Euro</td>
<td>13</td>
<td>6</td>
<td>(2)*</td>
</tr>
<tr>
<td>Total</td>
<td>110</td>
<td>54</td>
<td>2,374</td>
</tr>
</tbody>
</table>

* The sensitivity calculation is only performed for the Dollar denominated leg.
NOTE 27: FINANCIAL INSTRUMENTS (continued)

1) Currency risk (continued)

e) Analysis of foreign currency sensitivity (continued)

Fair Value (continued)

(4) As of December 31, 2012 (continued)

<table>
<thead>
<tr>
<th>Market factor: Yen</th>
<th>Loss (profit) from increase in market factor NIS in millions</th>
<th>Fair value NIS in millions</th>
<th>Loss (profit) from decrease in market factor</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>+10%</td>
<td>+5%</td>
<td>-5%</td>
</tr>
<tr>
<td>Financial assets:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payables</td>
<td>3</td>
<td>1</td>
<td>27</td>
</tr>
<tr>
<td>Loans and debentures</td>
<td>277</td>
<td>139</td>
<td>2,771</td>
</tr>
<tr>
<td>Swap transactions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NIS linked - Yen swap</td>
<td>(294)</td>
<td>(147)</td>
<td>322*</td>
</tr>
<tr>
<td>Forward transactions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dollar - Yen</td>
<td>(11)</td>
<td>(6)</td>
<td>9*</td>
</tr>
<tr>
<td>Total</td>
<td>(25)</td>
<td>(13)</td>
<td>3,129</td>
</tr>
</tbody>
</table>

* The sensitivity calculation is only performed for the Dollar denominated leg.

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).
3. The disclosure does not take into account the possible change in the risk coefficient due to change of rate of exchange.

2) Cash flow risk with respect to of interest rates

The Company is exposed to the difference between the interest recognized in the rate base (in foreign currency and in NIS) and on loans, which changes only once a year on the annual update of the rate and the actual interest rates (in foreign currency and in NIS) with respect to its financial liabilities. Therefore, the Company is also exposed to changes in the accepted interest rates in the market, mainly in connection to loans borrowed, which bear variable interest. The Company considers entering hedging transactions to spread the exposure to interest in foreign currency (variable/ fixed interest), used to reduce exposure to increase in interest rates, if market conditions will indicate its feasibility.

Changing trends of the variable interest rates are monitored constantly and the Company decides to enter IRS transactions to reduce exposure to the risk of an increase in interest rates.

Interest rate risk of the Company is mainly derived from long term loans.

Changing interest rates risks are not material to the cash flow of the Company.
3) **Risk according to Fair Value with respect to interest rates**

Loans bearing fixed interest rates expose the Company to interest rate risk from fair value.

**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.

**Sensitivity Analysis according to Fair Value**

a) As of December 31, 2013

<table>
<thead>
<tr>
<th>Change in currency rate in %</th>
<th>Increase of 200 base points*</th>
<th>+10%</th>
<th>+5%</th>
<th>Fair Value</th>
<th>-5%</th>
<th>-10%</th>
<th>Decrease of 200 base points*</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financial assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long term receivables</td>
<td>90</td>
<td>6</td>
<td>3</td>
<td>(817)</td>
<td>(3 )</td>
<td>(5 )</td>
<td>(108)</td>
</tr>
<tr>
<td>Financial liabilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long term loans at fixed interest rate</td>
<td>(379)</td>
<td>(76)</td>
<td>(38)</td>
<td>7,927</td>
<td>39</td>
<td>79</td>
<td>404</td>
</tr>
<tr>
<td>Long term loans at variable interest rate</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>5,306</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Negotiable debentures</td>
<td>173</td>
<td>2</td>
<td>1</td>
<td>6,448</td>
<td>(1 )</td>
<td>(1 )</td>
<td>146</td>
</tr>
<tr>
<td>Non-negotiable debentures</td>
<td>(2,963)</td>
<td>(679)</td>
<td>(353)</td>
<td>33,221</td>
<td>327</td>
<td>680</td>
<td>3,310</td>
</tr>
<tr>
<td>Debentures to the State of Israel</td>
<td>(498)</td>
<td>(188)</td>
<td>(98)</td>
<td>2,077</td>
<td>110</td>
<td>231</td>
<td>957</td>
</tr>
<tr>
<td>Swap transactions</td>
<td>(315)</td>
<td>3</td>
<td>34</td>
<td>2,807</td>
<td>(35)</td>
<td>(70)</td>
<td>371</td>
</tr>
<tr>
<td>Forward transactions</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>3</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>(4,238)</td>
<td>(932)</td>
<td>(451)</td>
<td>56,972</td>
<td>437</td>
<td>914</td>
<td>5,080</td>
</tr>
</tbody>
</table>
c. Market Risk (continued)

3) Risk according to Fair Value with respect to interest rates (continued)

Sensitivity Analysis according to Fair Value (continued)

b) As of December 31, 2012

<table>
<thead>
<tr>
<th>Change in currency rate in %</th>
<th>Increase of 200 base points*</th>
<th>+10%</th>
<th>+5%</th>
<th>(Profit) loss from increase in market factor</th>
<th>Fair Value</th>
<th>(Profit) loss from decrease in market factor</th>
<th>Decrease of 200 base points*</th>
</tr>
</thead>
<tbody>
<tr>
<td>NIS in millions</td>
<td></td>
<td></td>
<td></td>
<td>(Profit) loss from increase in market factor</td>
<td></td>
<td>(Profit) loss from decrease in market factor</td>
<td></td>
</tr>
<tr>
<td><strong>Financial assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long term receivables</td>
<td>128</td>
<td>11</td>
<td>5</td>
<td>(961)</td>
<td>(6)</td>
<td>(11)</td>
<td>(159)</td>
</tr>
<tr>
<td>Financial liabilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long term loans at fixed interest rate</td>
<td>(501)</td>
<td>(105)</td>
<td>(53)</td>
<td>7,798</td>
<td>54</td>
<td>109</td>
<td>559</td>
</tr>
<tr>
<td>Long term loans at variable interest rate</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>3,548</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Negotiable debentures</td>
<td>(340)</td>
<td>(17)</td>
<td>(8)</td>
<td>11,601</td>
<td>8</td>
<td>16</td>
<td>177</td>
</tr>
<tr>
<td>Non-negotiable debentures</td>
<td>(2,832)</td>
<td>(767)</td>
<td>(395)</td>
<td>32,321</td>
<td>388</td>
<td>798</td>
<td>3,363</td>
</tr>
<tr>
<td>Debentures to the State of Israel</td>
<td>(532)</td>
<td>(198)</td>
<td>(104)</td>
<td>2,174</td>
<td>114</td>
<td>241</td>
<td>1,044</td>
</tr>
<tr>
<td>Swap transactions</td>
<td>138</td>
<td>(111)</td>
<td>(120)</td>
<td>771</td>
<td>(138)</td>
<td>(147)</td>
<td>(553)</td>
</tr>
<tr>
<td>Forward transactions</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>15</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>(3,939)</td>
<td>(1,187)</td>
<td>(675)</td>
<td>57,267</td>
<td>420</td>
<td>1,006</td>
<td>4,431</td>
</tr>
</tbody>
</table>

* 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.
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 and stress conditions without incurring unnecessary loss or affecting its reputation.

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.

1) Liquidity Risk as of December 31, 2013 (continued)

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.

<table>
<thead>
<tr>
<th>First year</th>
<th>Second year</th>
<th>Third year</th>
<th>Fourth year</th>
<th>Fifth year</th>
<th>Sixth onwards</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>NIS millions</td>
<td>Cash and cash equivalents</td>
<td>3,401</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Short term investments</td>
<td>493</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Trade receivables</td>
<td>4,345</td>
<td>144</td>
<td>144</td>
<td>99</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Other receivables</td>
<td>205</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Loans in Dollars</td>
<td>84</td>
<td>64</td>
<td>64</td>
<td>62</td>
<td>58</td>
<td>469</td>
</tr>
<tr>
<td>Loans in Linked NIS</td>
<td>9</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Unlinked Loans</td>
<td>28</td>
<td>16</td>
<td>13</td>
<td>9</td>
<td>7</td>
<td>13</td>
</tr>
<tr>
<td>Total financial assets</td>
<td>121</td>
<td>80</td>
<td>77</td>
<td>71</td>
<td>65</td>
<td>482</td>
</tr>
<tr>
<td>Derivative Financial Instruments, net</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Swap transactions Net:

| In Euro | 476 | 388 | 55 | (54) | - | - | (973) |
| In US Dollars | 622 | (599) | (1,242) | (1,986) | (1,135) | (6,899) | (12,483) |
| In Yen | 34 | (391) | (202) | (30) | (30) | (1,689) | (2,376) |
| In linked NIS | 1,157 | 1,537 | 1,623 | 2,306 | 1,289 | 9,907 | 17,819 |
| Unlinked | - | - | - | - | - | 820 | 820 |
| Total swap transactions: | 25 | 159 | 124 | 236 | 236 | 1,139 | 2,807 |

Forward transactions Net:

| Loans in US Dollars | (64) | - | - | - | - | - | (64) |
| Loans in unlinked NIS | 67 | - | - | - | - | - | 67 |
| Total forward transactions | 3 | - | - | - | - | - | 3 |

| Total derivatives | 28 | 159 | 124 | 236 | 124 | 2,139 | 2,810 |
### Financial Instruments (continued)

#### Liquidity Risk (continued)

1. **Liquidity Risk as of December 31, 2013 (continued)**

<table>
<thead>
<tr>
<th>Financial Liabilities</th>
<th>First year</th>
<th>Second year</th>
<th>Third year</th>
<th>Fourth year</th>
<th>Fifth year</th>
<th>Sixth onwards</th>
<th>Total</th>
<th>Effective Interest rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade payables</td>
<td>1,726</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1,726</td>
<td></td>
</tr>
<tr>
<td>Accounts payable and accruals</td>
<td>1,742</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1,742</td>
<td></td>
</tr>
<tr>
<td>Short term loans</td>
<td>187</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>187</td>
<td></td>
</tr>
</tbody>
</table>

| Debentures             |            |             |             |             |             |               |       |                       |
| Debentures in US Dollars | 1,046 | 1,046 | 1,046 | 2,722 | 4,752 | 14,462 | 25,074 | 2.1-9.8 |
| Debentures in Yen      | 96         | 96          | 96         | 96          | 96         | 3,518        | 3,998 | 3.7-4.3 |
| Debentures in linked NIS | 3,829 | 5,167 | 2,098 | 2,953 | 1,377 | 5,362 | 20,786 | 1.1-7.1 |
| Unlinked debentures    | 56         | 56          | 56         | 647         | 72         | -            | 887   | 6.6-7.4 |
| Total                  | 5,027      | 6,365       | 3,296      | 6,418       | 6,297      | 23,342       | 50,745 |                       |

| Debitures to the State of Israel in Linked NIS | 132 | 132 | 132 | 132 | 1,876 | 2,536 | 5.1-5.8 |

| Liabilities to banking corporations: |            |             |             |             |             |               |       |                       |
| Loans in Euro              | 431        | 393         | 375         | 369         | 172         | 777           | 2,517 | 1.01-4.69 |
| Loans in US Dollars        | 96         | 105         | 103         | 103         | 102         | 660           | 1,169 | 1.04-4.74 |
| Loans in linked NIS        | 1,157      | 61          | 61          | 13          | 13          | 304           | 1,609 | 0.2-5.7  |
| Unlinked loans             | 2,070      | 2,435       | 6           | 6           | 6           | 259           | 4,782 | 2.0-3.1  |
| Total                     | 3,754      | 2,994       | 545         | 491         | 293         | 2,000         | 10,077 |                       |

| Loans from the State of Israel in $ | 471       | 469        | 465        | 461        | 458        | 2,032         | 4,356 | 7.1-8.1 |

| Other Liabilities |            |             |             |             |             |               |       |                       |
| Other liabilities in linked NIS | 2 | 1 | 2 | 2 | 2 | 11 | 20 | 4.50 |
| Other liabilities in non-linked NIS | - | - | - | - | - | - | - | |
| Other liabilities in Euro | - | - | - | - | - | - | 46 | 46 |
| Other liabilities in Dollars | - | - | - | - | - | - | 69 | 69 |
| Total other liabilities | 2 | 1 | 2 | 2 | 2 | 141 | 150 | |

| Total Financial Liabilities | 13,041 | 9,961 | 4,440 | 7,504 | 7,182 | 29,391 | 71,519 | |

---

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### NOTE 27: FINANCIAL INSTRUMENTS (continued)
#### d. Liquidity Risk (continued)

#### 2) Liquidity Risk as of December 31, 2012

<table>
<thead>
<tr>
<th></th>
<th>First year</th>
<th>Second year</th>
<th>Third year</th>
<th>Fourth year</th>
<th>Fifth year</th>
<th>Sixth onwards</th>
<th>Total</th>
</tr>
</thead>
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<tr>
<td><strong>Financial Assets</strong></td>
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<td>Cash and cash equivalents</td>
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<tr>
<td>Trade receivables</td>
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<td>4,127</td>
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<tr>
<td>Other receivables</td>
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<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>250</td>
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<tr>
<td><strong>Long-term receivables</strong></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans in Dollars</td>
<td>68</td>
<td>64</td>
<td>65</td>
<td>66</td>
<td>62</td>
<td>707</td>
<td>1,032</td>
</tr>
<tr>
<td>Loans in Linked NIS</td>
<td>8</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>8</td>
</tr>
<tr>
<td>Unlinked Loans</td>
<td>30</td>
<td>19</td>
<td>12</td>
<td>8</td>
<td>5</td>
<td>10</td>
<td>85</td>
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<td></td>
<td><strong>106</strong></td>
<td><strong>83</strong></td>
<td><strong>77</strong></td>
<td><strong>74</strong></td>
<td><strong>67</strong></td>
<td><strong>717</strong></td>
<td><strong>1,125</strong></td>
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<td><strong>Total financial assets</strong></td>
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<td><strong>83</strong></td>
<td><strong>77</strong></td>
<td><strong>74</strong></td>
<td><strong>67</strong></td>
<td><strong>717</strong></td>
<td><strong>9,728</strong></td>
</tr>
</tbody>
</table>

| **Derivative Financial Instruments, net** | | | | | | | |
| Swap transactions Net: |            |             |            |             |            |               |           |
| In Euro               | (367)      | (492)       | (376)      | (51)        | (50)       | -             | (1,336)   |
| In US Dollars         | (574)      | (491)       | (463)      | (1,263)     | (1,861)    | (6,805)       | (11,457)  |
| In Yen                | (43)       | (43)        | (501)      | (240)       | (38)       | (2,073)       | (2,938)   |
| In other foreign currency | (4)       | -           | -          | -           | -          | -             | (4)       |
| Linked NIS            | 1,036      | 988         | 1,308      | 1,523       | 2,032      | 8,767         | 15,654    |
| Unlinked              | -          | -           | -          | -           | -          | -             | 852       |
|                     | **15**     | **83**      | **31**     | **83**      | **741**    | **786**       |           |

| Forward transactions Net: | | | | | | | |
| Loans in Euro           | 125        | -           | -          | -           | -          | -             | 125       |
| Loans in US Dollars     | (168)      | -           | -          | -           | -          | -             | (168)     |
| Loans in Yen            | (114)      | -           | -          | -           | -          | -             | (114)     |
| Loans in unlinked NIS   | 172        | -           | -          | -           | -          | -             | 172       |
|                     | **15**     | **83**      | **31**     | **83**      | **741**    | **786**       |           |

**Total derivatives** | **63** | **(38)**  | **(32)**  | **(31)**  | **83**  | **741**  | **786**  |
### Note 27: Financial Instruments (continued)
#### d. Liquidity Risk (continued)

#### 2) Liquidity Risk as of December 31, 2012 (continued)

<table>
<thead>
<tr>
<th></th>
<th>First year</th>
<th>Second year</th>
<th>Third year</th>
<th>Fourth year</th>
<th>Fifth year</th>
<th>Sixth onwards</th>
<th>Total</th>
<th>Effective Interest rate</th>
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<td></td>
<td>NIS millions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Trade payables</td>
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<td>-</td>
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<td>Accounts payable and accruals</td>
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<td>-</td>
<td>-</td>
<td>-</td>
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<td>1,581</td>
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<tr>
<td>Short term loans</td>
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<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td></td>
<td>744</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Debentures</strong></td>
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<td></td>
<td></td>
<td></td>
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<tr>
<td>Debentures in US Dollars</td>
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<td>817</td>
<td>817</td>
<td>817</td>
<td>2,652</td>
<td>14,706</td>
<td>20,627</td>
<td>2.3-9.8</td>
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<td>Debentures in Yen</td>
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<td>128</td>
<td>128</td>
<td>128</td>
<td>4,822</td>
<td>5,576</td>
<td>11,498</td>
<td>0.3-4.3</td>
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<tr>
<td>Debentures in linked NIS</td>
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<td>3,826</td>
<td>5,163</td>
<td>2,096</td>
<td>2,951</td>
<td>6,735</td>
<td>25,317</td>
<td>1.1-7.1</td>
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<td>Unlinked debentures</td>
<td>4,982</td>
<td>57</td>
<td>57</td>
<td>57</td>
<td>659</td>
<td>72</td>
<td>5,884</td>
<td>6.6-7.5</td>
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<td><strong>Total</strong></td>
<td>10,588</td>
<td>4,828</td>
<td>6,165</td>
<td>3,098</td>
<td>6,390</td>
<td>26,335</td>
<td>57,404</td>
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<tr>
<td><strong>Debentures to the State of Israel in Linked NIS</strong></td>
<td>132</td>
<td>132</td>
<td>132</td>
<td>132</td>
<td>1,874</td>
<td>2,534</td>
<td>5-5.75</td>
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<td><strong>Liabilities to banking corporations:</strong></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans in Euro</td>
<td>479</td>
<td>409</td>
<td>347</td>
<td>326</td>
<td>320</td>
<td>462</td>
<td>2,343</td>
<td>0.7-5.6</td>
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<tr>
<td>Loans in US Dollars</td>
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<td>62</td>
<td>60</td>
<td>61</td>
<td>60</td>
<td>434</td>
<td>991</td>
<td>1.2-8.1</td>
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<td>1,156</td>
<td>61</td>
<td>60</td>
<td>13</td>
<td>317</td>
<td>1,761</td>
<td>0.6-5.7</td>
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<td>8</td>
<td>8</td>
<td>275</td>
<td>2,425</td>
<td>2.7-3.3</td>
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<td><strong>Total</strong></td>
<td>1,004</td>
<td>3,696</td>
<td>476</td>
<td>455</td>
<td>401</td>
<td>1,488</td>
<td>7,520</td>
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<td><strong>Loans from the State Of Israel in $</strong></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Liabilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other liabilities in linked NIS</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>16</td>
<td>27</td>
<td>4.50</td>
</tr>
<tr>
<td>Other liabilities payable in non-linked NIS</td>
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<td>-</td>
<td>-</td>
<td>-</td>
<td></td>
<td>12</td>
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</tr>
<tr>
<td>Other liabilities payable in Dollar</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td></td>
<td>35</td>
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<tr>
<td><strong>Total other liabilities</strong></td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>136</td>
<td>147</td>
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<tr>
<td><strong>Total Financial Liabilities</strong></td>
<td>16,579</td>
<td>9,174</td>
<td>7,288</td>
<td>4,196</td>
<td>7,431</td>
<td>32,560</td>
<td>77,228</td>
<td></td>
</tr>
</tbody>
</table>
Credit Risk Management

Credit risk is a risk of financial loss incurred by the Company if a customer or the other side 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 is 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's.

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, 2013 are:

1) Local guarantees in Israel

   a) A guarantee in the approximate amount of NIS 19 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 35 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 54 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, 2013, amounts to approximately NIS 475 million.

   b) Total balance of guarantees to parties abroad in the form of conditional bank guarantees and letters of credit as on December 31, 2013, amounts to approximately NIS 147 million.

Total letters of credit and guarantees as on December 31, 2013 amount to approximately NIS 676 million.
NOTE 27:-  FINANCIAL INSTRUMENTS (Continued)

f.  Linkage Basis Report

<table>
<thead>
<tr>
<th>Assets</th>
<th>Linkage to US$</th>
<th>Linkage to Euro</th>
<th>Linkage to Japanese Yen</th>
<th>Linkage to CPI</th>
<th>Un-linked</th>
<th>Non-financial</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and cash equivalents</td>
<td>3</td>
<td>-</td>
<td>-</td>
<td>3,398</td>
<td>-</td>
<td>3,401</td>
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<tr>
<td>Short term investments</td>
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<td>-</td>
<td>493</td>
<td>-</td>
<td>493</td>
<td></td>
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<tr>
<td>Trade receivables for sale of electricity</td>
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<td>-</td>
<td>4,345</td>
<td>-</td>
<td>4,345</td>
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<td>Accounts receivable</td>
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<td>-</td>
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<td>51</td>
<td>377</td>
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<td>Inventory- fuel</td>
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<td>144</td>
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<td>Regulatory assets, net</td>
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<td>-</td>
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<td>2,972</td>
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<tr>
<td>Long term inventory - fuel</td>
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<td>-</td>
<td>-</td>
<td>1,736</td>
<td>1,736</td>
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</tr>
<tr>
<td>Long term receivables</td>
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<td>-</td>
<td>-</td>
<td>459</td>
<td>1</td>
<td>1,178</td>
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<td>Investment in an included company</td>
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<td>98</td>
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<td>Long term regulatory assets</td>
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<td>-</td>
<td>-</td>
<td>-</td>
<td>696</td>
<td>696</td>
<td></td>
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<tr>
<td>Assets with respect to benefits after employment termination</td>
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<td>-</td>
<td>-</td>
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<td>3,748</td>
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<tr>
<td>Fixed assets, net</td>
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<tr>
<td>Intangible assets, net</td>
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<td>-</td>
<td>-</td>
<td>948</td>
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<td></td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>978</strong></td>
<td><strong>2</strong></td>
<td><strong>-</strong></td>
<td><strong>8,762</strong></td>
<td><strong>76,182</strong></td>
<td><strong>85,924</strong></td>
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</table>
### Linkage Basis Report (continued)

#### Liabilities

<table>
<thead>
<tr>
<th></th>
<th>Linkage to US$</th>
<th>Linkage to Euro</th>
<th>Linkage to Japanese Yen</th>
<th>Linkage to CPI</th>
<th>Un-linked</th>
<th>Non-financial</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short term debentures and credit from banks and other credit providers (***)</td>
<td>498</td>
<td>398</td>
<td>-</td>
<td>4,087</td>
<td>2,014</td>
<td>93</td>
<td>7,090</td>
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<td>Forward and interest transactions</td>
<td>(64)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>67</td>
<td>-</td>
<td>3</td>
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<tr>
<td>Current maturities currency swap transactions</td>
<td>(622)</td>
<td>(476)</td>
<td>(34)</td>
<td>1,157</td>
<td>-</td>
<td>-</td>
<td>25</td>
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<td>Trade payables</td>
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<td>-</td>
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<td>1,092</td>
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<td>1,726</td>
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<td>21</td>
<td>446</td>
<td>940</td>
<td>-</td>
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<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>730</td>
<td>730</td>
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<td>Advances from work orders less works in progress</td>
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<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>398</td>
<td>398</td>
</tr>
<tr>
<td>Debentures, liabilities to banks and others (***)</td>
<td>16,202</td>
<td>2,007</td>
<td>2,480</td>
<td>14,515</td>
<td>3,322</td>
<td>725</td>
<td>39,251</td>
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<td>Hedging transactions summary</td>
<td>(12,483)</td>
<td>(973)</td>
<td>(2,376)</td>
<td>17,819</td>
<td>820</td>
<td>-</td>
<td>2,807</td>
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<td>Classification of hedging transactions into assets and/or current maturities</td>
<td>622</td>
<td>476</td>
<td>34</td>
<td>(1,157)</td>
<td>-</td>
<td>-</td>
<td>(25)</td>
</tr>
<tr>
<td>Liabilities due to long term currency swap transactions, net</td>
<td>(11,861)</td>
<td>(497)</td>
<td>(2,342)</td>
<td>16,662</td>
<td>820</td>
<td>-</td>
<td>2,782</td>
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<td>Liability to the State of Israel</td>
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<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>(22)</td>
<td>2,856</td>
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<td>Liabilities with respect to benefits after employment termination</td>
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<td>-</td>
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<td>2,924</td>
<td>2,924</td>
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<tr>
<td>Regulatory liabilities, net</td>
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<td>-</td>
<td>-</td>
<td>-</td>
<td>1,397</td>
<td>1,397</td>
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<tr>
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<td>-</td>
<td>-</td>
<td>2,565</td>
<td>2,565</td>
</tr>
<tr>
<td>Deferred taxes, net</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>9,088</td>
<td>5,088</td>
<td></td>
</tr>
<tr>
<td>Shareholders Equity</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>14,811</td>
<td>14,811</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>7,841</strong></td>
<td><strong>1,591</strong></td>
<td><strong>125</strong></td>
<td><strong>39,403</strong></td>
<td><strong>8,255</strong></td>
<td><strong>28,709</strong></td>
<td><strong>85,924</strong></td>
</tr>
<tr>
<td><strong>Total, Net</strong></td>
<td><strong>(6,863)</strong></td>
<td><strong>(1,589)</strong></td>
<td><strong>(125)</strong></td>
<td><strong>(39,403)</strong></td>
<td><strong>507</strong></td>
<td><strong>47,473</strong></td>
<td></td>
</tr>
<tr>
<td>Exposure cover through hedging mechanism recognized in the electricity rate (*)</td>
<td>2,082</td>
<td>956</td>
<td>-</td>
<td>(3,038)</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>(4,781)</strong></td>
<td><strong>(633)</strong></td>
<td><strong>(125)</strong></td>
<td><strong>(42,441)</strong></td>
<td><strong>507</strong></td>
<td><strong>47,473</strong></td>
<td></td>
</tr>
</tbody>
</table>

(*) 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.
NOTE 27: FINANCIAL INSTRUMENTS (Continued)

f. Linkage Basis Report (continued)

As on December 31, 2012

<p>| Linkage to | Linkage to | Linkage to | Linkage to | Linkage to | Un-linked | Non-financial | Total |</p>
<table>
<thead>
<tr>
<th>US$</th>
<th>Euro</th>
<th>Japanese Yen</th>
<th>other currency</th>
<th>CPI</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and cash equivalents</td>
<td>1</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>4,225</td>
<td>-</td>
<td>4,226</td>
</tr>
<tr>
<td>Trade receivables for sale of electricity</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>4,127</td>
<td>-</td>
<td>4,127</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>92</td>
<td>31</td>
<td>-</td>
<td>-</td>
<td>227</td>
<td>43</td>
<td>113</td>
</tr>
<tr>
<td>Current maturities currency swap transactions</td>
<td>(30)</td>
<td>242</td>
<td>2</td>
<td>(2)</td>
<td>(179)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Inventory- fuel</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>2,681</td>
</tr>
<tr>
<td>Inventory- stores</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>149</td>
</tr>
<tr>
<td>Regulatory assets, net</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>3,325</td>
</tr>
<tr>
<td>Long term receivables</td>
<td>923</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>59</td>
<td>2</td>
</tr>
<tr>
<td>Assets with respect to long term currency swap transactions</td>
<td>1,986</td>
<td>29</td>
<td>288</td>
<td>-</td>
<td>(2,238)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Regulatory assets (non-current)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>4,875</td>
</tr>
<tr>
<td>Assets with respect to benefits after employment termination</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>3,155</td>
</tr>
<tr>
<td>Fixed assets, net</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>64,673</td>
</tr>
<tr>
<td>Intangible assets, net</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>921</td>
</tr>
<tr>
<td>Total</td>
<td>2,972</td>
<td>302</td>
<td>290</td>
<td>(2)</td>
<td>(2,190)</td>
<td>8,454</td>
<td>79,894</td>
</tr>
</tbody>
</table>
NOTE 27:-

FINANCIAL INSTRUMENTS (Continued)

f. Linkage Basis Report (continued)

As of December 31, 2012

(Adjust to NIS purchasing power of December 2013)

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Linkage to US$</th>
<th>Linkage to Euro</th>
<th>Linkage to Japanese Yen</th>
<th>Linkage to other currency</th>
<th>Linkage to CPI</th>
<th>Un-linked</th>
<th>Non-financial</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short term debentures and credit from banks and other credit providers(***)</td>
<td>1,179</td>
<td>456</td>
<td>114</td>
<td>-</td>
<td>3,570</td>
<td>4,906</td>
<td>130</td>
<td>10,355</td>
</tr>
<tr>
<td>Forward transactions and interest swap</td>
<td>(166)</td>
<td>139</td>
<td>(114)</td>
<td>-</td>
<td>-</td>
<td>174</td>
<td>-</td>
<td>33</td>
</tr>
<tr>
<td>Current maturities currency swap transactions</td>
<td>(608)</td>
<td>(138)</td>
<td>(41)</td>
<td>(5)</td>
<td>856</td>
<td>-</td>
<td>-</td>
<td>64</td>
</tr>
<tr>
<td>Liabilities to suppliers and service providers</td>
<td>840</td>
<td>81</td>
<td>-</td>
<td>1</td>
<td>-</td>
<td>1,086</td>
<td>-</td>
<td>2,008</td>
</tr>
<tr>
<td>Accounts payable and accruals</td>
<td>324</td>
<td>7</td>
<td>27</td>
<td>-</td>
<td>483</td>
<td>740</td>
<td>-</td>
<td>1,581</td>
</tr>
<tr>
<td>Provisions</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>732</td>
<td>732</td>
</tr>
<tr>
<td>Customer advances, net of work in progress</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>468</td>
<td>468</td>
</tr>
<tr>
<td>Debentures, liabilities to banks and others (**)</td>
<td>11,990</td>
<td>1,841</td>
<td>3,308</td>
<td>-</td>
<td>18,571</td>
<td>2,972</td>
<td>810</td>
<td>39,492</td>
</tr>
<tr>
<td>Summary of hedging transactions</td>
<td>(11,460)</td>
<td>(1,349)</td>
<td>(2,938)</td>
<td>(3)</td>
<td>15,653</td>
<td>851</td>
<td>-</td>
<td>754</td>
</tr>
<tr>
<td>Classifying hedging transactions to assets and/or current maturities</td>
<td>2,564</td>
<td>409</td>
<td>331</td>
<td>3</td>
<td>(3,273)</td>
<td>-</td>
<td>-</td>
<td>34</td>
</tr>
<tr>
<td>Liabilities with respect to long term currency swap transactions, net</td>
<td>(8,896)</td>
<td>940</td>
<td>(2,607)</td>
<td>-</td>
<td>12,380</td>
<td>851</td>
<td>-</td>
<td>788</td>
</tr>
<tr>
<td>Liability to the State of Israel</td>
<td>3,432</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>(26)</td>
<td>3,406</td>
</tr>
<tr>
<td>Debentures to the State of Israel</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>2,534</td>
<td>-</td>
<td>-</td>
<td>2,534</td>
</tr>
<tr>
<td>Liabilities with respect to benefits after employment termination</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>3,050</td>
<td>-</td>
<td>3,050</td>
</tr>
<tr>
<td>Regulatory liabilities, net</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>2,384</td>
<td>-</td>
<td>2,384</td>
</tr>
<tr>
<td>Provision for refunding amounts due to restatement of the financial statements</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>2,449</td>
<td>-</td>
<td>2,449</td>
</tr>
<tr>
<td>Deferred taxes, net</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>4,909</td>
<td>-</td>
<td>4,909</td>
</tr>
<tr>
<td>Shareholders Equity</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>15,467</td>
<td>15,467</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>8,095</strong></td>
<td><strong>1,446</strong></td>
<td><strong>687</strong></td>
<td><strong>(4)</strong></td>
<td><strong>38,394</strong></td>
<td><strong>10,729</strong></td>
<td><strong>30,373</strong></td>
<td><strong>89,720</strong></td>
</tr>
</tbody>
</table>

**Total, Net**

| Expos | (5,123) | (1,144) | (397) | 2 | 40,584 | (2,275) | 49,521 |

**Exposure cover through hedging mechanism recognized in the electricity rate (*)**

| 2,240 | 985 | - | - | (3,225) | - | - | - |

**Total**

| (2,883) | (159) | (397) | 2 | (43,809) | (2,275) | 49,521 |

(*) For details of the hedging mechanism see Note 9c above.

(**) In the consolidated reports of the financial position, the section includes hedging transactions that were presented separately in the linkage base report.
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, 2013 and 2012 respectively.

<table>
<thead>
<tr>
<th>Swap Transactions (1)</th>
<th>Forward Transactions (2)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013</td>
</tr>
<tr>
<td>Purchase of:</td>
<td></td>
</tr>
<tr>
<td>Dollar ..................</td>
<td>12,483</td>
</tr>
<tr>
<td>Euro .....................</td>
<td>973</td>
</tr>
<tr>
<td>Japanese Yen ............</td>
<td>2,376</td>
</tr>
<tr>
<td>Pounds Sterling ........</td>
<td>-</td>
</tr>
<tr>
<td>Linked NIS .............</td>
<td>-</td>
</tr>
<tr>
<td>NIS .....................</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>15,832</td>
</tr>
<tr>
<td>In return for:</td>
<td></td>
</tr>
<tr>
<td>Linked NIS .............</td>
<td>(17,819)</td>
</tr>
<tr>
<td>NIS .....................</td>
<td>(820)</td>
</tr>
<tr>
<td>Euro .....................</td>
<td>-</td>
</tr>
<tr>
<td>Pounds Sterling ........</td>
<td>-</td>
</tr>
<tr>
<td>Dollar ..................</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>(18,639)</td>
</tr>
</tbody>
</table>

(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 2013, losses amount to NIS 2,164 million
In 2012, gains amount to NIS 1,363 million.
The Company does not hold or sell financial instruments for trading purposes.
NOTE 27:- FINANCIAL INSTRUMENTS (Continued)

h. Fair value of financial instruments

<table>
<thead>
<tr>
<th>Financial Assets:</th>
<th>Book Value</th>
<th>Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>December 31</td>
<td>December 31</td>
</tr>
<tr>
<td></td>
<td>2013</td>
<td>2012</td>
</tr>
<tr>
<td>Financial Assets:</td>
<td>NIS in millions</td>
<td>NIS in millions</td>
</tr>
<tr>
<td>Long term debts (including current maturities)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Interest (2)</td>
<td>102</td>
<td>103</td>
</tr>
<tr>
<td>Variable interest</td>
<td>774</td>
<td>1,018</td>
</tr>
<tr>
<td>Financial liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long term debentures and loans (including current maturities)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long term loans at fixed interest (2)</td>
<td>7,368</td>
<td>7,226</td>
</tr>
<tr>
<td>Long term loans at variable interest</td>
<td>5,083</td>
<td>3,450</td>
</tr>
<tr>
<td>Marketable debentures (in Israel) (1)</td>
<td>6,224</td>
<td>11,224</td>
</tr>
<tr>
<td>Fixed interest non-marketable debentures in Israel and abroad (3)</td>
<td>28,796</td>
<td>29,176</td>
</tr>
<tr>
<td>Variable interest non-negotiable debentures (in Israel and abroad)</td>
<td>868</td>
<td>950</td>
</tr>
<tr>
<td>Debentures to the State of Israel (2)</td>
<td>2,536</td>
<td>2,534</td>
</tr>
</tbody>
</table>

(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 of 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.
i. 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 2o above).

<table>
<thead>
<tr>
<th>Year ended December 31</th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Swap and Forward</td>
<td>-</td>
<td>98</td>
</tr>
<tr>
<td>transactions</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| Financial Liabilities  |      |      |
| Swap and Forward       | 2,810| 884  |
| transactions           |      |      |
| Total                  | 2,810| 786  |

NOTE 28:- REVENUES

<table>
<thead>
<tr>
<th>For the Year ended December 31</th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential</td>
<td>8,386</td>
<td>8,914</td>
<td>7,311</td>
</tr>
<tr>
<td>Public-Commercial</td>
<td>9,058</td>
<td>9,008</td>
<td>7,226</td>
</tr>
<tr>
<td>East Jerusalem Company</td>
<td>824</td>
<td>783</td>
<td>624</td>
</tr>
<tr>
<td>Palestinian Authority</td>
<td>1,238</td>
<td>1,127</td>
<td>911</td>
</tr>
<tr>
<td>Agricultural</td>
<td>916</td>
<td>833</td>
<td>668</td>
</tr>
<tr>
<td>Industrial</td>
<td>4,549</td>
<td>5,040</td>
<td>4,026</td>
</tr>
<tr>
<td>Water pumping</td>
<td>1,238</td>
<td>1,218</td>
<td>973</td>
</tr>
<tr>
<td>Revenues from the sale of electricity, gross</td>
<td>26,209</td>
<td>26,923</td>
<td>21,739</td>
</tr>
<tr>
<td>Add:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Collection and provision for regulatory assets, net</td>
<td>1,067</td>
<td>100</td>
<td>3,379</td>
</tr>
<tr>
<td>Revenues from the sale of electricity, net</td>
<td>27,276</td>
<td>28,013</td>
<td>25,118</td>
</tr>
<tr>
<td>Other income*</td>
<td>380</td>
<td>307</td>
<td>268</td>
</tr>
<tr>
<td>Total</td>
<td>27,656</td>
<td>28,320</td>
<td>25,386</td>
</tr>
</tbody>
</table>

* Including income arising with respect to works on account of others for the years 2013, 2012 and 2011, in an approximate total of NIS 61 million, NIS 42 million, and NIS 80 million, respectively and income with respect to yield capitalization of equity to assets in the years 2013, 2012 and 2011 in the amount of NIS 147 million, NIS 142 million and NIS 61 million, respectively.
<table>
<thead>
<tr>
<th>NOTE 29: - SALES AND MARKETING EXPENSES</th>
<th>For the Year ended December 31</th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>NIS in millions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wages</td>
<td>593</td>
<td>738</td>
<td>553</td>
<td></td>
</tr>
<tr>
<td>Consumer services</td>
<td>170</td>
<td>186</td>
<td>216</td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>142</td>
<td>143</td>
<td>141</td>
<td></td>
</tr>
<tr>
<td></td>
<td>905</td>
<td>1,067</td>
<td>910</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>NOTE 30: - ADMINISTRATIVE AND GENERAL EXPENSES</th>
<th>For the Year ended December 31</th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>NIS in millions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wages</td>
<td>447</td>
<td>523</td>
<td>398</td>
<td></td>
</tr>
<tr>
<td>Provision for doubtful accounts and bad debts</td>
<td>272</td>
<td>46</td>
<td>34</td>
<td></td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>123</td>
<td>133</td>
<td>130</td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td>271</td>
<td>169</td>
<td>177</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1,113</td>
<td>871</td>
<td>739</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>NOTE 31: - WAGE COSTS</th>
<th>For the Year ended December 31</th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total wage costs</td>
<td>4,926</td>
<td>6,302</td>
<td>4,554</td>
<td></td>
</tr>
<tr>
<td>Less:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wages charged to works on account of others</td>
<td>84</td>
<td>73</td>
<td>68</td>
<td></td>
</tr>
<tr>
<td>Wages charged to fixed assets</td>
<td>1,864</td>
<td>2,602</td>
<td>1,792</td>
<td></td>
</tr>
<tr>
<td><strong>Total wage costs included in statement of operations items, net</strong></td>
<td><strong>2,978</strong></td>
<td><strong>3,627</strong></td>
<td><strong>2,694</strong></td>
<td></td>
</tr>
</tbody>
</table>
## NOTE 32: FINANCIAL EXPENSES (INCOME), NET

a. **Financial expenses (income), net**

<table>
<thead>
<tr>
<th></th>
<th>For the Year ended December 31, 2013</th>
<th>NIS in millions</th>
<th>For the Year ended December 31, 2012</th>
<th>NIS in millions</th>
<th>For the Year ended December 31, 2011</th>
<th>NIS in millions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Other financial expenses (income)</strong></td>
<td></td>
<td></td>
<td><strong>Erosion of liabilities</strong></td>
<td></td>
<td><strong>Total</strong></td>
<td></td>
</tr>
<tr>
<td>Debentures</td>
<td>2,203</td>
<td>(2,217)</td>
<td>86</td>
<td>2,309</td>
<td>(1,011)</td>
<td>1,298</td>
</tr>
<tr>
<td>Loans</td>
<td>464</td>
<td>(406)</td>
<td>58</td>
<td>411</td>
<td>(213)</td>
<td>198</td>
</tr>
<tr>
<td>Hedge transactions</td>
<td>3</td>
<td>2,161</td>
<td>2,164</td>
<td>8</td>
<td>1,355</td>
<td>1,363</td>
</tr>
<tr>
<td>Loans and account receivables</td>
<td>(138)</td>
<td>25</td>
<td>(113)</td>
<td>(106)</td>
<td>31</td>
<td>(75)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>2,532</td>
<td>(337)</td>
<td>2,195</td>
<td>2,622</td>
<td>162</td>
<td>2,784</td>
</tr>
<tr>
<td><strong>Capitalization of financing expenses, net transfer to regulatory asset</strong></td>
<td>(279)</td>
<td></td>
<td>(279)</td>
<td>(278)</td>
<td>(278)</td>
<td>(207)</td>
</tr>
<tr>
<td><strong>Financial expenses, net</strong></td>
<td>2,176</td>
<td>(6)</td>
<td>2,170</td>
<td>2,253</td>
<td>438</td>
<td>2,691</td>
</tr>
<tr>
<td><strong>Transfer of financing (expenses) income to regulatory asset</strong></td>
<td>(77)</td>
<td>331</td>
<td>254</td>
<td>(91)</td>
<td>276</td>
<td>185</td>
</tr>
<tr>
<td></td>
<td>(137)</td>
<td></td>
<td></td>
<td>(140)</td>
<td></td>
<td>(277)</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td></td>
<td><strong>Total</strong></td>
<td></td>
<td><strong>Total</strong></td>
<td></td>
</tr>
</tbody>
</table>
NOTE 32:- FINANCIAL EXPENSES (INCOME), NET (continued)

b. Gain (loss) from erosion of liabilities, net (1)

<table>
<thead>
<tr>
<th></th>
<th>For the Year ended December 31</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013</td>
<td>2012</td>
<td>2011</td>
</tr>
<tr>
<td>Loss resulting from the change in the CPI</td>
<td>(106)</td>
<td>(1)</td>
<td>62</td>
</tr>
<tr>
<td>Loss resulting from the change between the known CPI and the CPI</td>
<td>25</td>
<td>(68)</td>
<td>88</td>
</tr>
<tr>
<td>Loss from real depreciation (gain from the real appreciation) of foreign currency, net (2)</td>
<td>(281)</td>
<td>200</td>
<td>(152)</td>
</tr>
<tr>
<td>Loans and receivables</td>
<td>25</td>
<td>31</td>
<td>88</td>
</tr>
<tr>
<td></td>
<td>(337)</td>
<td>162</td>
<td>86</td>
</tr>
</tbody>
</table>

(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.
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

<table>
<thead>
<tr>
<th>December 31,</th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>NIS in millions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade receivables for sales of electricity and others</td>
<td>90</td>
<td>75</td>
</tr>
<tr>
<td>Natural Gas Lines Ltd., see section b below (including current maturities)</td>
<td>723</td>
<td>920</td>
</tr>
<tr>
<td>Other receivables from institutions</td>
<td>8</td>
<td>8</td>
</tr>
<tr>
<td>Liabilities to suppliers and service provides (including debt to Natural Gas Lines Ltd. and to infinity – Central Pension Fund Management)</td>
<td>44</td>
<td>40</td>
</tr>
<tr>
<td>Trade payables to institutions</td>
<td>356</td>
<td>218</td>
</tr>
<tr>
<td>Debentures to the State of Israel, see Note 23 above</td>
<td>2,536</td>
<td>2,534</td>
</tr>
<tr>
<td>Liabilities to the State of Israel (including current maturities), see section b(2)(d) below</td>
<td>3,107</td>
<td>3,666</td>
</tr>
</tbody>
</table>

The Company sent requests for balances confirmations at the end of 2013 to approximately 458 electricity customers, and approximately 325 suppliers and other customers who conform to the aforementioned criteria. The Company received 47 confirmations from customers and 83 confirmations from suppliers.

2) The total transactions with the related and interested parties, quoted 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 2,977 million (mainly revenues from Mekorot Ltd. of approximately NIS 718 million and from the Ministry of Defense of approximately NIS 506 million and local authorities).

(2) Invoices issued to Natural Gas Lines Ltd. (hereinafter: “Natural Gas Lines”) for building the natural gas pipeline, of approximately NIS 9 million (see details in section b (1)(a) below).

b) Expenses

(1) Expenses for natural gas transmission to Natural Gas Lines – about NIS 275 million (see details in section b(2)(e) below).

(2) The remaining expenses (primarily local authorities, leasehold fees, State guarantee, transmission of fuels and water) - about NIS 651 million.
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. The disputes between the parties are still pending until the appointment of an arbitrator to replace the appointed arbitrator that has left his duty.

In the meantime, in accordance with the agreement reached between the Gas Lines, the Company and the State, 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.

Completion of the litigation between the parties cannot be estimated at the present time.

(2) The Financial Statements include an adequate provision for covering damages of it may be charged with.

(3) Another claim in an amount of NIS 35 million, filed against the Company in 2007 by Ordan Fishing and Marketing Company et al against the parties to the "tripartite agreement", the Natural Gas Authority and Yam Thetis Ltd., with respect to alleged damages caused to fishermen by the marine pipeline project is still being heard in court. The legal advisors of the Company believe that it is more likely than not that the Company will not be required to incur any cost at the end of the legal process.

(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 723 million.

b) E.M.G.

See details on the agreement with E.M.G. to supply natural gas in Note 34 a2 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.
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, 2013 was approximately NIS 19 million as compared with NIS 25 million as of December 31, 2012. 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 240 months each from the date of their delivery. The balance of the amount of the charter fees as of December 31, 2013 is approximately NIS 39 million and as of December 31, 2012 is approximately NIS 45 million. 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 70 million. The effect of this transaction on the profitability of the Company is negligible.

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, 2013 amounts to approximately NIS 19 million as compared with NIS 20 million as of December 31, 2012. The amortized amount as of December 31, 2013 is approximately NIS 16.4 million and NIS 17.7 million as of December 31, 2012.

   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, 2013 is NIS 3,107 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.

e) Commitment for the Transmission of Natural Gas

   In June 2006, the Company and Israel Natural Gas Lines Ltd. 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 who enter into a transmission agreement with Israel Natural Gas Lines Ltd. In January 2009, the agreement of 2006 was replaced by a new agreement with a validity of 15 years, that applies to Company sites that will be connected to the gas system. The agreement was entered into during the normal course of business of the Company and under market conditions. The Company's Board of Directors approved the agreement on February 2, 2008.

   Estimated original cost of the transaction for the period of the agreement is approximately NIS 2,520 million. The agreement does not affect the profitability of the Company due to the full recognition that the Company receives of its fuels costs.
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 (continued)
Up to the end of 2011 all sites were connected to the gas delivery system. Following the update of the transmission rate in accordance with the decision of the Natural Gas Authority in the Ministry of 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 20.1 million every month, or an aggregated amount of approximately NIS 241 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.
In May 2013 an advance agreement was signed between the Company and IPC for the execution of stage one out of the four stages of the agreement, in order to enable the commencement of the planning works.
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. The scope of the contract is estimated at approximately NIS 230 million.

g) Establishing solar power stations at Ashalim
Within the framework of the tender to construct up to three solar power stations in the Ashalim area, it was agreed that the Company will promote the construction of a joint switching for intaking the energy that will be created array that will serve the whole site, at a cost of approximately NIS 24 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.
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.

Negligible Transactions Procedure
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.
NOTE 33:- RELATED AND INTERESTED PARTIES (continued)

c. Benefits to Interested Parties

<table>
<thead>
<tr>
<th>Group</th>
<th>Year Ended December 31,</th>
<th>Year Ended December 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number of Individuals</td>
<td>NIS in millions</td>
</tr>
<tr>
<td>1) Salary of interested parties employed by the Company (including interested parties employed during part of the year)</td>
<td>4*</td>
<td>4*</td>
</tr>
<tr>
<td>2) Directors not employed by the Company</td>
<td>15</td>
<td>16</td>
</tr>
</tbody>
</table>
| 3) Other interested parties not employed by the Company** | - | - | - | - | - | - | *In 2012 and 2013, two directors on behalf of the employees were in office, that do not receive salary for their participation in meetings of the Board of Directors. **The Company does not have benefits to other interested parties who are not employed by the Company.

d. Compensation To Key Management Personnel

1) Key management personnel in the Company include: members of Company Management, CEO, Chairman of the Board of Directors, 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 49 persons in 2013.

2) 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 and updates thereto and decide on the approval of terms of service and employment where such approval is required by law.

3) 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.

4) In December 2012, the Company’s Board of Directors appointed a Compensation Committee from among its members. On January 9, 2014, the Board of Directors approved the Company’s compensation policy as was requested by the committee. The approval is in effect for 3 years from the approval date.

For the year ended December 31

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total salaries cost</td>
<td>34.2</td>
<td>30.1</td>
</tr>
<tr>
<td>Of which, costs due to the pension plan</td>
<td>2.1</td>
<td>2</td>
</tr>
<tr>
<td>Three key Management personnel retired during the year 2013, for which payment of compensations and retirement grants were made</td>
<td>3.3</td>
<td>4.3</td>
</tr>
<tr>
<td>Balance of pension liability</td>
<td>155.5</td>
<td>140.9</td>
</tr>
<tr>
<td>Balance of vacation reserve</td>
<td>2.1</td>
<td>1.9</td>
</tr>
</tbody>
</table>
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 Letter to the Outgoing Actuary of the Company

Commencing in December 2009 and until July 2013, the actuary had a letter of indemnity from the Inbal Insurance Company Ltd. (hereinafter: “Inbal”), and at the same time the Company provided Inbal with an autonomous and irrevocable bank guarantee.

In the month of July, 2013, as agreed by the Company and the departing actuary and Inbal, and with the approval of the Court, the letter of indemnity given by Inbal to the actuary was void ab initio, and the letter of guarantee given to the Company by Inbal was cancelled, and the actuary received a letter of indemnity from the Company, under which the Company undertakes to indemnify him with respect to any sum, liability or expense paid by him or that he will be required to pay with respect to any claim, demand, allegation or other proceedings filed against him (including civil or criminal, in courts or outside courts, arbitration and mediation proceedings) as detailed in the letter of indemnity.

2) 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 21, 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 said prospectus and the issuance of debentures by the Company based on the said 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 said 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).
NOTE 33: RELATED AND INTERESTED PARTIES (continued)
f. Several Indemnification Letters furnished by the Company: (continued)

2) Indemnification of Directors and Officers of the Company (continued)

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.

3) 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 in impair its value, in accordance with section 197 to the Planning and Building Law.

c) The Company furnished a letter of indemnification to the Gan Raveh 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 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 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. 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 l l above.
a. Agreements

1) Agreement on the Supply of Gas from the Tamar Field

a) On March 14, 2012, the Company entered an agreement for the supply of natural gas from the Tamar field (hereinafter: the “Agreement”), with the holding partners in the Tamar Field. According to the agreement, the Company undertook to buy from the holding partners of the Tamar field (hereinafter: "The Sellers") natural gas in a total minimum quantity of about 42.5 BCM, and a maximum quantity of approximately 77 BCM, for a period of approximately 15 years starting from mid-2013, with an option to the Company, which can be exercised up to April 2013, to increase the maximum quantity to about 99 BCM (hereinafter: the “Option”).

On March 30, 2013, the gas production from the Tamar field commenced, and the gas supply to the generation units of the Company started 24 hours later. The contractual running in period ended on June 30, 2013.

In its meeting on April 11, 2013, the Board of Directors gave the Company its approval to exercise the option in the gas purchase agreement with the “Tamar” partners. Within this framework, the Company will increase the maximum gas quantities in the Tamar agreement from 77 BCM to approximately 99 BCM and the “take or pay” quantity of 3.5 BCM per annum to a “take or pay” quantity of 5 BCM per annum, while increasing the rights for an hourly capacity, all in accordance with the terms detailed in the agreement.

b. Regulation of the use of the capacity of the natural gas pipeline from the Tamar rig and up to the exit of the natural gas from the Ashdod reception terminal

On August 14, 2012, the Natural Gas Authority of the Ministry of National Infrastructures, Energy and Water published a document on behalf of the Director of the Natural Gas Authority, entitled “An appeal to those who intend to submit a proposal or express a position with respect to regulation of the use of the natural gas pipeline capacity from the Tamar rig and up to the exit of the natural gas from the Ashdod reception terminal”. The purpose of the document is to conduct a proceeding for the purpose of enabling any interested party, who intends to submit a proposal or express a position with respect to regulation of the use of the natural gas pipeline capacity from the Tamar rig to the exit of the natural gas from the Ashdod reception terminal, up to September 2, 2012.

On November 29, 2012, the Natural gas Authority reached a decision with respect to regulation of the use of the natural gas pipeline capacity from the Tamar rig to the Ashdod reception terminal, due to the inability of this pipeline to supply all the expected hourly demands of the natural gas consumers in the coming years. The decision determines that the capacity limitation of the transmission pipeline will not prevent the Tamar partners from signing contracts for the sale of natural gas to additional consumers and relates to the manner of distribution of the capacity among all the consumers, when the demand for the supply of gas through the pipeline is expected to exceed the maximum capacity.

In its application to the Natural Gas Authority of February 14, 2013, the Company presented its position, according to which the above mentioned decision will aggravate the injury to the Company and the public of electricity consumers, and the economy in general, as it will force the Company to make increased use of alternative, expensive and polluting fuels.

Furthermore, the Company claims that the decision creates significant difficulties for the possibility of laying a second gas pipeline, from the Tamar reserve and from additional gas reserves, for the entry of additional gas to the shores of the State of Israel. The Company is of the opinion that restricting the use of the capacity in accordance with the decision of the Natural Gas Authority will delay the construction of the second pipeline since the situation at present, when consumers are increasing and in case of a capacity restriction each of them receives a limited and relative quantity of the available capacity in the pipeline, is a situation where the incentive to construct an additional pipeline is much smaller in comparison with a situation where the existing capacity is divided among consumers who have already signed contracts to purchase gas. Additionally, the transmission of gas from the Tamar reserve by a single pipeline harms the reliability of the supply of the natural gas, and as a result, harms the reliability of supplying electricity that is generated through it and the survivability and redundancy of the system in cases of various malfunctions. The Company estimates that the significance of not constructing a second pipeline from the Tamar reserve is a significant increase in times of failure to supply electricity due to the dependency on a single source of supply.

The Company has requested the Director of the Natural Gas Authority to reexamine the contents of the decision of the Natural Gas Authority and to change it so that the problem detailed by it will be addressed.

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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)

The response of the Natural Gas Authority was received on February 21, 2013, according to which it has no intention of changing its decision, since the decisions of the Authority are decisions that are reached in a level-headed manner and derive from considerations of promoting the objectives of the Natural Gas Law and out of a broad perspective of its objectives.

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 (hereinafter: the “Zemakh Committee”). 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.

An increased gas supply to the Company will be possible through this array, within the realization of the option of the Company, 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) 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.

In April 2012, the International Chamber of Commerce in Paris appointed the arbitrators for the arbitration against EMG and the Egyptian companies.
NOTE 34:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)

a. Agreements (continued)

2) E.M.G. (continued)

The arbitration started in September 2011 and 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.

3) 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 Israel Gas Lines Company Ltd. (hereinafter Gas Lines), 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.

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 (see Note 9 h above).

In August 2012, the Company signed an agreement with the BP Gas Marketing Ltd. company for the purchase of 10 L.N.G. cargos, for the period between December 2012 and April 2013. Additionally, in September 2012, the Company signed an agreement with the BP Gas Marketing Company Ltd. for the purchase of an additional LNG cargo, the first cargo, whose loading was executed at the end of October 2012. Part of the gas of this cargo was required, inter alia, for initial cooling of the gasification ship, its arrival at the marine buoy erected by the Gas Lines Company opposite the coast of Hadera, and executing a trial run of the connection array of the ship to the marine buoy.

In September 2012, the Company signed an agreement with the Hadera Gateway LLC Company to lease and operate a ship with a gasification (L.N.G.) capability.

In October 2013, the Company extended the contractual engagement with the Hadera Gateway LLC Company for the lease of the gasification ship until the month of October, 2017 (a total of 5 years).

The gas supply from the marine buoy began on January 26, 2013.
Following the beginning of regular supply of natural gas from the “Tamar” field, the use of LNG is executed only when there is a break / malfunction in the supply of gas from the “Tamar” field and during times of peak demand, when the quantities of gas available to the Company from “Tamar” are not enough to produce electricity in order to meet the electricity demand of the economy.

It should be noted that following the delay in the construction of the marine buoy by the Gas Line Company, and as a result of bringing forward the commencement of transmission of gas from the Tamar Field, the Company was forced to sell five of the 10 LNG cargos of the BP company in the free open market (two were sold at a comprehensive loss of approximately USD 24 million and the rest were sold without loss).

During the month of July, 2013, the Company signed an agreement with the Vitol S.A. company for the supply of LNG cargo in August 2013. During the month of February, 2014, the Company signed an agreement with the BP Gas Marketing Ltd. Company to supply an LNG cargo at the beginning of March 2014.

Yam Thetis Group

In June 2002, an agreement to supply gas was signed between the Company and the “Yam Thetis” Group under which “Yam Thetis” will supply the Company with natural gas for approximately 11 years from the date of the beginning of the gas supply, that is from February 2004 until December 2014, or until consumption of a total amount of 18 BCM natural gas, according to the earliest. The total monetary sum of the agreement with “Yam Thetis” is approximately USD 1.8 billion, as of the date of signing the agreement in 2002 (the price is fixed in USD). In July 2009, the Company entered an obliging memorandum of principles with the “Yam Thetis” Group for the purchase of additional quantities of natural gas, in an annual amount of 1 BCM for five (5) years, until December 2014, and in total an additional 5 BCM. The estimate of the scope of the engagement as of the date of signing the memorandum of principles in 2009 was approximately USD 1 billion. The quantity of gas at the credit of the Company on December 31, 2012 within the two gas agreements with the “Yam Thetis” Group amounted to 1.77 BCM, of which 1.06 BCM which remained from the first agreement of 2002.

During the second quarter of 2011 the daily and hourly rate of production from the Mari B reserve of the “Yam Thetis” Group was reduced, due to depletion of the field and collapse of some of the production wells, so that the gas production from the reserve was reduced to approximately one fifth of the contractual gas quantity under the agreement. As a result, the Company had to consume increasingly larger quantities of liquid fuels. Additionally, the Director of the Electricity Administration in the Ministry of Energy and Water set instructions that limit the scope of use of gas from this field, so that according to these instructions the Company was limited to an annual consumption of 2.5 BCM, in order to ensure continuity of the gas supply between the depletion of the Mari B reserve and the beginning of the supply of gas from the “Tamar” reserve.

Commercial supply of natural gas from the “Noa Tsafon” reserve and the “Pinnacles 1” reserve began in the months of June and July 2012, respectively, as part of the gas agreements of the Company with the “Yam Thetis” Group. The daily aggregate amount of natural gas supplied to the Company at this stage from the “Noa Tsafon”, “Pinnacles 1” and “Mari B” reserves by the “Yam Thetis” Group was approximately 50% of the daily contractual quantity.

On December 3, 2012, a compromise agreement was signed between the Company and “Yam Thetis”, which brought an end to the dispute between the Company and “Yam Thetis” over the significant reduction of gas quantities supplied by the “Yam Thetis” partnership from September, 2011, in relation to the contractual quantities and the compensation the Company is entitled to with respect to this reduction. The compromise agreement includes monetary compensation for the Company and instructions as to the manner of the supply of gas by “Yam Thetis” until the gas supply from the “Tamar” field and its continued supply by “Yam Thetis” after the date of commencement of gas supply from the “Tamar” reserve.

The validity of the second agreement signed by the parties, as stated above, in 2009, ended with the commencement of the supply of gas from the “Tamar” field in March 31, 2013.

At the end of December, 2013, the supply of the remainder of the gas quantity within the first agreement with “Yam Thetis”, of 2002, ended.

After the contractual gas quantity of 18 BCM was supplied in full, in accordance with the provisions of the original agreement and the compromise agreement mentioned above, the validity of this agreement ended.
5) **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.

6) **Contractual Engagements by the Company with Private Producers**

Hereinafter are details of engagements of the Company with private producers as of December 31, 2013:

The scope of production capacity of active private producers:

<table>
<thead>
<tr>
<th>Name of Producer</th>
<th>Status</th>
<th>Technology</th>
<th>Capacity (megawatts)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rotem O.P.C</td>
<td>Active</td>
<td>Conventional</td>
<td>448</td>
</tr>
<tr>
<td>Etgal Investments Ltd.</td>
<td>Active</td>
<td>Conventional</td>
<td>26</td>
</tr>
<tr>
<td>IPP Delek Ashkelon</td>
<td>Active</td>
<td>Cogeneration</td>
<td>87</td>
</tr>
<tr>
<td>Mashav Initiating and Development Ltd. Nesher Ramla</td>
<td>Active</td>
<td>Conventional</td>
<td>48</td>
</tr>
<tr>
<td>Paz Ashdod Oil Refineries Ltd.</td>
<td>Active</td>
<td>Cogeneration</td>
<td>49</td>
</tr>
<tr>
<td>Paz Ashdod Oil Refineries Ltd.</td>
<td>Active</td>
<td>Cogeneration</td>
<td>60</td>
</tr>
<tr>
<td>Others</td>
<td>Active</td>
<td></td>
<td>167</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td><strong>885</strong></td>
</tr>
</tbody>
</table>

The following is the scope of production of entrepreneurs with conditional licenses who have signed an agreement with the Electric Company:

<table>
<thead>
<tr>
<th>Name of Producer</th>
<th>Status</th>
<th>Technology</th>
<th>Capacity (megawatts)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dorad Energy Ltd</td>
<td>Under partial running in</td>
<td>Conventional</td>
<td>850</td>
</tr>
<tr>
<td>Dalia Power Energy Ltd.</td>
<td>Inactive</td>
<td>Conventional</td>
<td>870</td>
</tr>
<tr>
<td>Others</td>
<td>Inactive</td>
<td></td>
<td>949</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td><strong>2,669</strong></td>
</tr>
</tbody>
</table>

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 3,612 megawatts.

On July 6, 2013, the OPC Company began to produce electricity commercially.

In 2013, private producers generated approximately 7.5% of the total generation capacity installed in the economy (including self producers). The entrance of these private producers and others with a significant capacity, is affecting and is expected to continue to affect the scope of revenue in the Company.
7) 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. (A negative difference exists with respect to one agreement for the purchase of coal at a fixed price that is higher than the market price of coal and that accounts for 9% of the coal purchases planned for the full year 2014).
   b) The Coal Company entered into agreements with shipping companies to ship coal up to 2015 in the amount of NIS 31 million and for long term leasing of ships, up to 2019, 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 11,061 thousand tons.
   c) On December 25, 2013, the Coal Company entered an agreement with an Israeli company to lease a bulk freighter for 10 years.
   d) On November 21, 2013, the Coal Company entered into a memorandum of understanding with a foreign company for executing a transaction that combines purchase of a bulk freighter and leasing it for 10 years.

8) As of December 31, 2012, 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 $191 million, € 241 million, £2.3 million and 6.8 million Japanese Yen. 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 2,897 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 9,225 million and NIS 5,543 million.

9) Following a non-binding memorandum of understandings which was signed on December 19, 2012 between the Company and Electricite De France S.A. (“EDF”), a company owned by the Government of France and one of the world’s largest companies in the field of energy, according to which the parties agreed on main terms of a memorandum of understandings within which the manner and areas of cooperation between them will be arranged (subject to the provisions of the law that apply to the Company), an additional non-binding memorandum of understandings was signed on November 21, 2013 between the Company and EDF, within which the parties expressed their joint and non-binding intention to cooperate and conduct negotiations relating to Project d and the Alon Tavor power station, subject to receiving all the required approvals from all the relevant authorities and fulfilling all the relevant provisions of the law (the "Non-binding Principles "). According to the Non-binding principles, the parties agreed to immediately continue the discussions between them in order to examine, inter alia, the possibility of reaching consents in the subject of technical principles, joint development and investment of the Company and EDF in these projects, and the examination of their financing feasibility.
b. Contingent Claims and Liabilities

There are approximately 510 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, 2012, to approximately NIS 28,103 million, of which NIS 25,226 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 24,447 million, of which NIS 21,623 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, 2013, amounting to approximately NIS 355.2 million (the net provision as on December 31, 2012 amounted to approximately NIS 358.8 million) as follows:

1) A provision of approximately NIS 96.4 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 239.8 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 13.2 million with respect to uninsured claims for which a full provision was recorded.
4) Approximately NIS 5.8 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 same board.

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), up to the end of 2005, when the collection of the special surcharge ended.

The Company had collected a nominal sum of NIS 8,831 million on account of the special surcharge. According to a procedural accord between the parties that received the force of a decision, the parties waived conducting cross examinations of the declarers in the case and filed written complementary pleas. The parties completed filing their complementary pleas during 2010.

At this stage, the parties are awaiting the decision of the Court on the request for approval (that will relate to either the threshold claims only or the actual request for approval).

The Company's legal advisors believe that the Company has good defense arguments against the request for approval and believe that it is more likely than not that it will be rejected.
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 (all allegedly 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 Petach Tikva 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 to approve (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. According to the decision of the Supreme Court, the representative of the Attorney General of the Government announced on August 11, 2013 his decision to be present himself in the proceeding.

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 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) are permitted to respond to the position of the Attorney General of the Government up to March 26, 2014, and the Company is permitted to respond up to April 13, 2014. The Supreme Court will decide the manner of continuation of the proceedings after the submission of the responses as stated.
b) (2) On October 15, 2013, two of the applicants submitted an application to approve (hereinafter: the “Additional Application”). The 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 tp 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.

The claimants claim that the average electricity disconnections in the Gush Etzion area are ten to fifteen times higher than the national average of high voltage lines failures. The claimants claim that the faults in electricity supply are caused by faulty maintenance of the electricity grids that supplies electricity to Gush Etzion. The claim requests the Court to order the Company to execute within a reasonable time, all maintenance works required to prevent exceptional failures in electricity supply (and also to repair new failures immediately) and also requests the Court to order compensation relief, for pecuniary damage amounting to approximately NIS 5 million (and alternately establish a mechanism to review the entitlement and to prove the alleged pecuniary damage) and for non-pecuniary damage (suffering and mental anguish) approximately NIS 34 million.

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.

It is the opinion of the legal advisors of the Company that the Decision of Approval is wrong for a number of reasons. Therefore, 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. At this stage dates for the continuation of the hearing at the District Court have not yet been scheduled. The legal advisors of the Company estimate that it is more likely than not that the application for approval will be dismissed.
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 Petach Tikva District Court, by force of principles in the Damages Law and Consumers Contracts Law ("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 18 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. Until now an alternative class action claimant has not been presented by the representative of the applicant. The position of the legal advisors of the Company is of the opinion that it 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 Central District Court, 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. Alternately, the applicant claims that the Company was prevented from collecting the said "double" fees up to March 1, 2006. 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). The applicant filed additional claims for which he requests declaratory relief and mandatory injunctions only. According to the claims the calculation of the interest that the Company charges its customers for payment in arrears is erroneous and contrary to the law and that the Company interprets "invoice generation date", mentioned in the criteria book, incorrectly, in a manner that decreases the period for paying the electricity bill, while offending the consumers. The parties held negotiations for an agreed termination of the proceeding (subject to the approval of the Court), but the applicant retracted from the agreements reached, and on October 29, 2013, even notified the Court that he is requesting to hold an evidentiary hearing in the application for approval. An evidentiary hearing has been scheduled for February 9, 2014, but this date was postponed upon the request of the parties, after the applicant approached the Company and requested to hold further discussions with it in order to end the proceeding by agreement. The date of the evidentiary hearing has been scheduled for July 13, 2014. Regarding the applicant’s claim that the Company collects, contrary to the law, disconnection and connection fees that are executed "in the premises", the opinion of the legal advisors of the Company is that the Company is not expected to bear costs with respect to this cause, beyond the negligible amount that was attributed as provision in the books. Regarding the rest of the applicant’s claims, the legal advisors of the Company are of the opinion that the Company has good defense arguments for dismissing the request for approval in limine and for dismissing the claim and estimate that it is more likely than not that the claim will be dismissed.
Court, to approve the application to withdraw the claim, and this request was dismissed on May 22, 2013 in the Jerusalem District Court. On May 17, 2013, the Jerusalem District Court gave its decision, allowing the claimants to withdraw the application without costs of action.

On April 25, 2013, the Company submitted to the Jerusalem District Court an application for change of venue of the hearing of the application for approval detailed in section h below, which is essentially similar to this approval (and was approved against an under lodgment by the Court. On May 20, 2013, the Court approved the withdrawal in the agreed format, and ruled that the Company has to pay the applicant remuneration of NIS 50 thousand and lawyer fees in the amount of NIS 250 thousand plus VAT to the applicant’s representatives. The proceeding has ended with the approval of the withdrawal as stated.

On June 3, 2012, four claimants ("The Claimants") filed a request with the Haifa District Court, to approve a class action against the Company, in accordance with item 1 in the second addition to the Class Actions Law, 2006 ("The Request for Approval").

The claimants claim that the Company bills its customers according to two methods, an actual regular reading of the electricity meter, or estimated consumption, without reading the meter, according to data held by the Company regarding that customer. The claimants claim that whenever the consumption is estimated, the Company always estimates a lower than actual consumption. Therefore, accumulated consumption differences are added to the billing that is based on the actual reading, following the bill that was based on estimated consumption. According to the claimants, in the event of an increase in electricity rates during the period in which the meter was read, after estimated consumption, the Company bills its customers with respect to the accumulated consumption differences, causing the differences, or a considerable part of them to be billed according to the higher rate, while the electricity was actually consumed in periods prior to the invoice period, when the electricity rates were lower. The claimants set the claimed amount at approximately NIS 1 billion.

The claimants argue that they have causes for a claim against the Company for misleading, contrary to the Consumer Protection Law, due to violating a legal duty by the Company, due to violating the Contracts Law unfaithfully and due to unjust enrichment.

On February 25, 2013, the plaintiffs submitted, with the Company’s agreement, an application to withdraw from the claim, and claim for approval without costs of action. On April 11, 2013, the Court dismissed the claimants’ withdrawal request, because it was not supported by declarations as required (despite the time extensions granted to the claimants for this purpose). On May 12, 2013, the applicants filed an additional withdrawal request, and this request was dismissed on May 22, 2013 in light of the position of the Company.

On April 25, 2013, the Company submitted to the Jerusalem District Court an application for change of venue of the application for approval detailed in section h below, which is essentially similar to this approval (and was submitted to the Jerusalem District Court). On May 17, 2013, the Jerusalem District Court gave its decision, under which the hearing of the application for approval detailed in section h below will be transferred to the District Court of Haifa.

Following the transfer of the hearing, the applicants filed an application to strike the application for approval. The Company objected to the motion to strike and a hearing of the application to strike was held on December 22, 2013, at the District Court of Haifa. On January 5, 2014, the District Court of Haifa gave its decision on the application to strike, according to which the proceeding in the application for approval will be stricken (and the proceeding detailed in section h below will continue). Thus ended the proceeding of application for approval.
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 January 31, 2013, two claimants (hereinafter: “the Claimants”) filed a petition to the Jerusalem 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”). The Request for Approval is substantially similar to the Request for Approval detailed in section g) above.

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 said diagram.

The Claimants argue that they have causes for claim against the Company for the violation of a legal duty, misleading contrary to the Consumer Protection Law and unjust enrichment.

On April 25, 2013, the Company filed an application requesting the Court to transfer the venue of the hearing of the Request for Approval to the panel of judges that is deliberating the request for approval mentioned in section (g) above (at the Haifa District Court). On May 27, 2013, the Jerusalem District Court gave its decision under which the hearing of the application to approve will be transferred to the Haifa District Court. Following the transfer of the proceeding, the applicants filed an application to dismiss the application for the request described in section (g) above. The Company opposed the application to strike and a hearing on the application to strike was held in the Haifa District Court on December 22, 2013. On January 5, 2014, the Haifa District Court gave its decision in the application to strike, in which the proceeding in the application for approval described in section g above was stricken, and accordingly, the Company has to submit its response to the application for approval.

The Company submitted the response to the application for approval on February 20, 2014, and the appellants submitted their reply to the response on March 18, 2013. A preliminary hearing of the application for approval was held on March 23, 2014 and an evidentiary hearing is scheduled for June 1, 2014.

Some of the arguments raised in the application for approval are largely similar to those raised in the application for approval that was described in section g above (which was stricken, as stated) regarding which the legal advisors of the Company are of the opinion that it is more likely than it will be dismissed. At this preliminary stage, 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.
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 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 Central District Court (Lod), 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 for 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”.

The Applicants claim that the Company sends its customers electricity bills to be paid, and they often reach the customers after the deadline for payment, on the deadline or too close to the deadline. The Applicants further claim that as a result of receiving the electricity bills at a late date, the customers pay after the last date for payment that appears on the bill, and are debited – in the following bill – with arrears interest due to not paying the bill on time, and sometimes also with expenses with respect to sending a warning to pay the debt or a warning before cut-off.

Within the claim the Court is requested to approve as a class action, the Court is requested to issue an order instructing the Company to return to the customers all the amounts of money paid as arrears interest with respect to the period from the payment deadline date up to five days after the bill reached the customers, as well as with respect to warning expenses or other debit executed due to the delay in payment for this period, with the addition of linkage and interest differentials; to issue an order instructing the Company to deliver current bills to customers not less than five days before the payment date that is stated in the bills; to issue an order forbidding the respondent from debiting its customers with arrears interest, warning expenses or any other debit, for the period of up to five days after the bill reaches the customer; to issue an order to instruct the appointment of an office holder who will supervise the execution of the requested judgment.

On October 8, 2013, an additional application was filed with the Central District Court, requesting approval as detailed in section k below, against the Company and against Messer B.A.B. Ltd (hereinafter: “Messer”), which is largely similar to this application for approval. Following the submission of the application for approval detailed in section k, the applicants in this application for approval filed an application to the panel of judges set to hear the application for approval detailed in section k below to transfer its hearing to the panel of judges that was set to hear this application for approval. The application was approved and the hearing of the application to approve detailed in section k below was transferred to the panel of judges hearing this application to approve. The Court granted the various parties an opportunity to submit various applications with regard to the manner of conducting the two applications for approval. Accordingly, the applicants of each application for approval submitted various applications to dismiss the other application for approval in limine, and Messer submitted an application to dismiss the application for approval detailed in section k below in limine.

On January 20, 2014, after a hearing was held on the matter, it was determined that as regards the Company, this application for approval is the one that will be conducted and the application for approval detailed in section k below will be stricken. It was further determined that the applicants in this application for approval are permitted to submit an amended application for approval. Regarding the Messer company, against which the application for approval detailed in section k below was also submitted against, it was determined that its application to dismiss in limine will be heard after the submission of the response of the Company to this application for approval.

On February 2, 2014, the applicants of this application for approval submitted an amended application for approval. The Company submitted a response on its behalf to the amended application for approval on March 20, 2014. An additional preliminary hearing for the applications for approval has been scheduled for April 9, 2014.

It is the opinion of the legal advisors of the Company that it is not possible to estimate the prospects of the Request for Approval at this stage due to its preliminary stage and since the examination of the factual errors arising in the application has not yet been completed.
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)

j) On May 8, 2013, an application to approve a class action 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.

Within the application to approve, it was argued that the Company, a monopoly indifferent to its costs, was negligent in its engagements with Siemens, unrelated to the bribe received by Dan Cohen, including by not executing the required examinations (including through price comparison in the global market), and by purchasing some of the turbines a long time before they were needed and even before the Company had the necessary planning approvals. It was also argued that the Company used its monopolistic position and misled the Electricity Authority and the consumers with regard to its true costs that stemmed from its negligent engagement with Siemens.

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.

It should be noted that 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 response to the application for unification of the hearing, within which it opposed the unification of the hearing by reason that the proceedings of the application to approve were delayed until after the decision was reached in the application for leave to appeal described in section b above, by reasons of preclusion, bad faith and judicial estoppels, and on its own merits. The application is still pending at with the President of the District Court of the Central District.

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.
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)

k) On October 8, 2013, an application was filed with the Central District Court (in Lod), requesting approval to submit a class action against the Company and against Messer B.A.B. Ltd (hereinafter: the “Request for Approval” and “Messer”, respectively), on behalf of all the customers of the Company that do not pay the electricity bill by authorization for direct debit, who, since April 2011 onwards, did not receive the electricity bill on time as defined by law and/or were debited with interest on arrears, warning letter expenses, or any other debit due to late payment, when the electricity bill was not delivered to them on time, as stated. The applicant estimated the sum of the action as regards the group at approximately NIS 200 million and at a sum of NIS 10,324 with regard to him.

The applicant claims that since the month of April, 2011, at which time the Company hired the services of Messer Ltd. to distribute electricity bills to its customers, significant delays occurred in servicing the bills to customers, such that the bills are often delivered after the final date for payment, or on this date, or too close to this date, in a manner that does not enable them to prepare to pay them before the final date for payment. As argued, as a result of the delay in receiving the bills, the Company's customers are forced to execute the payment urgently, without examination, in some cases after the final date for payment that appears on the bill, and are debited – in the following bill – with interest on arrears due to not paying the bill on time, and sometimes also with expenses due to the issue of a warning letter to pay a debt or a warning prior to disconnection. It is further argued that there are hundreds of thousands of Company customers that have been in this situation for over two years, and this situation, which is known to the Company and to the Messer Ltd., has not been corrected.

On October 29, 2013, the applicants of the application for approval detailed in section i above submitted an application to the panel set to hear this application, requesting it to transfer its hearing to the panel set to hear the application for approval detailed in section i above. The application was approved and the hearing of this application to approve was transferred to the panel of judges hearing the application to approve detailed in section i above. The Court granted the various parties an opportunity to submit various applications with regard to the manner of conducting the two applications for approval. Accordingly, the applicants of each application for approval submitted applications to dismiss the other application for approval in limine, and the Messer Company submitted an application to dismiss this application for approval in limine.

On January 20, 2014, after a hearing was held on the matter, it was determined that as regards the Company, this application for approval will be stricken and the application for approval detailed in section i above will be the one conducted against it. Regarding the Messer company, whom this application for approval was also submitted against, it was determined that its application to dismiss in limine will be heard after the submission of the response of the Company to the application for approval detailed in section i above.
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, 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 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, 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.

The cause of action argued against the Cartel Companies in the application for approval is the existence of a prohibited restrictive arrangement in violation of the Restrictive Trade Practices Law, whereas the causes of action argued within the application for approval against the Company are negligence and breach of duties of administrative law, as well as unjust enrichment due to the “excessive rollover” from the interest gap described above.

It should be noted that a few days before the submission of the application for approval against the Company and the Cartel Companies, another application for approval of a class action on the same matter was submitted against the Cartel Companies (hereinafter: the “Early Application for Approval” and together the “Applications for Approval”). The Company is not a party to the Early Application for Approval.

As of this date a number of preliminary applications for dismissal in limine and/or stay of proceedings of the applications for approval are pending at Court, that were submitted by the members of the cartel (the “Preliminary Applications”): applications on behalf of Siemens AG and SA Alstom for stay of proceedings of the Applications for Approval, until a decision is reached in the appeal over the decision of the General Director, that they intend to submit; an application by ABB Ltd., under section 7 of the Class Actions Law - 2006, to strike off in limine one of the Applications for Approval (the “Application Under Section 7 of the Law”), and an additional application on behalf of ABB to dismiss in limine or alternatively to stay the proceedings of the applications for approval until a decision is reached in the claim against the cartel companies (“application for dismissal due to the claim of the Company”). According to the decision of the court, the application for dismissal due to the claim of the Company will be decided first from among the preliminary applications that were submitted.

The Company has to submit a response to the application for approval up to 60 days after the decision of the court in the application under section 7 of the law (which in any case will be determined, if determined, only after a decision is given in the application for dismissal due to the claim of the Company).

It is the opinion of the legal advisors of the Company that the Company has good defense pleas and it is more likely than not that the application for approval will be dismissed.
2) Claims for the pollution of the Kishon River

In the framework of a claim filed against "Haifa Chemicals Ltd." and "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).

It should be noted that in these claims, the question of the narrow meaning of the causal relation came first, namely the causal relation between the claimed exposure of the claimants to substances claimed to be found in the water of the Kishon River and its surrounding and their diseases, considering the relevant circumstances of each of the claimants.

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. The appeal is lengthy and contains approximately 300 pages, and the Company has therefore acted, together with other defendants, to submit an application to strike out the appeal. In its decision of November 6, 2013, the Supreme Court ordered the appellants to submit an amended statement of appeal of not more than 75 pages and it was done. 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. The Company also submitted an application to increase the amount of security the appellants have to deposit in the Court Fund to secure the expenses of the respondents (a decision has not yet been given).

With respect to the second claim that was heard separately, it can be assumed that a procedural arrangement, that will freeze its discussion until a decision is reached in the appeal regarding the judgment of the first claim, will be attained.

It is our estimate that it is hard to assess the prospects of the appeal, as it is known that these are complex and unique claims that raise complex legal and scientific questions regarding the existence of a causal connection between the materials claimed to be in the waters of the Kishon River and its surroundings and each and every one of the diseases of the claimants. and especially when considering the fact that there are many materials, and additionally, it is about a large variety of diseases in which the claimants allegedly fell ill with, and these raise medical questions in all that relates to deciding the causal connection between each disease and the waters of the Kishon River and its surroundings.

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 is in this claim is.

It follows that, in the assessment of the Company’s attorneys, the aggregate amount for the appeal, for both claims of estates and claims of living claimants, is in the range of between NIS 650 million and NIS 800 million, including legal fees and court expenses. The Company’s attorneys point out in their opinion that the reference is only to a general estimate, based on the assumptions that they make in the absence of data at this stage. In addition, this estimate disregards the various benefits that the plaintiffs are receiving and/or will receive in the future from third parties. It should be pointed out that the reference is to an assessment of the amount of the claims and not to the assessment of the risk of defendants and third parties in general and the Company in particular, since at this stage data is unavailable that would enable to make such an assessment.

In view of the complexity, 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, against which the Council claims that insofar as the plaintiffs sustained damages, these were caused pursuant to their direct or indirect exposure to electrical equipment owned and/or controlled by the Company and are under the responsibility of the Company, e.g. high voltage lines, transformers, etc. In addition, the Court ordered the splitting of the hearing of the case, where in the first stage each plaintiff will have to prove a causal relation and the second stage will clarify issues related to the broad responsibility in Damages Law, such as the obligation of caution, contributing blame and determining the measure of responsibility of all the defendants and third parties and among them.

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. At the same time they filed an application for granting an exemption from depositing a court bond, which was dismissed on March 31, 2013, as well as an application to delay the execution of the judgment, an application that was partially accepted in a decision of April 8, 2013, in relation to half of the lawyers’ fees ruled in favor of the claimants.

Regarding the prospects of the appeal, we will remark that this is a complex and unique claim, which raises very complex scientific questions regarding the existence of a causal connection between material and disease. The large complexity regarding the causal connection between material and disease is increased due to the interaction that exists between the materials themselves, especially considering the fact that it is about a large variety of diseases in which the claimants allegedly fell ill with, other possible disease factors and the contribution of each defendant/third party, if any, to the alleged pollution, which caused, according to the claims of the claimants, their disease.

In view of the complexity noted above, we will only be able to update our assessment further down the road, after receiving the judgment in the appeal. At this stage there are no data that enable an execution of an assessment of risk to the Company. However, it is the Company’s estimate that the probability that the Company will be debited with a material sum is very low.

4) **Derivative Claims**

a) On September 10, 2009, a letter was sent to the Chairman of the Board of Directors by the representatives of Mr. Dov Zelinger who, as he claims, holds a number of Company shares. Within the aforesaid latter, 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.
NOTE 34:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)
b. Contingent Claims and Liabilities (continued)

4) Derivative Claims (continued)

On October 28, 2009, the Company replied to Mr. Zelinger in writing. Within its letter, the Company rejected the claims of Mr. Zelinger, both regarding the claim that the members of the Board of Directors and the actuary of the Company violated their duties towards the Company, and regarding the claim that damage was caused to the Company as a result of the mistake in the calculation of the provisions for pension. On September 5, 2010 (approximately one year after the Company’s aforesaid reply), the representative of Mr. Zelinger approached the representative of the Company, and claimed, in general, that he is of the opinion that the claims presented in his first letter are established. In addition, Mr. Zelinger requested various details pertaining to the rejection of his application by the Company. The Company did not write a response to this application by Mr. Zelinger.

On October 21, 2012, the representative of Mr. Zelinger again approached the representative of 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 Finances of the Company and Head of the Financial Division of the Company. In light of the above, Mr. Zelinger requests within the Letter of Demand that the Company will submit an action in the amount of the financial fine against the office holders 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. It is noted that a derivative action, by its own nature and character, is not an action against the Company, and the Company is therefore not expected to incur any damage, except for potential damages of image and reputation.
NOTE 34: AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)
b. Contingent Claims and Liabilities (continued)

5) Claim by the Company 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 arrays (gas insulating voltage arrays): ABB Ltd., Siemens AG (hereinafter: “Siemens”), Alstom Societe Anonyme, 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) l) 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 array market between the years 1988 - 2004 was also implemented by the Cartel Companies in Israel towards the Electric Company, and that the acquisition proceeding conducted by the Company to purchase GIS arrays 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: “Application for Dismissal”) due to the existence of another proceeding that is pending - a claim for negative declaratory relief, which was submitted by Siemens against the Company in Germany. The claim in Germany was served to the Company on March 11, 2014. In it, Siemens requests the Court to declare that the Company will not be entitled to claim damages or any other claim against Siemens that derive from claimed breaches of the Antitrust Laws in the GIS array market in Israel. The Company has to submit its application for dismissal in limine of the claim in Germany at the beginning of June, 2014. Due to the preliminary stage of the claim I Germany, the legal advisors of the Company have not yet delivered their estimate as to its prospects.

The Company has to submit its reaction to the application for dismissal that was submitted by Siemens in Israel by March 26, 2014. The legal advisors of the Company are of the opinion that the prospects for dismissal of the application for dismissal are higher that its prospects to be accepted.

A pretrial hearing in the Company’s claim against the Cartel Companies has been scheduled to May 19, 2014. The legal advisors of the Company are of the opinion that the prospects of the Company against the Cartel Companies are higher that its prospects to be dismissed.

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 three times and currently the claim includes 150 collective settlements. According to the claimants, the electricity rate to which they are entitled is the “Collective Sale Rate” for high voltage consumers and not the high voltage Load and Time Rate, this in view of the definition of the aforesaid rate in the Criteria guide that is published by the Electricity Authority and considering the discrimination of the claimants in relation to other collective settlements that consume low voltage electricity from the Electricity Company and are charged the “Collective Sale Rate” for low voltage consumers.

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 the period from September 1, 2005 to September 1, 2011 as well as declaratory reliefs concerning the entitlement of the claimants to a high voltage “Collective Sale Rate” commencing on September 1, 2011 and thereinafter.

On October 31, 2011, the Company submitted an amended statement of defense on its behalf in respect of the claim.
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 (continued)

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 reduced rate 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 regular rate.

On July 2, 2013, a pretrial of the case was held, and dates were determined for submitting initial statements of evidence on behalf of the parties. On January 12 and 14, 2013, the plaintiffs submitted seven primary affidavits of evidence, and announced their intention to submit an expert opinion (which has not yet been submitted) within the framework of the claim. On March 16, 2014, the Company submitted an application for dismissal in limine of the claim discussed. An additional pretrial hearing is scheduled for May 15, 2014.

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 Other Municipal Taxes, Levies and Fees

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 118 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. As of the statement of financial position date, the Company has demands with respect to levies and fees in amounts exceeding the provision existing in the financial statements by approximately NIS 876 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. (Also see section 9 c) below).

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 indemnity letters, the Electricity Authority will be obligated to recognize them in the electricity rate.
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 said 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
      According to the development plan assigned to the Company by the Minister in 2001, the Company is required to construct and operate a coal operated power station comprised of two generation units of 630 megawatts each, at a location to be determined during the planning procedures. After examination of alternatives, the National Committee for National Infrastructure determined in 2003 that the planning scheme and the survey on the environmental effects will be carried out for the Rutenberg site. An investigator, appointed by the National Committee of National Infrastructures, conducted a hearing process during August 2009, of comments from district committees and public objections. The report of the investigator was not published and the planning processes in the committee were suspended.
      In December 2010, the Minister amended the development plan. According to the amended plan, the Company is required to build and operate two generation units with a capacity of 630 MW each, in a gas – coal configuration. Based on understandings between the Ministry of Energy and Water, the Ministry of the Interior and the Ministry for Environmental Protection, coal will be used only in an emergency. In June 2011, the National Planning and Building Committee started new planning procedures for National Planning Scheme 10 for a power station that will operate on natural gas as the primary fuel and use coal for backup only. In July 2011, the National Planning and Building Committee issued orders to prepare a national planning scheme and approved the guidelines for preparing a survey on the environmental effects.
      In 2012, the Electricity Company presented the proposed technology to the Ministry of National Infrastructures, Energy and Water and the Ministry initiated the required consultations with the Electricity Authority. On March 10, 2013, the development plan regarding Project D was amended, and the Minister approved as follows: “Construction of two steam thermal units with a configuration of natural gas-coal, each combined with a gas turbine operated by natural gas with a coal backup, at the Rutenberg site (Project D).” The output of each steam thermal unit will not exceed 550 megawatts and the output of each gas turbine will not exceed 180 megawatts”. Following the Minister’s amendment of the development plan, the project was updated and the Company prepared an environmental effect survey and a request for an emission permit and is acting to approve the outline plan.
      On January 1, 2014, the Company received a letter from the Israel Antitrust Authority under which the General Director of the Antitrust Authority is considering to use the authority vested in him and instruct the Company to refrain from directly or indirectly increasing its electricity generation capacity beyond 13,307 megawatts, as long as the electricity generation capacity of the Company is more than 50% of the total sectorial generation capacity in the electricity sector. It is noted in the letter that the aforesaid does not prevent the Company from executing works to increase efficiency in the electricity generation stations it owns, but if these works increase the electricity generation capacity in excess of the maximum generation capacity noted above, it will have to receive advance approval from the General Director of Antitrust Authority. The Company will be given an opportunity to present its position to the General Director of the Antitrust Authority before a decision is made on the subject.
      On March 4, 2014, the Company presented its position to the General Director of the Antitrust Authority within a written hearing that was conducted for the Company, and presented legal and economic arguments against granting an order as stated.
      On March 17, 2014, an oral hearing was conducted for the Company in this matter, and as of the date of publication of the report, a final decision on the matter by the General Director has not yet been received.
      Additionally, in view of the decision to transfer to a new technology and configuration of project D as a dual fuel station that will be operated by gas with coal backup, a provision for impairment under accounting standard SFAS90 was recorded. (See Note 14 i above).
      Regarding the draft of recommendations of the steering committee published on March 23, 204, see Note 1 e above.
NOTE 34:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)
b. Contingent Claims and Liabilities (continued)
9) Other Contingent Liabilities (continued)

c) Alon Tavor Betterment Levy

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. The date for submitting legal proceedings against the assessment was extended until April 12, 2014, and the Company intends, within the legal proceedings, to argue its arguments against the obligation of betterment levy itself and against the obligation sum.

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 a response from the committee to the arguments of the Company has not yet been received, and an initial hearing has not yet been held by the appeal committee, 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.

Regarding the draft of recommendations of the steering committee published on March 23, 204, see Note 1 e above

10) Guarantees

Regarding guarantees provided by the Company, see Note 27e above.

11) Indemnification Letters

a) Letter of indemnity to the actuary of the Company

On March 29, 2011, the new Company actuary from the offices of Ernst & Young (Israel) Ltd., which provides the Company with actuarial services as of the first quarter of 2010, received a letter of indemnity whose principle points are:

The Company undertakes to indemnify the actuary with respect to any sum, liability or expense that will be paid by him or that he will be required to pay with respect to an action, demand, claim or other proceedings that will be taken against the advisor (including civil or criminal, in court or out of court, arbitration proceedings and mediation proceedings) as detailed in the letter of indemnity.

The indemnity by the Company is limited to a total amount of NIS 30 million.

b) See details of indemnification letters furnished by the Company in Note 33 f above.
c. Labor disputes

1) On December 5, 2012, the Chairman of the Trade Union Division of the Histadrut announced a labor dispute. The disputed matters are:

a) One-sided actions of the Company’s Management, that in practice constitute 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 union 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 shed 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) On March 12, 2013, the Chairman of the Trade Union Division of the National Labor Federation announced a labor dispute. The following are the issues under dispute:

(a) A one-sided decision by the Company to cut back the permanency quotas existing in the Company, and its implications.

(b) A one-sided decision by the Company not to fill vacant permanent positions, and its implications.

(c) Implications and damages from work load for employees due to shortage of manpower deriving from not filling positions in shifts.

(d) Not giving permanency to temporary employees who are waiting many years for permanency, despite, as stated, the existence of positions of permanency.

(e) The Company’s unacceptable “revolving door” policy, according to which instead of appointing a permanent employee for a position that requires such an employee – an employee who is not permanent is appointed to the position.

4) 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 it is out of place to issue an injunction against the sanctions regarding the addition of the stated Note to the Financial Statements, and it is out of place 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.
c. Labor disputes (continued)

5) 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.

6) On June 26, 2013, the National Labor Court gave its decision giving effect to the accord reached by the Company, the State of Israel and the Company employees' organization, regarding sanctions taken by the employees' organization with respect to the intake of an EMS system (a command and control system at the national supervision for managing the system) in Company locations, for connection of the Dorad power station and connecting the electricity to the construction site of the Dalia power station (hereinafter: the "Works"). A joint notification of the renewal of negotiations was submitted to the national Court on July 25, 2013. In accordance with the decision of the National Labor Court of October 8, 2013, the parties reported to the Court about the status of the negotiations held between them on March 9, 2014.

7) 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 Court – see section 5 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 it is out of place to issue an injunction against the sanctions regarding the expansion of the arrangement regarding historic distributers and settling the account with customers of private producers, and it is out of place 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.

8) 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. In a discussion held in court on that date, agreements were reached and they received the validity of judgments. According to them the employees immediately returned to regular work, and negotiations will be held regarding the issue of deduction from the salary of the employees by September 20, 2013, and insofar as an agreement will not be reached on the matter, an appropriate application will be submitted to the Court. On October 6, 2013, the Electric Company submitted an application to the Haifa Regional Labor Court, requesting the determination of the appropriate wages that should be paid to employees with respect to the period in which they resorted to sanctions.

9) On October 10, 2013, the Company received the decision of the Commissioner of Wage regarding 4 wage deviations in 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. (See Note 12 g).
c. Labor disputes (continued)

10) 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.

11) On March 13, 2014, the Company CEO announced that the granting of the automatic ranking in the Company will be stopped immediately, and as of March 23, 2014 the Human Resources Division’s advanced studies will be cancelled.

On March 19, 2013, the employee union announced that it is taking a series of steps aimed at disrupting and interfering with the orderly work process of the Company, such as: not issuing electricity bills, not sending bills to customers, not collecting money from customers, ceasing to raise funds, not disconnecting debtors, breaking off contact with senior officers, breaking off contact with the Electricity Authority and the Electricity Supervisor of the Ministry of national Infrastructures, Energy and Water, not cooperation of the Human Resources Division employees with the Deputy CEO Human Resources, and lack of cooperation by the lawyers of the Company with the legal advisor of the Company and its external legal advisors.

On March 20, 2014, the Board of Directors of the Company instructed the management to continue to work towards reducing the Company expenses. For this purpose, the CEO will hold intensive and immediate communications with the employee union in order to find suitable solutions as soon as possible, including alternative solutions.
NOTE 35: SEGMENTAL REPORTING

a. General

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 4.

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 net income (loss) level. See detailed information in Note 38 below.
### NOTE 35: SEGMENTAL REPORTING (continued)

#### c. Analysis of Income and Results according to Operational Segments (continued)

<table>
<thead>
<tr>
<th></th>
<th>Generation segment</th>
<th>Transmission segment</th>
<th>Distribution segment</th>
<th>Total Company</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>For the Year ended December 31, 2013</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenues(*)</td>
<td>21,484</td>
<td>3,095</td>
<td>3,077</td>
<td>27,656</td>
</tr>
<tr>
<td>Operating income from ordinary operations</td>
<td>374</td>
<td>770</td>
<td>218</td>
<td>1,362</td>
</tr>
<tr>
<td>Profit (Loss) before income tax</td>
<td>(609)</td>
<td>285</td>
<td>(484)</td>
<td>(808)</td>
</tr>
<tr>
<td>Profit (Loss) for the year</td>
<td>(704)</td>
<td>330</td>
<td>(562)</td>
<td>(936)</td>
</tr>
<tr>
<td><strong>Additional Details</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>2,825</td>
<td>929</td>
<td>1,173</td>
<td>4,927</td>
</tr>
<tr>
<td>Financing expenses, net</td>
<td>983</td>
<td>485</td>
<td>702</td>
<td>2,170</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Generation segment</th>
<th>Transmission segment</th>
<th>Distribution segment</th>
<th>Total Company</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>For the Year ended December 31, 2012</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenues(*)</td>
<td>22,626</td>
<td>2,660</td>
<td>3,034</td>
<td>28,320</td>
</tr>
<tr>
<td>Operating income from ordinary operations</td>
<td>1,407</td>
<td>548</td>
<td>(562)</td>
<td>1,393</td>
</tr>
<tr>
<td>Profit (Loss) before income tax</td>
<td>190</td>
<td>(55)</td>
<td>(1,433)</td>
<td>(1,298)</td>
</tr>
<tr>
<td>Profit (Loss) for the year</td>
<td>147</td>
<td>(43)</td>
<td>(1,108)</td>
<td>(1,004)</td>
</tr>
<tr>
<td><strong>Additional Details</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>2,666</td>
<td>854</td>
<td>1,164</td>
<td>4,684</td>
</tr>
<tr>
<td>Financing expenses, net</td>
<td>1,217</td>
<td>603</td>
<td>871</td>
<td>2,691</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Generation segment</th>
<th>Transmission segment</th>
<th>Distribution segment</th>
<th>Total Company</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>For the Year ended December 31, 2011</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenues(*)</td>
<td>20,729</td>
<td>1,860</td>
<td>2,797</td>
<td>25,386</td>
</tr>
<tr>
<td>Operating income from ordinary operations</td>
<td>2,288</td>
<td>519</td>
<td>19</td>
<td>2,826</td>
</tr>
<tr>
<td>Profit (Loss) before income tax</td>
<td>1,260</td>
<td>1</td>
<td>(695)</td>
<td>566</td>
</tr>
<tr>
<td>Profit (Loss) for the period</td>
<td>(1,848)</td>
<td>(7)</td>
<td>1,022</td>
<td>(833)</td>
</tr>
<tr>
<td><strong>Additional Details</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>2,409</td>
<td>925</td>
<td>1,162</td>
<td>4,496</td>
</tr>
<tr>
<td>Financing expenses, net</td>
<td>1,028</td>
<td>518</td>
<td>714</td>
<td>2,260</td>
</tr>
</tbody>
</table>

(*) Revenues are attributed to the three segments according to their share in the electricity rate.
(**) Retrospective implementation of IAS 19 (2011) – see Note 37 below.
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.

<table>
<thead>
<tr>
<th></th>
<th>As of December 31, 2013</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Generation segment</td>
<td>Transmission segment</td>
<td>Distribution segment</td>
<td>Total Company</td>
</tr>
<tr>
<td></td>
<td>NIS in millions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Assets</td>
<td>44,230</td>
<td>16,644</td>
<td>25,050</td>
<td>85,924</td>
</tr>
<tr>
<td>Investments in the year(*)</td>
<td>3,654</td>
<td>652</td>
<td>983</td>
<td>5,289</td>
</tr>
<tr>
<td>Liabilities</td>
<td>37,523</td>
<td>13,433</td>
<td>20,157</td>
<td>71,113</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>As of December 31, 2012</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Generation segment</td>
<td>Transmission segment</td>
<td>Distribution segment</td>
<td>Total Company</td>
</tr>
<tr>
<td></td>
<td>NIS in millions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Assets</td>
<td>45,926</td>
<td>17,748</td>
<td>26,046</td>
<td>89,720</td>
</tr>
<tr>
<td>Investments in the year(*)</td>
<td>3,955</td>
<td>827</td>
<td>1,403</td>
<td>6,185</td>
</tr>
<tr>
<td>Liabilities(***</td>
<td>38,964</td>
<td>14,314</td>
<td>20,975</td>
<td>74,253</td>
</tr>
</tbody>
</table>

(*) Including investments with respect to the emergency plan for the electricity sector, which includes construction of three CCTGs, and investments with respect to the project of reducing emissions (see also Note 14 above.)

(**) Retrospective implementation of IAS 19 (2011) – see Note 37 below.
NOTE 36:- SUBSEQUENT EVENTS AFTER THE STATEMENT OF FINANCIAL POSITION DATE, IN ADDITION TO THE DETAILS IN THE AFOREMENTIONED NOTES

a. Appointment and retirement of directors and officeholders:
   1) On January 19, 2014, Mr. Yigal Harel ended his term as internal auditor and ombudsman of the Company.
   2) On January 23, 2014, Mr. Shmuel Schatz was appointed as Acting Internal Auditor of the Company.
   3) On February 6, 2014, Ms. Nitza Rogozinski was appointed as Internal Auditor of the Company. The appointment will become effective with the termination of the present office of Ms. Rogozinski as internal auditor at “Amitim, the Veteran Pension Funds”, and not later than three months from the date of her appointment.
   4) On March 13, 2014, Advocate David Zehavi, legal advisor and secretary of the Company announced his request to end his office at the Company. he will continue at this office until the end of 2014. An exact retirement date will be coordinated with the Chairman of the Board of Directors and the CEO.
   5) On March 13, 2014, Mr. Raik Abu-Reish was appointed as director of the Company.
   6) On March 15, 2014, Ms. Shlomit Barnea-Farago ended her term with the Board of Directors.

b. On January 1, 2014, the Company received a letter from the Anti-Trust Authority under which the General Director of the Antitrust Authority is considering using the authority vested in him and instructing the Company to refrain from directly or indirectly increasing its electricity generation capacity beyond 13,307 megawatts, as long as the electricity generation capacity of the Company is more than 50% of the total sectorial generation capacity in the electricity sector. It is noted in the letter that the aforesaid does not prevent the Company from executing works to increase efficiency in the electricity generation stations it owns, but if these works increase the electricity generation capacity in excess of the maximum generation capacity noted above, it will have to receive advance approval from the General Director of Antitrust Authority. The Company will be given an opportunity to present its position to the General Director of the Antitrust Authority before a decision is made on the subject.
   On March 4, 2014, the Company presented its position to the General Director of the Antitrust Authority within a written hearing that was conducted for the Company, and presented legal and economic arguments against granting an order as stated.
   On March 17, 2014, an oral hearing was conducted for the Company in this matter, and as of the date of publication of the report, a final decision on the matter by the General Director has not yet been received.
   For further detail see Note 34 b(9)(b) above.

c. On January 9, 2014, the annual general meeting reached a decision as to the terms of office and employment of the Chairman of the Board of Directors, on approval of liability insurance for directors and officeholders, on approval to purchase personal accident insurance for directors and on approval of the remuneration policy of the Company.

d. Regarding the consents between the Company and the employees on the arrangement of their rights in the communications company see Note 11 b above.

e. On February 12, 2014, the Minister approved the decision of the Electricity Authority to extend the validity of the new electricity production licenses until January 1, 2015.

f. On February 4, 2014, a letter was received from the Ministry for Environmental protection, regarding the approval of postponement in the schedules of the project for reducing emissions at the coal power stations of the Electric Company. The postponement was provided until June 30, 2018.

g. On March 3, 2014, the Company announced that during an inspection at the Hagit site, a leakage of diesel oil leaking into the Hagit stream was discovered. Upon discovery of the leakage, the Company carried out actions to stop it and locate its source. As yet, the Company cannot estimate the financial implications.

h. Regarding the Decision of the Commissioner of Wages and the Court’s decision on the matter, see Notes 12 g and 34 c 9 above.

i. Regarding labor disputes that occurred after the balance date see Note 34 c 11).
NOTE 36:-  SUBSEQUENT EVENTS AFTER THE STATEMENT OF FINANCIAL POSITION DATE, IN ADDITION TO THE DETAILS IN THE AFOREMENTIONED NOTES

j. On March 4, 2014, the Company signed a document of understandings with the Hindustan Salts Ltd., a company owned by the Government of India, and with the Sambhar Salts Ltd., which is a subsidiary of Hindustan Salts Ltd. (together: “HSL”), under which the Electric Company will share with HSL its expertise in development and execution of a solar energy project in India at a volume of up to 8000 megawatts. According to this document of understandings, the companies will act, inter alia, to execute feasibility studies for the stated project, and if positive results will be obtained, the parties will sign a final agreement whose terms will be agreed upon by the parties.

k. The conclusions of the team headed by the Director of the Government Companies Authority, Mr. Uri Yogev, were published on March 23, 2014. For further detail see Note 1 e above.

l. On March 21, 2014, the Company received the approval of its insurer (the Harel Company and its reinsurers) for an advance of Dollar 10 million with respect to compensation for the damage at the Gezer unit 40 of March 16, 2013. The Dollar 10 million advance is expected to be received during the coming period in payments, as will be transferred from time to time by the insurer.

m. **Material repayments after the date of the statement of financial position**

1) 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 repaid.

2) On March 19, 2014, private (non-negotiable) debentures of series Electric Linked 2014 in the amount of approximately NIS 169.7 million par value (a total of approximately NIS 197.5 million including linkage differentials were repaid).

For additional details see Note 20 c 3).

n) On March 24, 2014, the Board of Directors of the Company approved a private placement of non-negotiable debentures in Israel by one series during April 2014, or thereabout, at an amount of up to NIS 1 billion. The Board of Directors of the Company also approved, in accordance with the market conditions, to expand the issue and raise an additional sum approved by a team on behalf of the Board of Directors.
NOTE 37:- RETROSPECTIVE IMPLEMENTATION OF IAS 19 (2011) – “EMPLOYEE BENEFITS”

a. Effect of retrospective implementation on items of the Statements of Financial Position:

The Company is implementing the IAS 19 (2011) standard – “Employee Benefits” from January 1, 2013, by way of retrospective implementation. (see Note 2 y) 3) above).

The following are details of the main impact on the Company’s equity, profit, liabilities and assets.

The major changes in the accounting policy following the new standard:

1. The term “remeasurement” was defined. It includes three components: actuarial gains or losses due to the plan liability, yield on the plan assets except for sums that were included in the net interest of the net liability (the asset) for a definite benefit, and any change in the impact of the asset ceiling, except for amounts that were included in the net interest of the net liability (asset) for a definite benefit.

Remeasurements of the net liability (asset) for a definite benefit are partially recognized directly in capital in other comprehensive income, and are not reclassified to gain and loss in the consecutive period, and are partially capitalized to asset cost. The possibility to reject the recognition of actuarial gains losses under the corridor method was cancelled.

In other words, on the transition day and onwards, the asset for actuarial gains losses against the other comprehensive income charged to a remeasurement reserve fund, and against capitalization of assets cost, was cancelled. The reduction of the aforesaid against gain and loss and amending capitalization of assets cost was also cancelled.

2. All the costs of the transition services (whether they matured or not) with respect to the plan change, retrenchments and retirements – upon the execution of the plan, are immediately recognized in the period in which the plan was changed. I.e., a cancellation of past service cost that was not yet recognized was executed against gain and loss and capitalization of asset cost.

b. The effect on the Company’s equity, profit, liabilities and assets as on the transition date is as follows:

As of the date of January 1, 2011, an increase of approximately NIS 142 million in equity before tax effect (NIS 108 million after tax effect).

The effect on the Company’s equity, surplus, liabilities and assets is as follows:

<table>
<thead>
<tr>
<th>As of December 31, 2012</th>
<th>NIS in millions</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>As reported in the December 2012 Statement</td>
</tr>
<tr>
<td>Excess of pension plan assets over the pension liability</td>
<td>4,114</td>
</tr>
<tr>
<td>Liability for other benefits after termination of employment</td>
<td>(3,053)</td>
</tr>
<tr>
<td>Fixed assets, net</td>
<td>63,954</td>
</tr>
<tr>
<td>Intangible assets, net</td>
<td>890</td>
</tr>
<tr>
<td>Deferred taxes, net</td>
<td>(5,453)</td>
</tr>
<tr>
<td>Capital remeasurement reserves</td>
<td>-</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>(14,938)</td>
</tr>
<tr>
<td>Equity</td>
<td>(17,105)</td>
</tr>
</tbody>
</table>
NOTE 37:- RETROSPECTIVE IMPLEMENTATION OF IAS 19 (2011) – “EMPLOYEE BENEFITS” (continued)

c. Effect of retrospective implementation on items of the statements of operations/comprehensive income:

<table>
<thead>
<tr>
<th></th>
<th>For the year ended December 31, 2012</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>NIS in millions</td>
<td>As previously reported (in the December 2012 Statement)</td>
<td>Effect of retrospective implementation</td>
</tr>
<tr>
<td>Wages (belonging to the cost of operating the electricity system)</td>
<td>2,110</td>
<td>256</td>
<td>2,336</td>
</tr>
<tr>
<td>Depreciation and amortization (belonging to the cost of operating the electricity system)</td>
<td>4,371</td>
<td>37</td>
<td>4,408</td>
</tr>
<tr>
<td>Cost of operating the electricity system</td>
<td>23,149</td>
<td>293</td>
<td>23,442</td>
</tr>
<tr>
<td>Sales and marketing expenses</td>
<td>976</td>
<td>91</td>
<td>1,067</td>
</tr>
<tr>
<td>General and administrative expenses</td>
<td>812</td>
<td>59</td>
<td>871</td>
</tr>
<tr>
<td>Expenses from liabilities to pensioners, net</td>
<td>1,573</td>
<td>(26)</td>
<td>1,547</td>
</tr>
<tr>
<td>Loss before taxes on income</td>
<td>(881)</td>
<td>(417)</td>
<td>(1,298)</td>
</tr>
<tr>
<td>Taxes on income</td>
<td>(190)</td>
<td>(104)</td>
<td>(294)</td>
</tr>
<tr>
<td>Loss for the year</td>
<td>(690)</td>
<td>(313)</td>
<td>(1,004)</td>
</tr>
<tr>
<td>Other comprehensive loss after tax</td>
<td>-</td>
<td>(786)</td>
<td>786</td>
</tr>
<tr>
<td>Comprehensive loss for the year</td>
<td>(690)</td>
<td>(1,100)</td>
<td>(1,790)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>For the year ended December 31, 2011</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>NIS in millions</td>
<td>As previously reported (in the December 2012 Statement)</td>
<td>Effect of retrospective implementation</td>
</tr>
<tr>
<td>Wages (belonging to the cost of operating the electricity system)</td>
<td>1,741</td>
<td>2</td>
<td>1,743</td>
</tr>
<tr>
<td>Depreciation and amortization (belonging to the cost of operating the electricity system)</td>
<td>4,205</td>
<td>20</td>
<td>4,225</td>
</tr>
<tr>
<td>Cost of operating the electricity system</td>
<td>20,734</td>
<td>22</td>
<td>20,756</td>
</tr>
<tr>
<td>Sales and marketing expenses</td>
<td>909</td>
<td>1</td>
<td>910</td>
</tr>
<tr>
<td>General and administrative expenses</td>
<td>739</td>
<td>-</td>
<td>739</td>
</tr>
<tr>
<td>Expenses from liabilities to pensioners, net</td>
<td>151</td>
<td>4</td>
<td>155</td>
</tr>
<tr>
<td>Profit before taxes on income</td>
<td>593</td>
<td>(27)</td>
<td>566</td>
</tr>
<tr>
<td>Taxes on income</td>
<td>158</td>
<td>(7)</td>
<td>151</td>
</tr>
<tr>
<td>Loss for the year</td>
<td>(813)</td>
<td>(20)</td>
<td>(833)</td>
</tr>
<tr>
<td>Other comprehensive loss after tax</td>
<td>-</td>
<td>(627)</td>
<td>(627)</td>
</tr>
<tr>
<td>Comprehensive loss for the year</td>
<td>(813)</td>
<td>(647)</td>
<td>(1,460)</td>
</tr>
</tbody>
</table>
**NOTE 38:** ADDITIONAL INFORMATION REQUIRED IN ACCORDANCE WITH THE PROVISIONS OF THE GOVERNMENT COMPANIES AUTHORITY REGARDING THE ATTRIBUTION OF THE STATEMENT OF OPERATIONS & COMPREHENSIVE INCOME AND THE STATEMENT OF FINANCIAL POSITION ACCORDING TO ACTIVITY SEGMENTS: GENERATION, TRANSMISSION AND DISTRIBUTION (SEE NOTE 3.b AND 3.c TO THE ANNUAL FINANCIAL STATEMENTS)

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.

### Statement of operations for the year ended December 31, 2013:

<table>
<thead>
<tr>
<th></th>
<th>Total Company</th>
<th>Generation segment</th>
<th>Transmission segment</th>
<th>Distribution segment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Required revenues</strong></td>
<td>29,825</td>
<td>22,687</td>
<td>3,182</td>
<td>3,956</td>
</tr>
<tr>
<td><strong>Adjustment for segment revenues</strong></td>
<td>(2,549)</td>
<td>(1,398)</td>
<td>(101)</td>
<td>(1,050)</td>
</tr>
<tr>
<td><strong>Revenues from electricity</strong></td>
<td>27,276</td>
<td>21,289</td>
<td>3,081</td>
<td>2,906</td>
</tr>
<tr>
<td><strong>Other revenues</strong></td>
<td>380</td>
<td>195</td>
<td>14</td>
<td>171</td>
</tr>
<tr>
<td><strong>Total revenues</strong></td>
<td>27,656</td>
<td>21,484</td>
<td>3,095</td>
<td>3,077</td>
</tr>
<tr>
<td><strong>Cost for operating the electricity system</strong></td>
<td>24,256</td>
<td>20,462</td>
<td>2,173</td>
<td>1,621</td>
</tr>
<tr>
<td><strong>Income from operating the electricity system</strong></td>
<td>3,400</td>
<td>1,022</td>
<td>922</td>
<td>1,456</td>
</tr>
<tr>
<td>Sales and marketing expenses</td>
<td>905</td>
<td>-</td>
<td>-</td>
<td>905</td>
</tr>
<tr>
<td>Administrative and general expenses</td>
<td>1,113</td>
<td>638</td>
<td>150</td>
<td>325</td>
</tr>
<tr>
<td>Expenses from liabilities to pensioners, net</td>
<td>20</td>
<td>10</td>
<td>2</td>
<td>8</td>
</tr>
<tr>
<td></td>
<td>2,038</td>
<td>648</td>
<td>152</td>
<td>1,238</td>
</tr>
<tr>
<td><strong>Income from current operations</strong></td>
<td>1,362</td>
<td>374</td>
<td>770</td>
<td>218</td>
</tr>
<tr>
<td>Financial expenses, net</td>
<td>2,170</td>
<td>983</td>
<td>485</td>
<td>702</td>
</tr>
<tr>
<td><strong>Income (loss) before income taxes</strong></td>
<td>(808)</td>
<td>(609)</td>
<td>285</td>
<td>(484)</td>
</tr>
<tr>
<td>Income taxes</td>
<td>126</td>
<td>95</td>
<td>(45)</td>
<td>76</td>
</tr>
<tr>
<td><strong>Net Income (loss) after income tax</strong></td>
<td>(934)</td>
<td>(704)</td>
<td>330</td>
<td>(560)</td>
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<tr>
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<td>(2)</td>
<td>-</td>
<td>-</td>
<td>(2)</td>
</tr>
<tr>
<td><strong>Profit (loss) for the year</strong></td>
<td>(936)</td>
<td>(704)</td>
<td>330</td>
<td>(562)</td>
</tr>
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</table>
### Details of the generation sites statement of operations for the year ended December 31, 2013:

<table>
<thead>
<tr>
<th></th>
<th>Total generation segment</th>
<th>PEP and others</th>
<th>Rutenberg</th>
<th>Orot Rabin</th>
</tr>
</thead>
<tbody>
<tr>
<td>Required revenues</td>
<td>22,687</td>
<td>467</td>
<td>4,455</td>
<td>5,183</td>
</tr>
<tr>
<td>Adjustment for segment revenues</td>
<td>(1,398)</td>
<td>-</td>
<td>(280)</td>
<td>(326)</td>
</tr>
<tr>
<td>Revenues from electricity</td>
<td>21,289</td>
<td>467</td>
<td>4,175</td>
<td>4,857</td>
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<tr>
<td>Other revenues</td>
<td>195</td>
<td>-</td>
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<td>44</td>
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<tr>
<td>Total revenues</td>
<td>21,484</td>
<td>467</td>
<td>4,219</td>
<td>4,901</td>
</tr>
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<td>4,808</td>
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<tr>
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<td>371</td>
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<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Administrative and general expenses</td>
<td>638</td>
<td>-</td>
<td>133</td>
<td>151</td>
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<tr>
<td>Expenses from liabilities to pensioners, net</td>
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<td>-</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>648</td>
<td>-</td>
<td>135</td>
<td>153</td>
</tr>
<tr>
<td><strong>Income (loss) from current operations</strong></td>
<td>374</td>
<td>4</td>
<td>236</td>
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<tr>
<td>Financial expenses, net</td>
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<td>286</td>
<td>149</td>
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<tr>
<td><strong>Income (loss) before income taxes</strong></td>
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<td>(50)</td>
<td>(209)</td>
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<tr>
<td>Income taxes</td>
<td>95</td>
<td>(1)</td>
<td>8</td>
<td>35</td>
</tr>
<tr>
<td><strong>Net Income (loss)</strong></td>
<td>(704)</td>
<td>3</td>
<td>(58)</td>
<td>(244)</td>
</tr>
<tr>
<td>Company’s share of the loss of included companies, net</td>
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<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Profit (loss) for the year</strong></td>
<td>(704)</td>
<td>3</td>
<td>(58)</td>
<td>(244)</td>
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b. Details of the generation sites statement of operations for the year ended December 31, 2013 (continued)

<table>
<thead>
<tr>
<th></th>
<th>Haifa</th>
<th>Reading</th>
<th>Eshkol</th>
<th>Gezer</th>
</tr>
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<tr>
<td>Required revenues</td>
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<td>668</td>
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<td>2,425</td>
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<td>(159)</td>
<td>(153)</td>
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<td>Revenues from electricity</td>
<td>1,482</td>
<td>626</td>
<td>2,370</td>
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<td>Other revenues</td>
<td>13</td>
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<td>27</td>
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<td>Total revenues</td>
<td>1,495</td>
<td>637</td>
<td>2,397</td>
<td>2,289</td>
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<td>612</td>
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<td>2,164</td>
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<tr>
<td>Administrative and general expenses</td>
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<td>36</td>
<td>88</td>
<td>55</td>
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<td>1</td>
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<tr>
<td></td>
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<td>(38)</td>
<td>69</td>
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<tr>
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<td>16</td>
<td>67</td>
<td>123</td>
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<td>Loss before income taxes</td>
<td>(34)</td>
<td>(28)</td>
<td>(105)</td>
<td>(54)</td>
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<tr>
<td>Income taxes</td>
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<td>5</td>
<td>16</td>
<td>8</td>
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<tr>
<td>Net loss</td>
<td>(39)</td>
<td>(33)</td>
<td>(121)</td>
<td>(62)</td>
</tr>
<tr>
<td>Company’s share of the loss of included companies, net</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Loss for the year</td>
<td>(39)</td>
<td>(33)</td>
<td>(121)</td>
<td>(62)</td>
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### Details of the generation sites statement of operations for the year ended December 31, 2013 (continued)

<table>
<thead>
<tr>
<th></th>
<th>Hagit</th>
<th>Alon Tavor</th>
<th>Ramat Hovav</th>
<th>Zafit</th>
<th>Other gas turbines</th>
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<tbody>
<tr>
<td>Required revenues</td>
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<td>995</td>
<td>1,160</td>
<td>967</td>
<td>192</td>
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<td>(73)</td>
<td>(61)</td>
<td>(12)</td>
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<td>revenues</td>
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<td>906</td>
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<td>17</td>
<td>49</td>
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<td>22</td>
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<tr>
<td>Expenses from liabilities</td>
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<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>to pensioners, net</td>
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<td>25</td>
<td>29</td>
<td>22</td>
<td>9</td>
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<td>18</td>
<td>20</td>
<td>(5)</td>
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</tr>
<tr>
<td>Financial expenses, net</td>
<td>104</td>
<td>45</td>
<td>52</td>
<td>31</td>
<td>29</td>
</tr>
<tr>
<td>Income (loss) before</td>
<td>(47)</td>
<td>(27)</td>
<td>(32)</td>
<td>(36)</td>
<td>11</td>
</tr>
<tr>
<td>income taxes</td>
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<td></td>
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</tr>
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<td>5</td>
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<td>(2)</td>
</tr>
<tr>
<td>Net Income (loss)</td>
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<td>(31)</td>
<td>(37)</td>
<td>(41)</td>
<td>13</td>
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<td>-</td>
<td>-</td>
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<tr>
<td>loss of included</td>
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<td>(31)</td>
<td>(37)</td>
<td>(41)</td>
<td>13</td>
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<tr>
<td>year</td>
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<td></td>
<td></td>
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c. Details of the distribution sites statement of operations for the year ended December 31, 2013

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<thead>
<tr>
<th></th>
<th>Total distribution segment</th>
<th>Northern District</th>
<th>Haifa District</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Required revenues</strong></td>
<td>NIS in millions</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>3,956</td>
<td>814</td>
<td>466</td>
</tr>
<tr>
<td><strong>Adjustment for segment revenues</strong></td>
<td>(1,050)</td>
<td>(216)</td>
<td>(124)</td>
</tr>
<tr>
<td><strong>Revenues from electricity</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>2,906</td>
<td>598</td>
<td>342</td>
</tr>
<tr>
<td><strong>Other revenues</strong></td>
<td></td>
<td>171</td>
<td>38</td>
</tr>
<tr>
<td><strong>Total revenues</strong></td>
<td></td>
<td>636</td>
<td>363</td>
</tr>
<tr>
<td><strong>Cost for operating the electricity system</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1,621</td>
<td>316</td>
<td>200</td>
</tr>
<tr>
<td><strong>Income from operating the electricity system</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1,456</td>
<td>320</td>
<td>163</td>
</tr>
<tr>
<td><strong>Sales and marketing expenses</strong></td>
<td></td>
<td>905</td>
<td>199</td>
</tr>
<tr>
<td><strong>Administrative and general expenses</strong></td>
<td></td>
<td>325</td>
<td>66</td>
</tr>
<tr>
<td><strong>Expenses from liabilities to pensioners, net</strong></td>
<td></td>
<td>8</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1,238</td>
<td>267</td>
</tr>
<tr>
<td><strong>Income from current operations</strong></td>
<td></td>
<td>218</td>
<td>53</td>
</tr>
<tr>
<td><strong>Financial expenses, net</strong></td>
<td></td>
<td>702</td>
<td>148</td>
</tr>
<tr>
<td><strong>Loss before income taxes</strong></td>
<td>(484)</td>
<td>(95)</td>
<td>(61)</td>
</tr>
<tr>
<td><strong>Income taxes</strong></td>
<td></td>
<td>76</td>
<td>15</td>
</tr>
<tr>
<td><strong>Net loss</strong></td>
<td>(560)</td>
<td>(110)</td>
<td>(71)</td>
</tr>
<tr>
<td><strong>Company’s share of the loss of included companies, net</strong></td>
<td>(2)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Loss for the year</strong></td>
<td>(562)</td>
<td>(110)</td>
<td>(71)</td>
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</table>
c. Details of the distribution sites statement of operations for the year ended December 31, 2013 (continued)

<table>
<thead>
<tr>
<th></th>
<th>Jerusalem District</th>
<th>Dan District</th>
<th>Southern District</th>
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</thead>
<tbody>
<tr>
<td>Required revenues</td>
<td>539</td>
<td>778</td>
<td>1,359</td>
</tr>
<tr>
<td>Adjustment for segment revenues</td>
<td>(143)</td>
<td>(206)</td>
<td>(361)</td>
</tr>
<tr>
<td>Revenues from electricity</td>
<td>396</td>
<td>572</td>
<td>998</td>
</tr>
<tr>
<td>Other revenues</td>
<td>16</td>
<td>27</td>
<td>69</td>
</tr>
<tr>
<td><strong>Total revenues</strong></td>
<td><strong>412</strong></td>
<td><strong>599</strong></td>
<td><strong>1,067</strong></td>
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<td>Cost for operating the electricity system</td>
<td>249</td>
<td>322</td>
<td>534</td>
</tr>
<tr>
<td><strong>Income from operating the electricity system</strong></td>
<td><strong>163</strong></td>
<td><strong>277</strong></td>
<td><strong>533</strong></td>
</tr>
<tr>
<td>Sales and marketing expenses</td>
<td>100</td>
<td>175</td>
<td>327</td>
</tr>
<tr>
<td>Administrative and general expenses</td>
<td>46</td>
<td>60</td>
<td>112</td>
</tr>
<tr>
<td>Expenses from liabilities to pensioners, net</td>
<td>1</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td><strong>Income from current operations</strong></td>
<td><strong>16</strong></td>
<td><strong>40</strong></td>
<td><strong>92</strong></td>
</tr>
<tr>
<td>Financial expenses, net</td>
<td>88</td>
<td>136</td>
<td>252</td>
</tr>
<tr>
<td><strong>Loss before income taxes</strong></td>
<td><strong>(72)</strong></td>
<td><strong>(96)</strong></td>
<td><strong>(160)</strong></td>
</tr>
<tr>
<td>Income taxes</td>
<td>11</td>
<td>16</td>
<td>24</td>
</tr>
<tr>
<td><strong>Net loss</strong></td>
<td><strong>(83)</strong></td>
<td><strong>(112)</strong></td>
<td><strong>(184)</strong></td>
</tr>
<tr>
<td>Company’s share of the loss of included companies, net</td>
<td>-</td>
<td>(1)</td>
<td>(1)</td>
</tr>
<tr>
<td><strong>Loss for the year</strong></td>
<td><strong>(83)</strong></td>
<td><strong>(113)</strong></td>
<td><strong>(185)</strong></td>
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d. **Statement of Financial Position as of December 31, 2013:**

<table>
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<th></th>
<th>Total Company</th>
<th>Generation segment</th>
<th>Transmission segment</th>
<th>Distribution segment</th>
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<tr>
<td><strong>Current assets</strong></td>
<td>12,799</td>
<td>8,138</td>
<td>1,624</td>
<td>3,037</td>
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<tr>
<td><strong>Long-term receivables</strong></td>
<td>7,456</td>
<td>5,038</td>
<td>482</td>
<td>1,936</td>
</tr>
<tr>
<td><strong>Fixed assets, net</strong></td>
<td>64,721</td>
<td>30,625</td>
<td>14,332</td>
<td>19,764</td>
</tr>
<tr>
<td><strong>Intangible assets, net</strong></td>
<td>948</td>
<td>429</td>
<td>206</td>
<td>313</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>85,924</td>
<td>44,230</td>
<td>16,644</td>
<td>25,050</td>
</tr>
<tr>
<td><strong>Current liabilities</strong></td>
<td>11,714</td>
<td>6,060</td>
<td>2,433</td>
<td>3,221</td>
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<tr>
<td><strong>Non-current liabilities, net</strong></td>
<td>59,399</td>
<td>31,463</td>
<td>11,000</td>
<td>16,936</td>
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<tr>
<td><strong>Shareholders' equity</strong></td>
<td>14,811</td>
<td>6,707</td>
<td>3,211</td>
<td>4,893</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>85,924</td>
<td>44,230</td>
<td>16,644</td>
<td>25,050</td>
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</table>
### e. Details of the generation segment Statement of Financial Position as of December 31, 2013:

<table>
<thead>
<tr>
<th></th>
<th>Total generation segment</th>
<th>PEP and others</th>
<th>Rutenberg</th>
<th>Orot Rabin</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>NIS in millions</td>
<td>NIS in millions</td>
<td>NIS in millions</td>
<td>NIS in millions</td>
</tr>
<tr>
<td>Current assets</td>
<td>8,138</td>
<td>210</td>
<td>1,735</td>
<td>1,696</td>
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<tr>
<td>Long-term receivables</td>
<td>5,038</td>
<td>655</td>
<td>907</td>
<td>1,133</td>
</tr>
<tr>
<td>Fixed assets, net</td>
<td>30,625</td>
<td>137</td>
<td>8,071</td>
<td>5,119</td>
</tr>
<tr>
<td>Intangible assets, net</td>
<td>429</td>
<td>2</td>
<td>116</td>
<td>58</td>
</tr>
<tr>
<td></td>
<td><strong>44,230</strong></td>
<td><strong>1,004</strong></td>
<td><strong>10,829</strong></td>
<td><strong>8,006</strong></td>
</tr>
<tr>
<td>Current liabilities</td>
<td>6,060</td>
<td>143</td>
<td>1,516</td>
<td>1,193</td>
</tr>
<tr>
<td>Non-current liabilities, net</td>
<td>31,463</td>
<td>831</td>
<td>7,502</td>
<td>5,912</td>
</tr>
<tr>
<td>Shareholders' equity</td>
<td>6,707</td>
<td>30</td>
<td>1,811</td>
<td>901</td>
</tr>
<tr>
<td></td>
<td><strong>44,230</strong></td>
<td><strong>1,004</strong></td>
<td><strong>10,829</strong></td>
<td><strong>8,006</strong></td>
</tr>
</tbody>
</table>
e. Details of the generation segment Statement of Financial Position as of December 31, 2013 (continued):

<table>
<thead>
<tr>
<th></th>
<th>Haifa</th>
<th>Reading</th>
<th>Eshkol</th>
<th>Gezer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets</td>
<td>641</td>
<td>259</td>
<td>863</td>
<td>818</td>
</tr>
<tr>
<td>Long-term receivables</td>
<td>331</td>
<td>192</td>
<td>578</td>
<td>347</td>
</tr>
<tr>
<td>Fixed assets, net</td>
<td>2,789</td>
<td>449</td>
<td>2,589</td>
<td>3,075</td>
</tr>
<tr>
<td>Intangible assets, net</td>
<td>42</td>
<td>7</td>
<td>26</td>
<td>50</td>
</tr>
<tr>
<td></td>
<td><strong>3,803</strong></td>
<td><strong>907</strong></td>
<td><strong>4,056</strong></td>
<td><strong>4,290</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Haifa</th>
<th>Reading</th>
<th>Eshkol</th>
<th>Gezer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current liabilities</td>
<td>467</td>
<td>116</td>
<td>617</td>
<td>522</td>
</tr>
<tr>
<td>Non-current liabilities, net</td>
<td>2,659</td>
<td>679</td>
<td>3,028</td>
<td>2,993</td>
</tr>
<tr>
<td>Shareholders' equity</td>
<td>677</td>
<td>112</td>
<td>411</td>
<td>775</td>
</tr>
<tr>
<td></td>
<td><strong>3,803</strong></td>
<td><strong>907</strong></td>
<td><strong>4,056</strong></td>
<td><strong>4,290</strong></td>
</tr>
</tbody>
</table>
e. Details of the generation segment Statement of Financial Position as of December 31, 2013 (continued):

<table>
<thead>
<tr>
<th></th>
<th>Hagit</th>
<th>Alon Tavor</th>
<th>Ramat Hovav</th>
<th>Zafit</th>
<th>Other gas turbines</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets</td>
<td>740</td>
<td>318</td>
<td>405</td>
<td>337</td>
<td>116</td>
</tr>
<tr>
<td>Long-term receivables</td>
<td>338</td>
<td>161</td>
<td>196</td>
<td>155</td>
<td>45</td>
</tr>
<tr>
<td>Fixed assets, net</td>
<td>3,101</td>
<td>1,128</td>
<td>1,836</td>
<td>1,156</td>
<td>1,175</td>
</tr>
<tr>
<td>Intangible assets, net</td>
<td>49</td>
<td>18</td>
<td>29</td>
<td>19</td>
<td>13</td>
</tr>
<tr>
<td></td>
<td><strong>4,228</strong></td>
<td><strong>1,625</strong></td>
<td><strong>2,466</strong></td>
<td><strong>1,667</strong></td>
<td><strong>1,349</strong></td>
</tr>
<tr>
<td>Current liabilities</td>
<td>525</td>
<td>213</td>
<td>317</td>
<td>207</td>
<td>224</td>
</tr>
<tr>
<td>Non-current liabilities, net</td>
<td>2,932</td>
<td>1,134</td>
<td>1,703</td>
<td>1,169</td>
<td>921</td>
</tr>
<tr>
<td>Shareholders' equity</td>
<td>771</td>
<td>278</td>
<td>446</td>
<td>291</td>
<td>204</td>
</tr>
<tr>
<td></td>
<td><strong>4,228</strong></td>
<td><strong>1,625</strong></td>
<td><strong>2,466</strong></td>
<td><strong>1,667</strong></td>
<td><strong>1,349</strong></td>
</tr>
</tbody>
</table>
f. **Details of the distribution segment Statement of Financial Position as of December 31, 2013:**

<table>
<thead>
<tr>
<th></th>
<th>Total distribution segment</th>
<th>Northern District</th>
<th>Haifa District</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current assets</strong></td>
<td>3,037</td>
<td>618</td>
<td>355</td>
</tr>
<tr>
<td><strong>Long-term receivables</strong></td>
<td>1,936</td>
<td>399</td>
<td>245</td>
</tr>
<tr>
<td><strong>Fixed assets, net</strong></td>
<td>19,764</td>
<td>4,158</td>
<td>2,147</td>
</tr>
<tr>
<td><strong>Intangible assets, net</strong></td>
<td>313</td>
<td>66</td>
<td>34</td>
</tr>
<tr>
<td><strong>Current liabilities</strong></td>
<td>3,221</td>
<td>697</td>
<td>350</td>
</tr>
<tr>
<td><strong>Non-current liabilities, net</strong></td>
<td>16,936</td>
<td>3,511</td>
<td>1,896</td>
</tr>
<tr>
<td><strong>Shareholders' equity</strong></td>
<td>4,893</td>
<td>1,033</td>
<td>535</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>25,050</td>
<td>5,241</td>
<td>2,781</td>
</tr>
</tbody>
</table>
f. Details of the distribution segment statement of financial position as of December 31, 2013 (continued):

<table>
<thead>
<tr>
<th></th>
<th>Jerusalem District</th>
<th>Dan District</th>
<th>Southern District</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current assets</strong></td>
<td>414</td>
<td>585</td>
<td>1,065</td>
</tr>
<tr>
<td><strong>Long-term receivables</strong></td>
<td>277</td>
<td>372</td>
<td>643</td>
</tr>
<tr>
<td><strong>Fixed assets, net</strong></td>
<td>2,513</td>
<td>3,742</td>
<td>7,204</td>
</tr>
<tr>
<td><strong>Intangible assets, net</strong></td>
<td>40</td>
<td>60</td>
<td>113</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>3,244</td>
<td>4,759</td>
<td>9,025</td>
</tr>
<tr>
<td><strong>Current liabilities</strong></td>
<td>429</td>
<td>574</td>
<td>1,171</td>
</tr>
<tr>
<td><strong>Non-current liabilities, net</strong></td>
<td>2,197</td>
<td>3,252</td>
<td>6,080</td>
</tr>
<tr>
<td><strong>Shareholders' equity</strong></td>
<td>618</td>
<td>933</td>
<td>1,774</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>3,244</td>
<td>4,759</td>
<td>9,025</td>
</tr>
</tbody>
</table>
### Statement of operations for the year ended December 31, 2012:

<table>
<thead>
<tr>
<th></th>
<th>Total Company</th>
<th>Generation segment</th>
<th>Transmission segment</th>
<th>Distribution segment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Required revenues</strong></td>
<td>30,245</td>
<td>22,934</td>
<td>2,806</td>
<td>4,505</td>
</tr>
<tr>
<td><strong>Adjustment for segment revenues</strong></td>
<td>(2,232)</td>
<td>(448)</td>
<td>(158)</td>
<td>(1,626)</td>
</tr>
<tr>
<td><strong>Revenues from electricity</strong></td>
<td>28,013</td>
<td>22,486</td>
<td>2,648</td>
<td>2,879</td>
</tr>
<tr>
<td><strong>Other revenues</strong></td>
<td>307</td>
<td>140</td>
<td>12</td>
<td>155</td>
</tr>
<tr>
<td><strong>Total revenues</strong></td>
<td>28,320</td>
<td>22,626</td>
<td>2,660</td>
<td>3,034</td>
</tr>
<tr>
<td><strong>Cost for operating the electricity system</strong></td>
<td>23,442</td>
<td>19,963</td>
<td>1,859</td>
<td>1,620</td>
</tr>
<tr>
<td><strong>Income from operating the electricity system</strong></td>
<td>4,878</td>
<td>2,663</td>
<td>801</td>
<td>1,414</td>
</tr>
<tr>
<td><strong>Sales and marketing expenses</strong></td>
<td>1,067</td>
<td>-</td>
<td>-</td>
<td>1,067</td>
</tr>
<tr>
<td><strong>Administrative and general expenses</strong></td>
<td>871</td>
<td>445</td>
<td>133</td>
<td>293</td>
</tr>
<tr>
<td><strong>Expenses from liabilities to pensioners, net</strong></td>
<td>1,547</td>
<td>811</td>
<td>120</td>
<td>616</td>
</tr>
<tr>
<td><strong>Financial expenses, net</strong></td>
<td>2,691</td>
<td>1,217</td>
<td>603</td>
<td>871</td>
</tr>
<tr>
<td><strong>Income (loss) from current operations</strong></td>
<td>1,393</td>
<td>1,407</td>
<td>548</td>
<td>(562)</td>
</tr>
<tr>
<td><strong>Income (loss) before income taxes</strong></td>
<td>(1,298)</td>
<td>190</td>
<td>(55)</td>
<td>(1,433)</td>
</tr>
<tr>
<td><strong>Income taxes</strong></td>
<td>(294)</td>
<td>43</td>
<td>(12)</td>
<td>(325)</td>
</tr>
<tr>
<td><strong>Net Income (loss)</strong></td>
<td>(1,004)</td>
<td>147</td>
<td>(43)</td>
<td>(1,108)</td>
</tr>
</tbody>
</table>

(*) Retrospective implementation of IAS 19 (2011) – see Note 37 above.
### Details of the generation segment statement of income for the year ended December 31, 2012:

<table>
<thead>
<tr>
<th></th>
<th>Total generation segment</th>
<th>PEP and others</th>
<th>Rutenberg</th>
<th>Orot Rabin</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Required revenues</strong> *</td>
<td>22,934</td>
<td>232</td>
<td>4,269</td>
<td>4,405</td>
</tr>
<tr>
<td><strong>Adjustment for segment revenues</strong></td>
<td>(448)</td>
<td>-</td>
<td>(83)</td>
<td>(87)</td>
</tr>
<tr>
<td><strong>Revenues from electricity</strong></td>
<td>22,486</td>
<td>232</td>
<td>4,186</td>
<td>4,318</td>
</tr>
<tr>
<td><strong>Other revenues</strong></td>
<td>140</td>
<td>-</td>
<td>29</td>
<td>30</td>
</tr>
<tr>
<td><strong>Total revenues</strong></td>
<td>22,626</td>
<td>232</td>
<td>4,215</td>
<td>4,348</td>
</tr>
<tr>
<td><strong>Cost for operating the electricity system</strong> *</td>
<td>19,963</td>
<td>232</td>
<td>3,492</td>
<td>3,836</td>
</tr>
<tr>
<td><strong>Income from operating the electricity system</strong></td>
<td>2,663</td>
<td>-</td>
<td>723</td>
<td>512</td>
</tr>
<tr>
<td><strong>Sales and marketing expenses</strong> *</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Administrative and general expenses</strong> *</td>
<td>445</td>
<td>-</td>
<td>84</td>
<td>101</td>
</tr>
<tr>
<td><strong>Expenses from liabilities to pensioners, net</strong> *</td>
<td>811</td>
<td>-</td>
<td>162</td>
<td>206</td>
</tr>
<tr>
<td><strong>Financial expenses, net</strong></td>
<td>1,217</td>
<td>-</td>
<td>366</td>
<td>192</td>
</tr>
<tr>
<td><strong>Income from current operations</strong></td>
<td>1,407</td>
<td>-</td>
<td>477</td>
<td>205</td>
</tr>
<tr>
<td><strong>Income before income taxes</strong></td>
<td>190</td>
<td>-</td>
<td>111</td>
<td>13</td>
</tr>
<tr>
<td><strong>Income taxes</strong> *</td>
<td>43</td>
<td>-</td>
<td>25</td>
<td>3</td>
</tr>
<tr>
<td><strong>Net Income</strong> *</td>
<td>147</td>
<td>-</td>
<td>86</td>
<td>10</td>
</tr>
</tbody>
</table>

(* Retrospective implementation of IAS 19 (2011) – see Note 37 above.)
h. Details of the generation segment statement of income for the year ended December 31, 2012 (continued):

<table>
<thead>
<tr>
<th></th>
<th>Haifa</th>
<th>Reading</th>
<th>Eshkol</th>
<th>Gezer</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Required revenues</strong> *</td>
<td>1,199</td>
<td>441</td>
<td>3,700</td>
<td>2,211</td>
</tr>
<tr>
<td><strong>Adjustment for segment revenues</strong></td>
<td>(24)</td>
<td>(9)</td>
<td>(73)</td>
<td>(44)</td>
</tr>
<tr>
<td><strong>Revenues from electricity</strong></td>
<td>1,175</td>
<td>432</td>
<td>3,627</td>
<td>2,167</td>
</tr>
<tr>
<td><strong>Other revenues</strong></td>
<td>9</td>
<td>9</td>
<td>19</td>
<td>14</td>
</tr>
<tr>
<td><strong>Total revenues</strong></td>
<td>1,184</td>
<td>441</td>
<td>3,646</td>
<td>2,181</td>
</tr>
<tr>
<td><strong>Cost for operating the electricity system</strong> *</td>
<td>962</td>
<td>328</td>
<td>3,880</td>
<td>1,907</td>
</tr>
<tr>
<td><strong>Income from operating the electricity system</strong></td>
<td>222</td>
<td>113</td>
<td>266</td>
<td>274</td>
</tr>
<tr>
<td><strong>Sales and marketing expenses</strong> *</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Administrative and general expenses</strong> *</td>
<td>28</td>
<td>33</td>
<td>71</td>
<td>34</td>
</tr>
<tr>
<td><strong>Expenses from liabilities to pensioners, net</strong> *</td>
<td>62</td>
<td>59</td>
<td>136</td>
<td>43</td>
</tr>
<tr>
<td><strong>Income from current operations</strong></td>
<td>132</td>
<td>21</td>
<td>59</td>
<td>197</td>
</tr>
<tr>
<td><strong>Financial expenses, net</strong></td>
<td>102</td>
<td>20</td>
<td>88</td>
<td>157</td>
</tr>
<tr>
<td><strong>Income (loss) before income taxes</strong></td>
<td>30</td>
<td>1</td>
<td>(29)</td>
<td>40</td>
</tr>
<tr>
<td><strong>Income taxes</strong> *</td>
<td>7</td>
<td>-</td>
<td>(6)</td>
<td>9</td>
</tr>
<tr>
<td><strong>Net Income (Loss)</strong> *</td>
<td>23</td>
<td>1</td>
<td>(23)</td>
<td>31</td>
</tr>
</tbody>
</table>

(*) Retrospective implementation of IAS 19 (2011) – see Note 37 above.
h. Details of the generation segment statement of income for the year ended December 31, 2012 (continued):

<table>
<thead>
<tr>
<th></th>
<th>Hagit</th>
<th>Alon Tavor</th>
<th>Ramat Hovav</th>
<th>Zafit</th>
<th>Other gas turbines</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>NIS in millions</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Required revenues *</td>
<td>2,748</td>
<td>1,122</td>
<td>1,604</td>
<td>745</td>
<td>258</td>
</tr>
<tr>
<td>Adjustment for segment revenues</td>
<td>(54)</td>
<td>(22)</td>
<td>(32)</td>
<td>(15)</td>
<td>(5)</td>
</tr>
<tr>
<td>Revenues from electricity</td>
<td>2,694</td>
<td>1,100</td>
<td>1,572</td>
<td>730</td>
<td>253</td>
</tr>
<tr>
<td>Other revenues</td>
<td>10</td>
<td>7</td>
<td>6</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>Total revenues</td>
<td>2,704</td>
<td>1,107</td>
<td>1,578</td>
<td>735</td>
<td>255</td>
</tr>
<tr>
<td>Cost for operating the electricity system *</td>
<td>2,496</td>
<td>1,000</td>
<td>1,486</td>
<td>660</td>
<td>184</td>
</tr>
<tr>
<td>Income from operating the electricity system</td>
<td>208</td>
<td>107</td>
<td>92</td>
<td>75</td>
<td>71</td>
</tr>
<tr>
<td>Sales and marketing expenses *</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Administrative and general expenses *</td>
<td>35</td>
<td>18</td>
<td>22</td>
<td>12</td>
<td>7</td>
</tr>
<tr>
<td>Expenses from liabilities to pensioners, net *</td>
<td>56</td>
<td>24</td>
<td>36</td>
<td>16</td>
<td>11</td>
</tr>
<tr>
<td></td>
<td>91</td>
<td>42</td>
<td>58</td>
<td>28</td>
<td>18</td>
</tr>
<tr>
<td>Income from current operations</td>
<td>117</td>
<td>65</td>
<td>34</td>
<td>47</td>
<td>53</td>
</tr>
<tr>
<td>Financial expenses, net</td>
<td>112</td>
<td>58</td>
<td>44</td>
<td>40</td>
<td>38</td>
</tr>
<tr>
<td>Income (loss) before income taxes</td>
<td>5</td>
<td>7</td>
<td>(10)</td>
<td>7</td>
<td>15</td>
</tr>
<tr>
<td>Income taxes *</td>
<td>1</td>
<td>2</td>
<td>(2)</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Net Income (Loss) *</td>
<td>4</td>
<td>5</td>
<td>(8)</td>
<td>6</td>
<td>12</td>
</tr>
</tbody>
</table>

(*) Retrospective implementation of IAS 19 (2011) – see Note 37 above.
### i. Details of the distribution segment statement of operations for the year ended December 31, 2012:

<table>
<thead>
<tr>
<th></th>
<th>Total distribution segment</th>
<th>Northern District</th>
<th>Haifa District</th>
</tr>
</thead>
<tbody>
<tr>
<td>Required revenues *</td>
<td>4,505</td>
<td>958</td>
<td>553</td>
</tr>
<tr>
<td>Adjustment for segment revenues</td>
<td>(1,626)</td>
<td>(346)</td>
<td>(200)</td>
</tr>
<tr>
<td>Revenues from electricity</td>
<td>2,879</td>
<td>612</td>
<td>353</td>
</tr>
<tr>
<td>Other revenues</td>
<td>155</td>
<td>32</td>
<td>19</td>
</tr>
<tr>
<td>Total revenues</td>
<td>3,034</td>
<td>644</td>
<td>372</td>
</tr>
<tr>
<td>Cost for operating the electricity system *</td>
<td>1,620</td>
<td>326</td>
<td>216</td>
</tr>
<tr>
<td>Income from operating the electricity system</td>
<td>1,414</td>
<td>318</td>
<td>156</td>
</tr>
<tr>
<td>Sales and marketing expenses *</td>
<td>1,067</td>
<td>249</td>
<td>119</td>
</tr>
<tr>
<td>Administrative and general expenses *</td>
<td>293</td>
<td>61</td>
<td>38</td>
</tr>
<tr>
<td>Expenses from liabilities to pensioners, net *</td>
<td>616</td>
<td>128</td>
<td>81</td>
</tr>
<tr>
<td>Loss from current operations</td>
<td>(562)</td>
<td>(120)</td>
<td>(82)</td>
</tr>
<tr>
<td>Financial expenses, net</td>
<td>871</td>
<td>184</td>
<td>97</td>
</tr>
<tr>
<td>Loss before income taxes</td>
<td>(1,433)</td>
<td>(304)</td>
<td>(179)</td>
</tr>
<tr>
<td>Income taxes *</td>
<td>(325)</td>
<td>(69)</td>
<td>(40)</td>
</tr>
<tr>
<td>Net loss *</td>
<td>(1,108)</td>
<td>(235)</td>
<td>(139)</td>
</tr>
</tbody>
</table>

(*) Retrospective implementation of IAS 19 (2011) – see Note 37 above.
### i. Details of the distribution segment statement of operations for the year ended December 31, 2012 (continued):

<table>
<thead>
<tr>
<th></th>
<th>Jerusalem District</th>
<th>Dan District</th>
<th>Southern District</th>
</tr>
</thead>
<tbody>
<tr>
<td>Required revenues *</td>
<td>561</td>
<td>912</td>
<td>1,521</td>
</tr>
<tr>
<td>Adjustment for segment revenues</td>
<td>(202)</td>
<td>(329)</td>
<td>(549)</td>
</tr>
<tr>
<td>Revenues from electricity</td>
<td>359</td>
<td>583</td>
<td>972</td>
</tr>
<tr>
<td>Other revenues</td>
<td>16</td>
<td>29</td>
<td>59</td>
</tr>
<tr>
<td><strong>Total revenues</strong></td>
<td><strong>375</strong></td>
<td><strong>612</strong></td>
<td><strong>1,031</strong></td>
</tr>
<tr>
<td>Cost for operating the electricity system *</td>
<td>229</td>
<td>333</td>
<td>516</td>
</tr>
<tr>
<td><strong>Income from operating the electricity system</strong></td>
<td><strong>146</strong></td>
<td><strong>279</strong></td>
<td><strong>515</strong></td>
</tr>
<tr>
<td>Sales and marketing expenses *</td>
<td>99</td>
<td>222</td>
<td>378</td>
</tr>
<tr>
<td>Administrative and general expenses *</td>
<td>37</td>
<td>56</td>
<td>101</td>
</tr>
<tr>
<td>Expenses from liabilities to pensioners, net *</td>
<td>78</td>
<td>122</td>
<td>207</td>
</tr>
<tr>
<td></td>
<td><strong>214</strong></td>
<td><strong>400</strong></td>
<td><strong>686</strong></td>
</tr>
<tr>
<td><strong>Loss from current operations</strong></td>
<td><strong>(68)</strong></td>
<td><strong>(121)</strong></td>
<td><strong>(171)</strong></td>
</tr>
<tr>
<td>Financial expenses, net</td>
<td>109</td>
<td>171</td>
<td>310</td>
</tr>
<tr>
<td><strong>Loss before income taxes</strong></td>
<td><strong>(177)</strong></td>
<td><strong>(292)</strong></td>
<td><strong>(481)</strong></td>
</tr>
<tr>
<td>Income taxes *</td>
<td>(40)</td>
<td>(66)</td>
<td>(110)</td>
</tr>
<tr>
<td>**Net loss ***</td>
<td><strong>(137)</strong></td>
<td><strong>(226)</strong></td>
<td><strong>(371)</strong></td>
</tr>
</tbody>
</table>

(*) Retrospective implementation of IAS 19 (2011) – see Note 37 above.
j. Statement of operations for the year ended December 31, 2011:

<table>
<thead>
<tr>
<th></th>
<th>Total Company</th>
<th>Generation segment</th>
<th>Transmission segment</th>
<th>Distribution segment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Required revenues</td>
<td>25,952</td>
<td>20,150</td>
<td>2,080</td>
<td>3,722</td>
</tr>
<tr>
<td>Adjustment for segment revenues</td>
<td>(834)</td>
<td>447</td>
<td>(226)</td>
<td>(1,055)</td>
</tr>
<tr>
<td>Revenues from electricity</td>
<td>25,118</td>
<td>20,597</td>
<td>1,854</td>
<td>2,667</td>
</tr>
<tr>
<td>Other revenues</td>
<td>268</td>
<td>132</td>
<td>6</td>
<td>130</td>
</tr>
<tr>
<td>Total revenues</td>
<td>25,386</td>
<td>20,729</td>
<td>1,860</td>
<td>2,797</td>
</tr>
<tr>
<td>Cost for operating the electricity system *</td>
<td>20,756</td>
<td>17,999</td>
<td>1,217</td>
<td>1,540</td>
</tr>
<tr>
<td>Income from operating the electricity system</td>
<td>4,630</td>
<td>2,730</td>
<td>643</td>
<td>1,257</td>
</tr>
<tr>
<td>Sales and marketing expenses *</td>
<td>910</td>
<td>-</td>
<td>-</td>
<td>910</td>
</tr>
<tr>
<td>Administrative and general expenses</td>
<td>739</td>
<td>360</td>
<td>112</td>
<td>267</td>
</tr>
<tr>
<td>Expenses from liabilities to pensioners, net *</td>
<td>155</td>
<td>82</td>
<td>12</td>
<td>61</td>
</tr>
<tr>
<td></td>
<td>1,804</td>
<td>442</td>
<td>124</td>
<td>1,238</td>
</tr>
<tr>
<td>Income from current operations</td>
<td>2,826</td>
<td>2,288</td>
<td>519</td>
<td>19</td>
</tr>
<tr>
<td>Financial expenses, net</td>
<td>2,260</td>
<td>1,028</td>
<td>518</td>
<td>714</td>
</tr>
<tr>
<td>Income (loss) before income taxes</td>
<td>566</td>
<td>1,260</td>
<td>1</td>
<td>(695)</td>
</tr>
<tr>
<td>Income taxes *</td>
<td>1,399</td>
<td>3,108</td>
<td>8</td>
<td>(1,717)</td>
</tr>
<tr>
<td>Net income (loss) *</td>
<td>(833)</td>
<td>(1,848)</td>
<td>(7)</td>
<td>1,022</td>
</tr>
</tbody>
</table>

(*) Retrospective implementation of IAS 19 (2011) – see Note 37 above.

#### k. Details of the generation segment statement of income for the year ended December 31, 2011:

<table>
<thead>
<tr>
<th>Total generation segment</th>
<th>NIS in millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Required revenues</td>
<td>20,150</td>
</tr>
<tr>
<td>Adjustment for segment revenues</td>
<td>447</td>
</tr>
<tr>
<td>Revenues from electricity</td>
<td>20,597</td>
</tr>
<tr>
<td>Other revenues</td>
<td>132</td>
</tr>
<tr>
<td>Total revenues</td>
<td>20,729</td>
</tr>
<tr>
<td>Cost for operating the electricity system *</td>
<td>17,999</td>
</tr>
<tr>
<td>Income from operating the electricity system</td>
<td>2,730</td>
</tr>
<tr>
<td>Sales and marketing expenses *</td>
<td>-</td>
</tr>
<tr>
<td>Administrative and general expenses</td>
<td>360</td>
</tr>
<tr>
<td>Expenses from liabilities to pensioners, net *</td>
<td>82</td>
</tr>
<tr>
<td>Financial expenses, net</td>
<td>1,028</td>
</tr>
<tr>
<td>Income before income taxes</td>
<td>1,260</td>
</tr>
<tr>
<td>Income taxes *</td>
<td>3,108</td>
</tr>
<tr>
<td>Net Loss *</td>
<td>(1,848)</td>
</tr>
</tbody>
</table>

(*) Retrospective implementation of IAS 19 (2011) – see Note 37 above.
### k. Details of the generation segment statement of income for the year ended December 31, 2011 (continued):

<table>
<thead>
<tr>
<th></th>
<th>Haifa</th>
<th>Reading</th>
<th>Eshkol</th>
<th>Gezer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Required revenues</td>
<td>409</td>
<td>443</td>
<td>2,185</td>
<td>1,685</td>
</tr>
<tr>
<td>Adjustment for segment revenues</td>
<td>9</td>
<td>10</td>
<td>50</td>
<td>38</td>
</tr>
<tr>
<td>Revenues from electricity</td>
<td>418</td>
<td>453</td>
<td>2,235</td>
<td>1,723</td>
</tr>
<tr>
<td>Other revenues</td>
<td>7</td>
<td>8</td>
<td>20</td>
<td>13</td>
</tr>
<tr>
<td>Total revenues</td>
<td>425</td>
<td>461</td>
<td>2,255</td>
<td>1,736</td>
</tr>
<tr>
<td>Cost for operating the electricity system *</td>
<td>311</td>
<td>390</td>
<td>1,996</td>
<td>1,414</td>
</tr>
<tr>
<td>Income from operating the electricity system</td>
<td>114</td>
<td>71</td>
<td>259</td>
<td>322</td>
</tr>
<tr>
<td>Sales and marketing expenses *</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Administrative and general expenses</td>
<td>17</td>
<td>23</td>
<td>55</td>
<td>29</td>
</tr>
<tr>
<td>Expenses from liabilities to pensioners, net *</td>
<td>4</td>
<td>6</td>
<td>13</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td>21</td>
<td>29</td>
<td>68</td>
<td>33</td>
</tr>
<tr>
<td>Income from current operations</td>
<td>93</td>
<td>42</td>
<td>191</td>
<td>289</td>
</tr>
<tr>
<td>Financial expenses, net</td>
<td>47</td>
<td>18</td>
<td>79</td>
<td>140</td>
</tr>
<tr>
<td>Income before income taxes</td>
<td>46</td>
<td>24</td>
<td>112</td>
<td>149</td>
</tr>
<tr>
<td>Income taxes *</td>
<td>113</td>
<td>59</td>
<td>276</td>
<td>367</td>
</tr>
<tr>
<td>Net loss *</td>
<td>(67)</td>
<td>(35)</td>
<td>(164)</td>
<td>(218)</td>
</tr>
</tbody>
</table>

(*) Retrospective implementation of IAS 19 (2011) – see Note 37 above.
NOTE 38:- ADDITIONAL INFORMATION REQUIRED IN ACCORDANCE WITH THE PROVISIONS OF THE GOVERNMENT COMPANIES AUTHORITY REGARDING THE ATTRIBUTION OF THE STATEMENT OF PROFIT AND LOSS AND THE STATEMENT OF FINANCIAL POSITION ACCORDING TO ACTIVITY SEGMENTS: GENERATION, TRANSMISSION AND DISTRIBUTION (SEE NOTE 3.b AND 3.c TO THE ANNUAL FINANCIAL STATEMENTS) (Continued)

k. Details of the generation segment statement of income for the year ended December 31, 2011 (continued):

<table>
<thead>
<tr>
<th></th>
<th>Hagit</th>
<th>Alon Tavor</th>
<th>Ramat Hovav</th>
<th>Zafit</th>
<th>Other gas turbines</th>
</tr>
</thead>
<tbody>
<tr>
<td>Required revenues</td>
<td>1,796</td>
<td>976</td>
<td>1,475</td>
<td>656</td>
<td>242</td>
</tr>
<tr>
<td>Adjustment for segment revenues</td>
<td>41</td>
<td>22</td>
<td>34</td>
<td>15</td>
<td>6</td>
</tr>
<tr>
<td>Revenues from electricity</td>
<td>1,837</td>
<td>998</td>
<td>1,509</td>
<td>671</td>
<td>248</td>
</tr>
<tr>
<td>Other revenues</td>
<td>10</td>
<td>5</td>
<td>6</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td><strong>Total revenues</strong></td>
<td><strong>1,847</strong></td>
<td><strong>1,003</strong></td>
<td><strong>1,515</strong></td>
<td><strong>675</strong></td>
<td><strong>250</strong></td>
</tr>
<tr>
<td>Cost for operating the electricity system *</td>
<td>1,594</td>
<td>874</td>
<td>1,388</td>
<td>608</td>
<td>184</td>
</tr>
<tr>
<td><strong>Income from operating the electricity system</strong></td>
<td><strong>253</strong></td>
<td><strong>129</strong></td>
<td><strong>127</strong></td>
<td><strong>67</strong></td>
<td><strong>66</strong></td>
</tr>
<tr>
<td>Sales and marketing expenses *</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Administrative and general expenses</td>
<td>29</td>
<td>15</td>
<td>20</td>
<td>13</td>
<td>6</td>
</tr>
<tr>
<td>Expenses from liabilities to pensioners, net *</td>
<td>5</td>
<td>2</td>
<td>4</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td><strong>Income from current operations</strong></td>
<td><strong>219</strong></td>
<td><strong>112</strong></td>
<td><strong>103</strong></td>
<td><strong>52</strong></td>
<td><strong>59</strong></td>
</tr>
<tr>
<td>Financial expenses, net</td>
<td>99</td>
<td>50</td>
<td>39</td>
<td>21</td>
<td>30</td>
</tr>
<tr>
<td><strong>Income before income taxes</strong></td>
<td><strong>120</strong></td>
<td><strong>62</strong></td>
<td><strong>64</strong></td>
<td><strong>31</strong></td>
<td><strong>29</strong></td>
</tr>
<tr>
<td>Income taxes *</td>
<td>295</td>
<td>154</td>
<td>158</td>
<td>79</td>
<td>72</td>
</tr>
<tr>
<td><strong>Net Loss</strong> *</td>
<td><strong>(175)</strong></td>
<td><strong>(92)</strong></td>
<td><strong>(94)</strong></td>
<td><strong>(48)</strong></td>
<td><strong>(43)</strong></td>
</tr>
</tbody>
</table>

(*) Retrospective implementation of IAS 19 (2011) – see Note 37 above.
I. Details of the distribution segment statement of operations for the year ended December 31, 2011:

<table>
<thead>
<tr>
<th>Total distribution segment</th>
<th>Northern District</th>
<th>Haifa District</th>
</tr>
</thead>
<tbody>
<tr>
<td>Required revenues</td>
<td>3,722</td>
<td>754</td>
</tr>
<tr>
<td>Adjustment for segment revenues</td>
<td>(1,055)</td>
<td>(214)</td>
</tr>
<tr>
<td>Revenues from electricity</td>
<td>2,667</td>
<td>540</td>
</tr>
<tr>
<td>Other revenues</td>
<td>130</td>
<td>29</td>
</tr>
<tr>
<td>Total revenues</td>
<td>2,797</td>
<td>569</td>
</tr>
<tr>
<td>Cost for operating the electricity system *</td>
<td>1,540</td>
<td>297</td>
</tr>
<tr>
<td>Income from operating the electricity system</td>
<td>1,257</td>
<td>272</td>
</tr>
<tr>
<td>Sales and marketing expenses *</td>
<td>910</td>
<td>196</td>
</tr>
<tr>
<td>Administrative and general expenses</td>
<td>267</td>
<td>52</td>
</tr>
<tr>
<td>Expenses from liabilities to pensioners, net *</td>
<td>61</td>
<td>12</td>
</tr>
<tr>
<td></td>
<td>1,238</td>
<td>260</td>
</tr>
<tr>
<td>Income (loss) from current operations</td>
<td>19</td>
<td>12</td>
</tr>
<tr>
<td>Financial expenses, net</td>
<td>714</td>
<td>151</td>
</tr>
<tr>
<td>Loss before income taxes</td>
<td>(695)</td>
<td>(139)</td>
</tr>
<tr>
<td>Income taxes *</td>
<td>(1,717)</td>
<td>(341)</td>
</tr>
<tr>
<td>Net income *</td>
<td>1,022</td>
<td>202</td>
</tr>
</tbody>
</table>

(*) Retrospective implementation of IAS 19 (2011) – see Note 37 above.

I. Details of the distribution segment statement of operations for the year ended December 31, 2011 (continued):

<table>
<thead>
<tr>
<th></th>
<th>Jerusalem District</th>
<th>Dan District</th>
<th>Southern District</th>
</tr>
</thead>
<tbody>
<tr>
<td>Required revenues</td>
<td>503</td>
<td>754</td>
<td>1,266</td>
</tr>
<tr>
<td>Adjustment for segment revenues</td>
<td>(142)</td>
<td>(214)</td>
<td>(359)</td>
</tr>
<tr>
<td>Revenues from electricity</td>
<td>361</td>
<td>540</td>
<td>907</td>
</tr>
<tr>
<td>Other revenues</td>
<td>16</td>
<td>20</td>
<td>52</td>
</tr>
<tr>
<td><strong>Total revenues</strong></td>
<td><strong>377</strong></td>
<td><strong>560</strong></td>
<td><strong>959</strong></td>
</tr>
<tr>
<td>Cost for operating the electricity system *</td>
<td>212</td>
<td>320</td>
<td>517</td>
</tr>
<tr>
<td>Income from operating the electricity system</td>
<td>165</td>
<td>240</td>
<td>442</td>
</tr>
<tr>
<td>Sales and marketing expenses *</td>
<td>127</td>
<td>176</td>
<td>308</td>
</tr>
<tr>
<td>Administrative and general expenses</td>
<td>37</td>
<td>51</td>
<td>94</td>
</tr>
<tr>
<td>Expenses from liabilities to pensioners, net *</td>
<td>8</td>
<td>12</td>
<td>21</td>
</tr>
<tr>
<td></td>
<td>172</td>
<td>239</td>
<td>423</td>
</tr>
<tr>
<td>Income (loss) from current operations</td>
<td>(7)</td>
<td>1</td>
<td>19</td>
</tr>
<tr>
<td>Financial expenses, net</td>
<td>90</td>
<td>141</td>
<td>251</td>
</tr>
<tr>
<td><strong>Loss before income taxes</strong></td>
<td><strong>(97)</strong></td>
<td><strong>(140)</strong></td>
<td><strong>(232)</strong></td>
</tr>
<tr>
<td>Income taxes *</td>
<td>(240)</td>
<td>(351)</td>
<td>(573)</td>
</tr>
<tr>
<td>**Net income ***</td>
<td><strong>143</strong></td>
<td><strong>211</strong></td>
<td><strong>341</strong></td>
</tr>
</tbody>
</table>

(*) Retrospective implementation of IAS 19 (2011) – see Note 37 above.
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 was 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.

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 d 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 2 a (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.
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 for the segment published by the Electricity Authority, multiplied by the quantity sold (kWh) for that segment.

(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 (quantity measured in a systematic way for each segment), with the addition of the quantity purchased from private producers (known quantity for each segment) and their adjustment to the generation data, net (continuous measured quantity), by adding the quantity of normative loss for each segment and standardizing it according to the actual amount of loss.

Adjustment of the quantities between the segments is required since there is a gap between the quantity sold and the quantity generated and purchased. The gap derives from losses in the systems that are primarily caused by weather conditions, system load and the distance of transmission.

Since there is no continuous quantitative measurement of KWhs transferred between the transmission segments and the distribution segment, it is not possible to estimate the scope of losses in each segment. For that purpose, they are aided by normative loss coefficients that the Electricity Authority determined for calculating the quantity of sales between the segments.

The total losses in the system are added to segments according to the ratio of normative losses that were determined by the Electricity Authority.

(2) Rate for the segment

The electricity rates that were determined by the Electricity Authority are divided into two main 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.
NOTE 38:- ADDITIONAL INFORMATION REQUIRED IN ACCORDANCE WITH THE PROVISIONS OF THE GOVERNMENT COMPANIES AUTHORITY REGARDING THE ATTRIBUTION OF THE STATEMENT OF OPERATIONS & COMPREHENSIVE INCOME AND THE STATEMENT OF FINANCIAL POSITION ACCORDING TO ACTIVITY SEGMENTS: GENERATION, TRANSMISSION AND DISTRIBUTION (SEE NOTE 3.b AND 3.c ABOVE) (Continued)

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 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.4 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 are calculated at a rate per kWh multiplied by the quantity transmitted by the segment. Revenues from usage fees for connections are calculated at a rate per kWh multiplied by the installed transformation capacity.

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.
NOTE 38:- ADDITIONAL INFORMATION REQUIRED IN ACCORDANCE WITH THE PROVISIONS OF THE GOVERNMENT COMPANIES AUTHORITY REGARDING THE ATTRIBUTION OF THE STATEMENT OF OPERATIONS & COMPREHENSIVE INCOME AND THE STATEMENT OF FINANCIAL POSITION ACCORDING TO ACTIVITY SEGMENTS: GENERATION, TRANSMISSION AND DISTRIBUTION (SEE NOTE 3.b AND 3.c ABOVE) (Continued)

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.
NOTE 38:- ADDITIONAL INFORMATION REQUIRED IN ACCORDANCE WITH THE PROVISIONS OF THE GOVERNMENT COMPANIES AUTHORITY REGARDING THE ATTRIBUTION OF THE STATEMENT OF OPERATIONS & COMPREHENSIVE INCOME AND THE STATEMENT OF FINANCIAL POSITION ACCORDING TO ACTIVITY SEGMENTS: GENERATION, TRANSMISSION AND DISTRIBUTION (SEE NOTE 3.b AND 3.c ABOVE) (Continued)

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:

Fuel inventories and balance for fuel suppliers were fully attributed to the generation segment. The trade receivables balance 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.
NOTE 38:- ADDITIONAL INFORMATION REQUIRED IN ACCORDANCE WITH THE PROVISIONS OF THE GOVERNMENT COMPANIES AUTHORITY REGARDING THE ATTRIBUTION OF THE STATEMENT OF OPERATIONS & COMPREHENSIVE INCOME AND THE STATEMENT OF FINANCIAL POSITION ACCORDING TO ACTIVITY SEGMENTS: GENERATION, TRANSMISSION AND DISTRIBUTION (SEE NOTE 3.b AND 3.c ABOVE) (Continued)

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.
NOTE 38:- ADDITIONAL INFORMATION REQUIRED IN ACCORDANCE WITH THE PROVISIONS OF THE GOVERNMENT COMPANIES AUTHORITY REGARDING THE ATTRIBUTION OF THE STATEMENT OF OPERATIONS & COMPREHENSIVE INCOME AND THE STATEMENT OF FINANCIAL POSITION ACCORDING TO ACTIVITY SEGMENTS: GENERATION, TRANSMISSION AND DISTRIBUTION (SEE NOTE 3.b AND 3.c ABOVE) (Continued)

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.
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 the Internal Audit
According to Government Companies Regulations (additional report on actions taken and representations given to assure additional reports on the effectiveness of the internal control 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 the Internal control over the Financial Reporting, including setting up an entire array of internal controls. The principal objectives of this array are: examining the processes affecting the Company’s records of transactions, as well as assuring the existence of controls and their effectiveness and providing a reasonable degree of certainty that the Company’s receipts and expenditures are only performed in accordance with the authorization of the Board of Directors and the Company’s Management, and subject to the approvals of the State’s authorities as required by any law.
The Company established Administration, Control and Work units and elected a consultant to assist in the implementation of the said 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. A dedicated computerized system was integrated for management and current on-going maintenance of the controls. 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 provides the ability to monitor faults corrections and to generate various control and administration reports. All for the purpose of enabling position holders who sign the financial statements and the report of the Board of Directors to declare in an additional report that the financial statements and the report of the Board of Directors do not include any misstatement of a material fact and reflect properly from all material aspects, the financial condition, the operating results, the changes in equity and cash flow 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.
The Companies Authority required the Company to conduct audits according to the Government Companies Regulations (Additional Reports on the Effectiveness of the Internal Audit of 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 the audits in the notes to the financial statements on the 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 audit of 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, 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 audit of the financial reporting of the Company.
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:

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 audit of the financial reporting of the Company are experts and not service bureaus and therefore they do not satisfy 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.

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 (Statements on Standards for Attestation Engagements 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 control over financial reporting”.

A similar definition is also included in the ISAE 3402 (International Standard on Assurance Engagements 3402).

c. Government companies are required to verify that the Financial Statements and accompanying information submitted by them do not include any misstatement, including information that might mislead a reasonable reader of the Financial Statements and related information.

d. A 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 a 4) a) above and the position of the Companies Authority in sections f and k 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”). 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 contact you to decide on details of the issues to be reviewed for every period." 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.

As of the statement of financial position date, several subjects are still being reviewed and the subject of actuary liabilities is examined.
e. (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 on 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 December 10, 2009, the Company 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.

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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 above).

5) Regarding the pension liability and the capitalization rate, in its letter on March 12, 2008, the Companies Authority stated, inter alia, its position that "the capitalization rate should express the risk components and the uncertainty included in the pension."
NOTE 39:- ADDITIONAL INFORMATION REQUIRED UNDER THE PROVISIONS OF THE GOVERNMENT COMPANIES AUTHORITY (continued)

e.  (continued)

6) The Government Companies Authority required the Company to include the pertinent information of the effect of using the applicable discount/capitalization rate on high quality corporate debentures. In calculating the actuarial liability to pension, the Company used, at this stage, the suitable discount rate for market yield on government debentures. If it will be decided in future that a deep market for high quality corporate bonds exists in Israel, the Company will have to restate its pension actuarial liabilities by using the appropriate discount rate for market returns on AA rated corporate bonds. In Israel, there are currently no special publications of data required for the specific calculation of pension actuarial liabilities according to market returns on corporate bonds. According to data by "Mirvach Hogen", at every future time range, there is a different margin between the rate of return on AA rated corporate bonds and the rate of return on government bonds. The following is the mean effect of each 0.1% of the aforementioned gap on the actuarial liability and on the equity of the Company:

<table>
<thead>
<tr>
<th>December 31</th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>The weighted average of the gap (%)</td>
<td>0.8-1.0</td>
<td>1.7-1.9</td>
</tr>
<tr>
<td>Average effect of every 0.1% From the above gap (in NIS million):</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Decrease of the actuarial liabilities (1)</td>
<td>(410)</td>
<td>(215)</td>
</tr>
<tr>
<td>Increase of the equity (2)</td>
<td>(308)</td>
<td>(235)</td>
</tr>
</tbody>
</table>

(1) The impact on the liability is calculated according to the gaps between corporate interest and Government interest.
(2) The impact on the equity includes changes in the liability according to IAS 19 after tax effect.
Regarding the draft of recommendations of the steering committee published on March 23, 2014, see Note 1e above.

7) 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 12j 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 does not affect the financial statements of the Company.
f. The Government Companies Authority required the Company to ascertain and provide disclosure in a note, that when the accounting principles offer presentation of several alternatives, is should ascertain that the alternative chosen in the financial statement is the one that provides the most relevant, accurate and reliable, considering the economic environment in which the Company operates.

The Company's response to this requirement:
The main principles of the accounting policies, as detailed in Note 2 above, constitute the information on presenting the accounting alternative which yields the most relevant, accurate and reliable presentation, considering the economic environment in which the Company operates.

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:
As mentioned, the Company did not apply effective controls to ensure that the rights and benefits, according to which wages and pension were paid, and actuarial liabilities and current liabilities included, are authorized in conformity with the requirements of the Budget Foundations Law. The Company tightened the controls and established a procedure, approved by the Company's Board of Directors, on the subject of the rights and benefits, according to which wages and pension were paid, and are used to include actuarial liabilities and current liabilities with respect to wages. 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 acted to receive an opinion of its legal advisers on the effectiveness of the Company's obligation to pay these rights to its employees.

h. According to the circular of the Companies Authority (see Note 2 a1 above) which is available on the Government Companies Authority’s website, 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 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.

In addition, the Company does not currently possess all of the required information due to various problems in registering the many assets that have been accumulated by the Company over the decades and due to the considerable costs and duration required to issue assessments. The 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.

i. See Note 14 above for the composition of the fixed assets.
j. On the subject of risk management in the Company, the Government Companies Authority draws the attention of the Board of Directors to the 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 Companies Authority demanded to clarify that: “the Companies Authority approached the Company concerning the implementation of the risk survey and commented that a risk survey was not carried out as required, because of the assumption by the survey organizers that the relevant controls regarding the survey are effective, an assumption that is not reasonable in the specific circumstances, and in this manner the examination was only executed in the casing of the control environment. The Authority made it clear to the Company that there is a need to execute a material upgrading of the issue so that the control entities of the Company will ensure that the risk survey will indeed relate, in theory and in practice, to the examination of the effectiveness of the controls relevant for managing the risks in the Company pursuant to the Authority’s Circular of June, 2009, in general, and in particular to the circumstances of the findings with respect to weaknesses in the effectiveness of the controls as were found by the auditor auditing the Company.”

The position of the Company:
The process of risk survey and forming a perennial work plan for internal auditing in the Electric Company conforms to the circular of the Companies Authority and does not prevent an examination of the risk management process in the Company by the internal auditor, as required by the circular of the Authority.

Control of the risk management process in the Company is integrated in the work plans of the internal control in accordance with the circular of the Authority.

The risk survey for 2010, the object of the alleged faults that arose, was executed in complete and meticulous compatibility with the requirements of the Risk Management Circular 2009-1. The instructions of the circular of the Companies Authority are aimed at an examination and implementations of the controls within the framework of current risk management and do not at all require an examination of the effectiveness of the controls. Additionally, the Company did not, at any stage of the stages of execution of the risk survey carried out in 2010, assume that the controls are effective, but, as required by the instructions of the circular, the survey related to the actions of the management in managing the risks.

The proof that the Company did not base its actions on the assumption that the ensemble of controls is effective is the high level of risks presented in the risks chart. Notwithstanding, within the update of the risk survey that is carried out at present, emphasize will be placed on the reference of the Company to the framework of the internal control in the Company.

The Companies Authority has requested to note that the position of the Company does not suit the facts presented in the Company’s risk survey, and as stated in the Authority’s letter of March 17, 2013, according to which the assumption of the conductors of the risk survey is that the relevant controls for the risk survey are effective.

k. The Government Companies Authority requested to provide proper disclosure of the status of legislating Government Companies Regulations, see details in Note 2 a above.

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 f 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 commissioning thereof”).

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 approved by the Knesset on December 9, 2013, insofar as they are relevant to the operation of the Company within the electricity sector and the communications sector.

According to the provisions of the Centralization Law, every entity that wishes to allocate, renew or extend the licenses of the Company has to consider pan-sectorial centralization considerations and to consult with the committee for reducing centralization. In addition, in accordance with the Centralization law, if the Company will desire to enter into a contractual engagement with a third party to execute the activity which is a field of the essential infrastructure fields, the Company’s tender committee will have to consider pan-sectorial centralization considerations within the approval of the engagement.

In general, the Centralization Law is expected to enter into force on December 11, 2014. However, the provisions pertaining to allocation of a new license (including allocating a license to the Electric Company) are expected to enter into force on December 11, 2015, and 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 in the matter.

o. The Government Companies Authority requested to disclose the possible implications of applying the IAS 19 (2011) to the financial statements of the Company. The Company is implementing this standard commencing from the March 2013 Report and is providing such disclosure in Note 37 above.

p. Non-inclusion of misleading details in the Financial Statements and accompanying information of Government Companies:

1) Government Companies are required to ascertain that the submitted Financial Statements and enclosed information do not include misleading details as well as information that could mislead a reasonable reader of the Financial Statements and the enclosed information.

2) 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.

q. The Companies Authority requested the Company to define the procedure of examining the forecasted cash flows included in the reports of the Board of Directors or in the Notes to the Financial Statements as a united, central procedure that is reported by the Company and audited by the external auditor who methodically and independently audits according to the principles of SOX 404 regulations in governmental companies, including an examination of the effectiveness according to the COSO model and auditing the effectiveness of the procedure according to the PCAOB
q. (continued)

standards (Public Company Accounting Oversight Board - hereinafter: “PCAOB”) as is executed for any other procedure that is examined according to the principles of SOX 404 regulations and according to that stated in the Managers’ declarations in SOX 302 regulations and the risk management circular.

The Companies Authority demanded that the cash flow forecast included in the statement of the Board of Directors will completely match the definitions and terms included in the cash flow statement of the Financial Statements. Additionally, the Authority demanded to be notified of the implementation of the above mentioned, the time schedules and the milestones required to complete all that is stipulated.

The position of the Company:

In September 2012, the Company reported in its Financial Statements that it did not perform effective controls over the process of data collection, their processing and the preparation of a forecasted cash flow statement, and the Company therefore reported a material weakness.

The CEO of the Company decided to include and implement the process of producing the cash flow statement of the Company within the SOX limits, according to the meticulous methodology customary in the Company in accordance with the COSO model.

Within the framework of handling this fault, the Company executed an improvement and betterment of the work processes currently existing in the Company, while implementing and assimilating controls both in the aspect of the process (information flow, reasonable data, manual and computerized controls) and the aspect of control over the computerized model that serves the preparation of the Company’s forecasted cash flow statement. Therefore, the Company decided to remove the material weakness in the 2012 Financial Statements and the estimation of the fault as a significant fault.

Within this process of improvement, the Company documented the work process of the user, including work processes of the reporting entities, and many dozens of controls were added throughout the work processes that are involved in the preparation of the forecasted cash flow. These processes underwent a suitable documentation, verification including the effectiveness examination in accordance with the COSO model, and execution of control over the effectiveness of the processes in accordance with the standards of the PCAOB and in accordance with the principles of the SOX Regulations 404 and in accordance with that stipulated in the Managers’ declarations, SOX Regulations 302 and the risk management circular. Notwithstanding, the Company has not yet managed to complete the planned handling of the issue of the forecasted cash flow. The Company intends to continue and deepen the controls and improve the management tools also with material information that is indirectly transferred to the cash flow department and originates in units that are exogenous to the cash flow department that report to the cash flow department when preparing the forecast reports. The completion of control in these units will increase the measure of the reliability of the data received by the cash flow department and processed in the forecasted cash flow calculation to such a standard that will enable the Company, according to its estimate, to completely decrease the fault or at the very least to decrease the measure of its severity to beneath the level of a significant fault.

This significant fault was removed within the 2013 annual report.

The Management and Board of Directors of the Company are up to date with the details of the activities executed in this subject, the plan for the continued handling, and the timelines, and have approved them.

r. On January 10, 2013, the Company delivered a letter of indemnification to the Israel Land Administration with respect to damage that may be caused to it due to trial drilling works at Ashalim.

s. On May 13, 2013, a letter of indemnification was delivered in favor of the Middle East Tube Company against receipt of an owners’ signature on an application for permit for construction work of the Acre logistics center, with respect to damage that may be caused to the Middle East Tube Company due to these works.

t. 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. In 2013, approximately 40 big customers that purchase electricity from approximately 70 consumption locations transferred to private producers (or to O.P.C), and the Company estimates that approximately 30 more, purchasing electricity from approximately 2,000 consumption places, are expected to transfer to private producers (mainly Dorad) in 2014. The total generation that the Company is expected to lose after transfer of all the customers as detailed above is approximately 8.1 billion kWh (approximately NIS 3.2 billion) a year, from 2015. For additional details see Note 34 a 5) above.
u. 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 on July 31, 2013, which, based on his knowledge, the reports delivered to the Central Pension Fund of the employees of the Israel Electric Company do not include misrepresentation of material or misleading facts regarding the period of the account, and his declaration that the data, in all material aspects, properly reflect the financial position, results of operations and the change in the actuarial liability of the Fund.

The position of the Company:

As noted in the declaration given by the Deputy CEO Human Resources of the Company on July 31 2013, to the CEO of Infinity, the controls in the processes included in the declaration are effective.

v. 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 and 3 e above.

w. The Companies Authority requested the Company to attach audited financial statements of the Jordan Assets Incorporated 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 2013
Prominent Disclaimer

This English translation of the “Additional Particulars about the Corporation” for the year ended December 31, 2013 ("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, 2013

Date of the Report: March 24, 2014

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

Summary of reports on the comprehensive income of the Company for each of the Quarters in 2013 (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 (31.12.2013)

Subsidiaries and related companies held by the Company¹ on December 31, 2012, 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.
<table>
<thead>
<tr>
<th>Name of Subsidiary</th>
<th>Share Type</th>
<th>Number of Held Shares and Nominal Value</th>
<th>Proportion of the Company’s Holding (%)</th>
<th>Millions of NIS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>In Securities</td>
<td>In Capital</td>
<td>In Voting Rights</td>
</tr>
<tr>
<td>Jordan Investment Company Ltd.</td>
<td>Deferred</td>
<td>300,000 of NIS 0.0005 each</td>
<td>100.00</td>
<td>12.00</td>
</tr>
<tr>
<td></td>
<td>Ordinary A</td>
<td>(*)110,000 of NIS 0.0001 each</td>
<td>99.98</td>
<td>87.99</td>
</tr>
<tr>
<td>Migrashei Hakablanim Ltd.</td>
<td>Preferred</td>
<td>2,000,630(** of NIS 0.0001 each</td>
<td>100.00</td>
<td>100.00</td>
</tr>
<tr>
<td>National Coal Supply Company Ltd.</td>
<td>Ordinary A</td>
<td>909,000 of NIS 1 each</td>
<td>100.00</td>
<td>100.00</td>
</tr>
<tr>
<td>Advanced Training Fund of Israel Electric Corporation Ltd.(***)</td>
<td>Management A</td>
<td>6 of NIS 1 each</td>
<td>50.00 of the Management shares</td>
<td>50.00</td>
</tr>
<tr>
<td>PAMA Energy Resources Development Company Ltd.</td>
<td>Ordinary</td>
<td>3,467,790 of NIS 0.10 each</td>
<td>49.99</td>
<td>49.99</td>
</tr>
<tr>
<td>I.B.C. Israel Broadband Company (2013) Ltd.</td>
<td>Ordinary</td>
<td>400 of NIS 1 each</td>
<td>40.00</td>
<td>40.00</td>
</tr>
</tbody>
</table>

(*) 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.
(****) According to the founders’ agreement and the articles of I.B.C. Israel Broadband Company (2013) Ltd., the number of directors in the Company will not be less than 5 and will not exceed 9 directors. As long as there are no additional shareholders in the Company except for IEC and the controlling shareholder, 1) the controlling shareholder will have the right to appoint up to 5 directors to the board of directors of the company, but in any case the number of serving directors that were appointed by the controlling shareholder will not be less than 3 at any time; 2) IEC will have the right to appoint 2 to 4 directors to the board of directors of the Company, subject to the number of directors appointed by the Electric Company at any time being less than the number of directors appointed by the controlling shareholder.

Balance of loans to held companies: None.

For additional details see Notes 1h, 2e and 11 to the Financial Statements of the Company of December 31, 2013 (“Financial Statements”).

Regulation 12: Changes in investments in subsidiaries and related companies during 2013

For details regarding the establishment of a communications company see section 26.3 f in the Report of the Business Affairs of the Company and Note 11 to the Financial Statements.
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, 2013), 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, 2013:

<table>
<thead>
<tr>
<th>Name of Company</th>
<th>Net Profit (loss)</th>
<th>Comprehensive Profit (loss)</th>
<th>Proposed Dividend</th>
<th>Management Fees</th>
<th>Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>National Coal Supply Company Ltd.</td>
<td>11</td>
<td>11</td>
<td>7</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Issuance of series NIS Electric 2013.I.B.C. Israel Broadband Company (2013) Ltd.</td>
<td>(4)</td>
<td>(4)</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

Regulation 21: Rewards to Stakeholders and Officers

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 2013 as recognized in the financial statements for 2013 (adjusted to the CPI for the month of December 2013) is detailed below:
<table>
<thead>
<tr>
<th>Name</th>
<th>Position</th>
<th>Position Scope</th>
<th>Equity holding rate</th>
<th>Salary**</th>
<th>Bonus</th>
<th>Shares Based Payment</th>
<th>Management Fees</th>
<th>Consulting Fees</th>
<th>Commission</th>
<th>Other</th>
<th>Interest</th>
<th>Rent</th>
<th>Other</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eli Glickman</td>
<td>Company CEO</td>
<td>100%</td>
<td>One share (negligible)</td>
<td>1,246,233</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1,246,233</td>
</tr>
<tr>
<td>Yiftah Ron-Tal</td>
<td>Chairman of the Board of Directors</td>
<td>100%</td>
<td>-</td>
<td>1,244,558</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1,244,558</td>
</tr>
<tr>
<td>David Elmakias</td>
<td>Deputy CEO (lanning, development and Technology)</td>
<td>100%</td>
<td>-</td>
<td>1,151,148</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1,151,148</td>
</tr>
<tr>
<td>Adrian Bianu</td>
<td>Senior VP Corporate Sustainability</td>
<td>100%</td>
<td>-</td>
<td>1,130,501</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1,130,501</td>
</tr>
<tr>
<td>Hain Yakov</td>
<td>Deputy CEO and Senior VP Customers and Business Development</td>
<td>100%</td>
<td>-</td>
<td>1,065,480</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1,065,480</td>
</tr>
</tbody>
</table>

(*) 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, 2013 (adjusted to the CPI for December 2013).

(**) 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 (on the following page):

(1) 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 employment agreement of the CEO is a personal employment agreement, in a uniform version, dictated and required by the Companies Authority, in accordance with Government Companies Authority's circular No. 2001/1, of November 7, 2001 (The Authority's Circular on the Subject of Senior Employees”). The Salary of the CEO is determined according to the classification of the Company, as determined in the Government Companies Classification Committee, established by force of a Government decision (The Committee for Classifying Government Companies”) and updated once a year, according to the increase of the CPI and subject to the approval of the Company's Board of Directors. As part of his work and according to his employment agreement, and after receiving approval for it from the Board of Directors of the Company and approval of the Government Companies Authority, the CEO is entitled, 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 as Company CEO, Mr. Glickman 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 CEO 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 circular of the Companies Authority on the subject of 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 amount presented in the “Salary” column includes an annual salary of NIS 869,505 (which includes, inter alia, combined salary in the amount of NIS 772,111, annual payments of NIS 49,359 and Expenses Refund in the amount of NIS 48,036), plus employer's costs in the amount of NIS 297,411 plus Charges to Tax in the amount of NIS 79,316. The terms of office and employment of Mr. Glickman are compatible with the compensation policy of the Company.

(2) Yiftah Ron-Tal - started work 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 salary is paid according to an agreement which shall be in force until the expiry of his term in office. The employment agreement of the Chairman is a personal employment agreement, in a uniform version, dictated and required by the Companies Authority, in accordance with the Authority's circular on the subject of senior employees. The Salary of the Chairman is determined according to the classification of the Company, as determined in the Government Companies Classification Committee and updated once a year, according to the increase of the CPI and subject to the approval of the Company’s Board of Directors. Within the framework of his employment and according to his employment agreement, and after receiving approval for that from the Company's Board of Directors and approval of the Companies Authority, the Chairman is entitled to a vehicle for performing his duties and the Company incurs the usage cost thereof. Mr. Ron-Tal is also entitled, within his term of office as Chairman of the Board of Directors, to line and cellular telephone expenses, subsistence expenses, a clothes allowance, advanced studies fund, annual leave and convalescence fees. The Chairman of the Board of Directors will cease to serve in office and his term will expire according to the provisions of the Government Companies Law. The amount presented in the "Salary" column includes an annual salary of NIS 842,478 (which includes, inter alia, a combined salary in the amount of NIS 734,280, annual payments of NIS 80,825 and Expenses Refund in the amount of NIS 27,373), plus employer's costs in the amount of NIS 250,251 plus Charges to Tax in the amount of NIS 146,828. The terms of office and employment of Mr. Ron-Tal are compatible with the compensation policy of the Company.

(3) David Elmakias - started work in the Company on October 20, 1974. 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 other employees. The amount presented in the "Salary" column includes an annual salary of NIS 773,239 (which includes, inter alia, combined salary in the amount of NIS 389,351, salary increments of NIS 238,774, annual payments of NIS 75,120 and Expenses Refund in the amount of NIS 69,994), plus employer's costs in the amount of NIS 273,778 plus Charges to Tax in the amount of NIS 104,121. 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.

(4) Adrian Bianu - started work on August 8, 1978. 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 other employees. The amount presented in the "Salary" column includes an annual salary of NIS 751,076 (which includes, inter alia, combined salary in the amount of NIS 410,961, salary increments of NIS 204,145, annual payments of 78,457 and Expenses Refund in the amount of NIS 57,513), plus employer’s costs in the amount of NIS 276,652 and plus Charges to Tax in the amount of NIS 102,774. Employment
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. Bianu are compatible with the compensation policy of the Company.

(5) **Yakov Hain** - started work in the Company on August 6, 1980. 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 other employees. The amount presented in the "Salary" column includes an annual salary of NIS 703,211 (which includes, *inter alia*, combined salary in the amount of NIS 373,015, salary increments of NIS 195,128, annual payments of 72,307 and Expenses Refund in the amount of NIS 62,761), plus employer's costs in the amount of NIS 266,531 and plus Charges to Tax in the amount of NIS 95,738. 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. Hain are compatible with the compensation policy of the Company.

See section 14 in the Description of the Business of the Corporation report for details on the collective agreements and arrangements applied to Company employees.

**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 Authority

The compensation given to directors (except the Chairman of the Board of Directors) in 2013, which does not deviate from that which is customary, amounted to NIS 1,655,974 adjusted to the CPI of December 2013, (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 99.846% 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.

1.1 Private Placement of Non-Negotiable Debentures in Israel in the Amount of NIS 1.5 Billion, Secured by a Guarantee of the State of Israel. For details see Section 23.2 in the Description of the Company’s Business Affairs.

1.2 Loans and Guarantees:

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, as follows:

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, 2013, amounted to approximately NIS 5,161.6 million, as detailed below:

(1) A State guarantee to the benefit of Discount Bank Ltd., in June 1996 with respect to an amount of up to NIS 500 million, according to the loan agreement entered in May 1996 between the Company and Israel Discount Bank Ltd., the Company received a credit line in five payments, of NIS 100 million each, in July and August 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, 2013, is approximately NIS 25.2 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 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

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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.
Directors of the Company. The balance of the loan as on December 31, 2013, is approximately NIS 143.5 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.

(3) A State guarantee to the benefit of CITIBANK in December 2005 with respect to an amount of 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, 2013, is approximately NIS 592.9 million. The guarantee is with respect to the unpaid balance. The Company paid, in advance, a guarantee commission of approximately USD 4.5 million.

(4) On December 24, 2012, the Audit Committee of the Board of Directors approved a State guarantee provided in December 2012 to the benefit of Bank Hapoalim Ltd., according to a loan agreement that was signed in December 2012 between the Company and Bank Hapoalim for receiving credit in the amount of NIS 200 million. The balance of the loan as of December 31, 2013, is NIS 200 million. According to the letter of guarantee as of December 24, 2012, which was given to the bank, the Company is paying a commission at an annual rate of 0.5%.

(5) On December 24, 2012, the Audit Committee of the Board of Directors approved a State guarantee provided in December 2012 to the benefit of Israel Discount Bank Ltd., according to a loan agreement that was signed in December 2012 between the Company and Israel Discount Bank Ltd. for receiving credit in the amount of NIS 500 million. The balance of the loan as on December 31, 2013, is NIS 500 million. According to the letter of guarantee of December 24, 2012, which was given to the bank, the Company is paying a commission at an annual rate of 0.5%.

(6) On December 24, 2012, the Audit Committee of the Board of Directors approved a State guarantee provided in December 2012 to the benefit of Bank Leumi Ltd., according to a loan agreement that was signed in December 2012 between the Company and Bank Leumi Ltd. for receiving credit in the amount of NIS 1 billion. The balance of the loan as on December 31, 2013, is NIS 1 billion. According to the letter of guarantee of December 24, 2012, which was given to the bank, the Company is paying a commission at an annual rate of 0.5%.

(7) On December 24, 2012, the Audit Committee of the Board of Directors approved a State guarantee provided in December 2012 to the benefit of First International Bank of Israel Ltd., according to a loan agreement that was signed in December 2012 between the Company and the First International Bank of Israel Ltd. for receiving credit in the amount of NIS 300 million. The balance of the loan as on December 31, 2013, is NIS 300 million. According to the letter of guarantee of December 24, 2012, which was given to the bank, the Company is paying a commission at an annual rate of 0.5%.

(8) 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. 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

<table>
<thead>
<tr>
<th>Bank</th>
<th>Loan</th>
<th>Loan Currency</th>
<th>Repayment Period</th>
<th>Outstanding Balance as of December 31, 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>State of Israel</td>
<td>$800 mil.</td>
<td>USD</td>
<td>05/28/2002</td>
<td>494,457,112.47</td>
</tr>
<tr>
<td></td>
<td>$250 mil.</td>
<td>USD</td>
<td>09/10/2000</td>
<td>126,517,370.08</td>
</tr>
<tr>
<td></td>
<td>$180 mil.</td>
<td>USD</td>
<td>09/10/2003</td>
<td>123,942,783.99</td>
</tr>
<tr>
<td></td>
<td>$270 mil.</td>
<td>USD</td>
<td>08/10/2005</td>
<td>158,048,780.52</td>
</tr>
</tbody>
</table>

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 perpetual debentures to the State of Israel for an aggregate consideration of NIS 15.5 million, which as on December 31, 2013 (nominal value plus linkage to the CPI differences up to December 31, 2013), amounts to approximately NIS 536.2 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, 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. On December 31, 2005, the adjusted value of the perpetual debentures amounted to approximately NIS 2.1 billion, for which interest and linkage differences on the interest were paid with respect to 2005, in the approximate amount of NIS 100 million. 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.

<table>
<thead>
<tr>
<th>Series</th>
<th>Issued amount (in NIS)</th>
<th>Coupon</th>
<th>Outstanding Balance as of December 31, 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>342,940.69</td>
<td>5%</td>
<td>220,752,495.01</td>
</tr>
<tr>
<td>2</td>
<td>2,348,640.00</td>
<td>5.75%</td>
<td>149,768,987.83</td>
</tr>
<tr>
<td>3</td>
<td>702,538.71</td>
<td>5%</td>
<td>346,390,775.72</td>
</tr>
<tr>
<td>4</td>
<td>558,981.66</td>
<td>5%</td>
<td>233,256,653.57</td>
</tr>
<tr>
<td>5</td>
<td>834,185.81</td>
<td>5%</td>
<td>348,096,734.54</td>
</tr>
<tr>
<td>6</td>
<td>710,312.09</td>
<td>5%</td>
<td>196,516,091.22</td>
</tr>
<tr>
<td>7</td>
<td>759,335.64</td>
<td>5%</td>
<td>210,079,072.48</td>
</tr>
<tr>
<td>8</td>
<td>1,146,203.97</td>
<td>5%</td>
<td>317,110,643.47</td>
</tr>
<tr>
<td>9</td>
<td>8,064,000.00</td>
<td>5.75%</td>
<td>514,228,284.40</td>
</tr>
<tr>
<td>Total</td>
<td>15,467,138.57</td>
<td></td>
<td>2,536,199,691.58</td>
</tr>
</tbody>
</table>

1.3 State Guarantee to Debentures (Series 24) and (Series 25) Issued according to a Prospectus of the Company of June 26, 2012, as Amended in July 2, 2012

See details in section 23.2 of the Description of the Corporate Business report.

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.
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

<table>
<thead>
<tr>
<th>Name of Company</th>
<th>“Party at Interest” / Senior office holder</th>
<th>Type of Share</th>
<th>Nominal Value in NIS</th>
<th>No. of Shares</th>
<th>Proportion of Holding (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>In Capital</td>
<td>In Voting Rights</td>
<td>In Appointment of Directors</td>
</tr>
<tr>
<td></td>
<td>In the corporation</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Israel Electric Corporation Ltd.</td>
<td>State of Israel</td>
<td>Ordinary</td>
<td>0.1</td>
<td>79,980,010</td>
<td>99.77</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Adv. David Yahav</td>
<td>Ordinary B</td>
<td>0.1</td>
<td>40,053,252</td>
<td>100.00</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Yiftah Ron-Tal</td>
<td>Ordinary</td>
<td>0.1</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Yitzhak “Ika” Yakhin</td>
<td>Ordinary</td>
<td>0.1</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>National Coal Supply Company Ltd.</td>
<td>Israel Electric Corporation</td>
<td>Ordinary A</td>
<td>0.1</td>
<td>909,999</td>
<td>100.00</td>
</tr>
</tbody>
</table>

The Company has several other subsidiaries and second-tier subsidiaries in which office holders in the Company hold shares, 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 dateSee 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**

<table>
<thead>
<tr>
<th>Name of Shareholder</th>
<th>I.D. #</th>
<th>Address</th>
<th>Ordinary Shares of NIS 0.10 each</th>
</tr>
</thead>
<tbody>
<tr>
<td>Barlev Yehuda</td>
<td>64837123</td>
<td>3a Tolkovski St., Tel Aviv 69358</td>
<td>95</td>
</tr>
<tr>
<td>Birkenheim Alexander</td>
<td></td>
<td>Unknown address</td>
<td>8</td>
</tr>
<tr>
<td>Braker Yair</td>
<td>226583</td>
<td>14 Rachel St., Haifa 34401</td>
<td>8</td>
</tr>
<tr>
<td>Goldstein Ben-Zion</td>
<td>713800</td>
<td>39 Krinizi St., Ramat Gan 52100</td>
<td>112</td>
</tr>
<tr>
<td>Goldstein Zvi Ran</td>
<td></td>
<td>5 Shderot Ben Gurion , # 3, Tel Aviv</td>
<td>1</td>
</tr>
<tr>
<td>Gorodish Baruch</td>
<td></td>
<td>P.O.B 29, Sha'arei Tikva, Efraim 44810</td>
<td>1</td>
</tr>
<tr>
<td>Dr. Munny Eliyahu</td>
<td></td>
<td>3 Ha'Rimon St., Tel Aviv</td>
<td>95</td>
</tr>
<tr>
<td>DR. Yakov Razon</td>
<td>8201873</td>
<td>34 Shneor Zalman St., Herzliya 46364</td>
<td>1</td>
</tr>
<tr>
<td>Dr. Sharam Menachem</td>
<td></td>
<td>6 Freud St., Haifa 34753 (outdated address, deceased per returned post date)</td>
<td>116</td>
</tr>
<tr>
<td>Dvir Yosef</td>
<td></td>
<td>8 Giborei Gehto Varsha St., Haifa</td>
<td>1</td>
</tr>
<tr>
<td>David Rutenberg</td>
<td>24328510</td>
<td>P.O.B 922 Ashdod 77109</td>
<td>4,768</td>
</tr>
<tr>
<td>Davidzon - Gotter Sarah</td>
<td></td>
<td>Ahuzat Poleg, Building 621, Kibbutz Tel Itzhak 45805.</td>
<td>1</td>
</tr>
<tr>
<td>Giorah Dekel</td>
<td></td>
<td>63 Ha'Botnim St., Pardes Hanah - Karkur, 37013</td>
<td>15</td>
</tr>
<tr>
<td>Hershter Yakov Itzhak</td>
<td>57743759</td>
<td>57 Jabotinski St., #4 Tel Aviv 62748</td>
<td>572</td>
</tr>
<tr>
<td>Zelingar Dov</td>
<td>2180719</td>
<td>2 Ori St., Tel Aviv</td>
<td>95</td>
</tr>
<tr>
<td>Bank Leumi Listing Company Ltd.</td>
<td>Company No. 51-009806-4</td>
<td>2-4 Lilinblum St., Tel Aviv</td>
<td>68,569</td>
</tr>
<tr>
<td>--------------------------------</td>
<td>--------------------------</td>
<td>-----------------------------</td>
<td>-------</td>
</tr>
<tr>
<td>Hazan Dov</td>
<td>4a Narkis St., Kiryat Yam A, 29500</td>
<td>95</td>
<td></td>
</tr>
<tr>
<td>Shapirah Hanah</td>
<td>16 Bat Yiftah, Zahalah, Tel Aviv 69932 (outdated address)</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>Adv. David Yahav</td>
<td>50258946</td>
<td>19 Kinarat St., Kohav Yair, 1</td>
<td></td>
</tr>
<tr>
<td>Yifrah Ziporah</td>
<td>Moshav Eitan 79580</td>
<td>954</td>
<td></td>
</tr>
<tr>
<td>Cohen Elza</td>
<td>5 Gotlib St., Tel Aviv (outdated address)</td>
<td>79</td>
<td></td>
</tr>
<tr>
<td>Gideon Katz</td>
<td>13 Shoham St., Tel Aviv, 69359</td>
<td>668</td>
<td></td>
</tr>
<tr>
<td>Leon Lahav</td>
<td>6576474</td>
<td>1 ha shurat ha yishuv St., Haifa 34985</td>
<td>8</td>
</tr>
<tr>
<td>Eli Landau</td>
<td>63 Wingate St., Ze'elim Pituah 46752</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Lazovski Gila (senior)</td>
<td>Gila 346455 Zipora 346456</td>
<td>Gila - Palmah Zova, Yehuda Mountains 90870 Ziporah - 6 Golomb St., Hod Ha'Sharon 45303</td>
<td>31</td>
</tr>
<tr>
<td>Horev Ziporah</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Meir David</td>
<td>Lonz St., Jerusalem (outdated address)</td>
<td>40</td>
<td></td>
</tr>
<tr>
<td>Holder of shares derived from bearer 6% preferred stock</td>
<td>Unknown address</td>
<td>801</td>
<td></td>
</tr>
<tr>
<td>Miara Pinhas</td>
<td>P.O.B 6967, Haifa 31068</td>
<td>8</td>
<td></td>
</tr>
<tr>
<td>Noiman David</td>
<td>14 David Shimon St., Jerusalem</td>
<td>95</td>
<td></td>
</tr>
<tr>
<td>The Estate of the late Avraham Rutenberg</td>
<td>c/o Alexander Rutenberg, 13 Ye'ef Nof St., Haifa, 34372</td>
<td>801</td>
<td></td>
</tr>
<tr>
<td>The Estate of the late Yakov Hushi</td>
<td>c/o Ruth Lynn, 1 Keller St., Haifa</td>
<td>8</td>
<td></td>
</tr>
<tr>
<td>The Estate of the late Yakov Spivakovski</td>
<td>c/o Tali Sharon, 2 Andersen St., Tel Aviv, 69107</td>
<td>477</td>
<td></td>
</tr>
<tr>
<td>The Estate of the late Yakov Peled</td>
<td>4 Maabarot St., Haifa 34461</td>
<td>8</td>
<td></td>
</tr>
<tr>
<td>The Estate of the late Lipshits Shmuel</td>
<td>c/o Marit Taub, 7 Neve Sh'anan St., Jerusalem (outdated address)</td>
<td>8</td>
<td></td>
</tr>
<tr>
<td>The Estate of the late Narkis Zuckerman</td>
<td>c/o Niza Shelef, 5 Rachel St., Haifa 34401</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>The Estate of the late Adv. Moritz Yithak</td>
<td>c/o Yael Moritz, 10 Berkovich St., Tel Aviv</td>
<td>887</td>
<td></td>
</tr>
<tr>
<td>The Estate of the late Rogover Arie</td>
<td>c/o Naomi Hernik, 69 Shderot Ben Gurion, Tel Aviv</td>
<td>8</td>
<td></td>
</tr>
<tr>
<td>The Estate of the late Figenbaum Rivka</td>
<td>18 Pevzner St., Haifa (outdated address)</td>
<td>601</td>
<td></td>
</tr>
<tr>
<td>Pnini Israel</td>
<td>53 Eshel St., Herzliya</td>
<td>3,810</td>
<td></td>
</tr>
<tr>
<td>Panzer Natan</td>
<td>P.O.B 4241, Haifa 31042</td>
<td>92</td>
<td></td>
</tr>
<tr>
<td>Aminoff Perjulah and Latfula, by Ajayan Palti</td>
<td>4 Havazelet street, Jerusalem 94224 (outdated address)</td>
<td>1,650</td>
<td></td>
</tr>
<tr>
<td>Friedman Mordechai</td>
<td>26 Oscar Schiendler St, Tel Aviv</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Rozenbaum M.</td>
<td>P.O.B 51 Rehovot (outdated address)</td>
<td>8</td>
<td></td>
</tr>
<tr>
<td>Shasha Avraham</td>
<td>70319934</td>
<td>8/7 Ha'tishim Veshalosh St., Petah Tikva</td>
<td>12,555</td>
</tr>
<tr>
<td>Shasha Amnon</td>
<td>32 Yahalom St., Neve Savion, Or Yehuda, 60405</td>
<td>4,768</td>
<td></td>
</tr>
<tr>
<td>Shasha Efraim Shai</td>
<td>34181511</td>
<td>8/7 Ha'tishim Veshalosh street, Petah Tikva</td>
<td>4,007</td>
</tr>
<tr>
<td>Shor Natan</td>
<td>1 Barak, Zahalah, Tel Aviv, 69933</td>
<td>64</td>
<td></td>
</tr>
<tr>
<td>Shamai Haim</td>
<td>11 Borochov St., Givataim</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Zarfati Shlomi</td>
<td>9 Ha'oren St., Moshav Magshimin</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Goldstein Nir</td>
<td>8 Peretz St., Givat Shmuel</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Zarfati David</td>
<td>7a Nurit St., Nes Ziona</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Lasker Amos</td>
<td>13 Shchterman St., Ramat Efal</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Ron-Tal Yiftah</td>
<td>22/3 Asher St., Modein, 71724</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Name</td>
<td>Address</td>
<td>Shares</td>
<td></td>
</tr>
<tr>
<td>-----------------------</td>
<td>----------------------------------</td>
<td>--------</td>
<td></td>
</tr>
<tr>
<td>Shasha Elad</td>
<td>8/7 Ha'tishim Veshalosh street, Petah Tikva</td>
<td>4,005</td>
<td></td>
</tr>
<tr>
<td>Zeibert Efrat</td>
<td>11 Borochov St., Givataim</td>
<td>4,006</td>
<td></td>
</tr>
<tr>
<td>Yitzhak “Ika” Yakhin</td>
<td>17 Levona St., Gival Zeev 90917</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Nissim Hilu</td>
<td>7 Beiliss St., Haifa 3481407</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Total ordinary shares in Israel (private shareholders)</td>
<td></td>
<td>115,019</td>
<td></td>
</tr>
<tr>
<td>The State of Israel</td>
<td>Ministry of Finance, Jerusalem 91000</td>
<td>79,980,010</td>
<td></td>
</tr>
<tr>
<td><strong>Total ordinary shares in Israel</strong></td>
<td></td>
<td><strong>80,095,029</strong></td>
<td></td>
</tr>
<tr>
<td>The State of Israel Ordinary shares B</td>
<td></td>
<td>40,053,252</td>
<td></td>
</tr>
<tr>
<td><strong>Total shares in Israel</strong></td>
<td></td>
<td><strong>120,148,281</strong></td>
<td></td>
</tr>
</tbody>
</table>
### Shareholders – Abroad (excluding GB)

<table>
<thead>
<tr>
<th>Name of Shareholder</th>
<th>I.D. #</th>
<th>Address</th>
<th>Ordinary Shares of NIS 0.10 each</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estate of Simon and Matilda Budenstein</td>
<td></td>
<td>c/o Mr. Richard Budenstein, 1925 Welsh Road Box 3, Philadelphia, Pennsylvania 19115, U.S.A.</td>
<td>200</td>
</tr>
<tr>
<td>C&amp;R Fund Inc.</td>
<td></td>
<td>45 East End Ave, N.Y., N.Y 10028 Apt 14G (Invalid address)</td>
<td>5340</td>
</tr>
<tr>
<td>Estate of Samuel Fireman dec’d</td>
<td></td>
<td>c/o Mrs. Ruth Fireman, 59 Kittredge Terrace, San Francisco, California 94118, U.S.A.</td>
<td>801</td>
</tr>
<tr>
<td>Mrs. Shari Friedman</td>
<td></td>
<td>c/o Stanley J. Friedman of Shereff Friedman, Hoffman &amp; Goodman, 919 Third Avenue, New York 10022, U.S.A. (Invalid address)</td>
<td>384</td>
</tr>
<tr>
<td>Mr. Harry and Mrs. Fajga Gejerman</td>
<td></td>
<td>16461 40th St. Flushing, Long Island, New York 11365, U.S.A.</td>
<td>3204</td>
</tr>
<tr>
<td>Mrs. Morris and Mrs. Jenny Gejerman</td>
<td></td>
<td>16461 40th St. Flushing, Long Island, New York 11365, U.S.A.</td>
<td>1602</td>
</tr>
<tr>
<td>Mr. Harvey Goldberg</td>
<td></td>
<td>1041 Chestnut St. Valley Stream, N.Y., U.S.A (Invalid address)</td>
<td>801</td>
</tr>
<tr>
<td>Jacob Nachum Gutwirth</td>
<td></td>
<td>580 Fifth Avenue New York, N.Y., U.S.A (Invalid address)</td>
<td>921</td>
</tr>
<tr>
<td>Mr. Martin and Mrs. Kay Harrison</td>
<td></td>
<td>2725 Malcolm Ave., Los Angeles, CA. 90064, U.S.A. (Invalid address)</td>
<td>1907</td>
</tr>
<tr>
<td>Mrs. Kay Harrison</td>
<td></td>
<td>2725 Malcolm Ave., Los Angeles, CA. 90064, U.S.A.</td>
<td>1907</td>
</tr>
<tr>
<td>Mr. Jeffrey K., Israel</td>
<td></td>
<td>3357 NW 101 Ave. Sunrise, Florida 33351, U.S.A.</td>
<td>858</td>
</tr>
<tr>
<td>Mr. Fred and Mrs. Sara Levi</td>
<td></td>
<td>639 East Moore Blvd. Columbos 9, Ohio, U.S.A.</td>
<td>401</td>
</tr>
<tr>
<td>Mr. Elliot H. Lipschults</td>
<td></td>
<td>816 Cedar Lane, Northbrook, Illinois 60062, U.S.A.</td>
<td>601</td>
</tr>
<tr>
<td>Mr. Benjamin Feld</td>
<td></td>
<td>P.O. Box 272124, Houston, Texas, TX 77277-2124, U.S.A. (Invalid address)</td>
<td>801</td>
</tr>
<tr>
<td>Mr. I. Meltzer</td>
<td></td>
<td>4682 408th Street, W. Quartz, Hill Calif. 93536-2120, U.S.A.</td>
<td>954</td>
</tr>
<tr>
<td>Namen Namenson</td>
<td></td>
<td>1674 Mac Combs Road, Bronx N.Y.C., U.S.A. (Invalid address)</td>
<td>801</td>
</tr>
<tr>
<td>Mrs. Anne Oksenberg Fridman</td>
<td></td>
<td>993 Park Ave., Apt. 105, New York, NY 10028, U.S.A.</td>
<td>921</td>
</tr>
<tr>
<td>Shimon Piaskowsky and Ruth Piaskowsky</td>
<td></td>
<td>42 Verde Vistra Drive, Thousand Oaks, Calif. 91360, U.S.A.</td>
<td>401</td>
</tr>
<tr>
<td>Chaim Schitlowsky</td>
<td></td>
<td>c/o Amalgamated Bank of New York, 11-15 Union Square, N.Y., U.S.A.</td>
<td>8</td>
</tr>
<tr>
<td>Miss Liza Tausig</td>
<td></td>
<td>46 Arleigh Road, Great Neck, N.Y. 11021, U.S.A. (Invalid address)</td>
<td>401</td>
</tr>
<tr>
<td>Mr. Nochim Torczyner</td>
<td></td>
<td>c/o Harry Torczyner, 146 W 57, St. New York, N.Y. 10019-3301, U.S.A.</td>
<td>1065</td>
</tr>
<tr>
<td>Edward Weinstein</td>
<td></td>
<td>Kefar Adumim, D.N. Mizrahy Binyamin</td>
<td>8869</td>
</tr>
<tr>
<td>Name</td>
<td>Address</td>
<td>Country</td>
<td></td>
</tr>
<tr>
<td>-----------------</td>
<td>----------------------------------</td>
<td>---------------</td>
<td></td>
</tr>
<tr>
<td>Jacques Buchenhultz</td>
<td>634 Esmeralda, Buenos Aires, ARGENTINE</td>
<td>90618, Israel</td>
<td></td>
</tr>
<tr>
<td>Simon Dattner</td>
<td>60 Vestingstraat, Antwerp, BELGIUM (Invalid address)</td>
<td>634</td>
<td></td>
</tr>
<tr>
<td>Gregoire Karlin</td>
<td>86 Rue Due Pelican, Antwerp, BELGIUM (Invalid address)</td>
<td>512</td>
<td></td>
</tr>
<tr>
<td>Michel Karlin</td>
<td>86 Rue Due Pelican, Antwerp, BELGIUM (Invalid address)</td>
<td>512</td>
<td></td>
</tr>
<tr>
<td>Stanislas Van Mierlo</td>
<td>44 Stefanie St. Antwerp, BELGIUM (Invalid address)</td>
<td>144</td>
<td></td>
</tr>
<tr>
<td>Max Rosshandler</td>
<td>20 Rue Van Lerious, Antwerp, BELGIUM</td>
<td>88</td>
<td></td>
</tr>
<tr>
<td>Miss Judith Stern</td>
<td>22 Avenue Helene, Antwerp, BELGIUM</td>
<td>88</td>
<td></td>
</tr>
<tr>
<td>Mrs. Maryze Juster</td>
<td>72 Blvd. Exelmans, Paris 75016, FRANCE</td>
<td>115</td>
<td></td>
</tr>
<tr>
<td>Isaac Naiditch</td>
<td>30 Avenue Marceau, Paris, FRANCE</td>
<td>432</td>
<td></td>
</tr>
<tr>
<td><strong>Total abroad (Excluding GB)</strong></td>
<td></td>
<td>41,193</td>
<td></td>
</tr>
<tr>
<td>Name of Shareholder</td>
<td>I.D. #</td>
<td>Address</td>
<td>Ordinary Shares of NIS 0.10 each</td>
</tr>
<tr>
<td>-------------------------------------</td>
<td>---------</td>
<td>-------------------------------------------------------------------------</td>
<td>----------------------------------</td>
</tr>
<tr>
<td>Ohad Egoz, Adv.</td>
<td></td>
<td>1a Pinhas Rosen St., Tel Aviv 69512 (Amnon Egoz) For dividends: Flat 82, Maida Vale 33, London W9 1AJ, UK</td>
<td>14,477</td>
</tr>
<tr>
<td>Barclays Nominees (Branches) Ltd.</td>
<td></td>
<td>1 Churchill palace, London E14 5HP</td>
<td>1162</td>
</tr>
<tr>
<td>John William Watkinson Buckley, Esq.</td>
<td></td>
<td>4A Upper Park Road, Hampstead, London NW3 2UD</td>
<td>402</td>
</tr>
<tr>
<td>Arturo Dolcetta</td>
<td></td>
<td>c/o National Westminster Bank Ltd., 64 Knightsbridge, London SW1</td>
<td>801</td>
</tr>
<tr>
<td>Carlo Dolcetta</td>
<td></td>
<td>c/o General Manager Aircosse Ltd., Park Road, Waterford, Ireland</td>
<td>801</td>
</tr>
<tr>
<td>Roger Goodison, Esq.</td>
<td></td>
<td>36 Deer Park place, Sheffield S6 5ND</td>
<td>50</td>
</tr>
<tr>
<td>Thomas Hale, Esq.</td>
<td></td>
<td>37 Thrupps Lane Hersham Walton on Thames KT12 4LX</td>
<td>50</td>
</tr>
<tr>
<td>Mr. Jeremy Philip Hayes, and Mr. John Allan Hayes</td>
<td></td>
<td>19 Goodwyn Avenue, London NW7 3RJ</td>
<td>95</td>
</tr>
<tr>
<td>Dr. Israel Lifshitz</td>
<td></td>
<td>Barclays Bank International Ltd., P.O.ox 115, 168 Fenchurch Street, London EC3P 3HP</td>
<td>256</td>
</tr>
<tr>
<td>Rev. R. Nevin Lyons and William G. Wilson, Esq.</td>
<td></td>
<td>1. 813 Lisburn Road, Balmoral, Belfast. 2. 29 Wellkington Place, Belfast</td>
<td>1,049</td>
</tr>
<tr>
<td>Midland Bank (Overseas) Nominees Limited</td>
<td></td>
<td>60 Gracechurch Street, London E.C.3</td>
<td>2,099</td>
</tr>
<tr>
<td>Vera Elizabeth Mire</td>
<td></td>
<td>116 Walm Lane, London NW2 4RT</td>
<td>344</td>
</tr>
<tr>
<td>Kenneth Martin Nicol, Esq.</td>
<td></td>
<td>1 Shepparn Way, Minchinhampton, Stroud, Gloucestershire</td>
<td>801</td>
</tr>
<tr>
<td>Mr. Shirleyh Horacio Phillips</td>
<td></td>
<td>1 Fayland Avenue Streatham Park, London SW16 1TB</td>
<td>128</td>
</tr>
<tr>
<td>Rensburg Client Nominees Ltd.</td>
<td></td>
<td>100 Old Hall St., Liverpool L3 9AB</td>
<td>250</td>
</tr>
<tr>
<td>Antea Deryn Ennion</td>
<td></td>
<td>Four Walls, Dunstan Lane,Burton, South Wirral Cheshire L64 8TG</td>
<td>2,098</td>
</tr>
<tr>
<td>George Rex Shaw-Twilley, Esq.</td>
<td></td>
<td>4 Buckland Walk, Newport, Shropshire TF10 7NQ</td>
<td>50</td>
</tr>
<tr>
<td>Sale and District Hebrew Congregation</td>
<td></td>
<td>Hesketh Road, Sale, Cheshire</td>
<td>401</td>
</tr>
<tr>
<td>Gordon Taylor, Esq.</td>
<td></td>
<td>17 Colney Lane, Cringleford, Norwich Norfolk NR4 7RF</td>
<td>521</td>
</tr>
<tr>
<td>Shelagh M. Thomlinson</td>
<td></td>
<td>27 Drayson Mews, London W8 4LY, UK</td>
<td>144</td>
</tr>
</tbody>
</table>
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 2ND  
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

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, Battersea 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: UB71F@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, Business Development, Marketing and Service Committee, Human Resources and Organization Committee, Budget, Financial and Risks Management Committee, Agreements and Assets Committee, Corporate Liability Committee, Regulation Committee.

   External director: No. Has no accounting and financial expertise.

   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 16, 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), Chairman of the Management Committee of the Neot Kramim Nonprofit Organization (a housing project for I.D.F. officers) (2007-January 2013).

List of corporations in which he serves as a director: 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.

2. **Shlomit Barnea Farago**

Name: Shlomit Barnea Farago

Identity card no.: 055088991

Date of birth: March 23, 1958

Address: 18/39 HaCarmel St., Ganei Tikva 55900

Citizenship: Israel

Membership on board committees: Strategy, Structural Change and Image Committee; Business Development, Marketing and Service Committee; Human Resources and Organization Committee; Chairperson of Committee for Corporate Responsibility.

External director: No.

Independent Director: No.

Has accounting or financial expertise: No.Is she an employee of the company, of a subsidiary, of an Affiliated Company, or of a stakeholder? An employee of a stakeholder in the Company by being an employee of the State of Israel, which is a stakeholder in the Company.

Date of appointment: Initially appointed in April 14, 2002 (reappointed in March 15, 2011).

Education: LLB and LLM in law from Bar Ilan University.

Other Education and Professional Certificates: Certificate of Financial Statements Analysis and Companies Valuation Course from Tel Aviv University – LAHAV; B.C. from Vancouver School Board, majoring in Business communications.

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: Legal counsel to the Prime Minister’s Office.

List of corporations in which she serves as a director: Director and member of the general meeting of The Western Wall Heritage Foundation; member of the EMET (for science, art and culture) award Committee, Chairperson of the Disciplinary and Dispute resolution Court of the Institute of Internal Auditors in Israel.
3. **Rochelle Don-Yechiya**

   **Name:** Rochelle Don-Yechiya  
   **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, Regulation Committee.  
   **External director:** No.  
   **Independent Director:** No.  
   **Has accounting or financial expertise:** No.  
   **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; acted as a Director in the Company intermittently since 1998, member of sub-committees of the Israel Bar Association and member of the management team of the women’s lobby in Israel.  
   **List of corporations in which she serves as a director:** Ayalon Highways Ltd., Channel 2 News Company of the Israeli Television.

4. **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; Business Development Marketing and Services committee; Audit Committee; Agreements and Assets committee;  
   **External director:** No.  
   **Independent director:** No.  
   **Has accounting and financial expertise:** No.  
   **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 and on September 15, 2011).  
   **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, Chairperson of the “Ma’agalim” Fund for Persons with Eroding Professions, Chairperson of the Israel Women’s Network, a director in the Amal network; member of management of the Israel Ballet and the Suzanne Dellal Center.

List of corporations in which she serves as a director: AMAL network.

5. **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: Strategy Committee; Restructuring and Image Committee; Business Development, Committee of Human Resources and Organization.

   External director: No.
   Independent director: No.

   Has accounting and financial expertise: No.

   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, MH MD Health systems administration 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: Head of Misgav Ledech Hospital, Chairman of Committee Practice of Shiba, Head of Shiba Talpiot.

6. **Gideon Frank**

   Name: Gideon Frank
   Identity card no.: 07570237
   Date of birth: November 13, 1943
   Address: Beit Itzhak Sha’ar Hefer42920 PO Box 8109
   Citizenship: Israel

   Membership on board committees: Strategy Organizational Restructuring and Image Committee; Business Development Marketing and Service Committee; Corporate Responsibility Committee; Audit Committee, Chairman of the Regulation Committee.

   External director: No.
   Independent director: No.

   Has accounting and financial expertise: No.

   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: Deputy Chairman of the Atomic Energy Committee (from 2008 to December 2012), General Director of the Israeli Atomic Energy Commission from 1992 up to September 2007. Chairman of the Board of Crecor (wholly-owned by Van Leer Group Foundation) (from January 2010), Lecturer in the MBA Course of the Interdisciplinary Center Herzlia from 2011.

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, since 2011; since 2008 Director in CRECOR (Subsidiary of Van-Leer Fund), Board of trustees of the Afeka Engineering College.

7. **Vered Itzhaki**

   Name: Vered Itzhaki
   
   Identity card no.: 025437542
   
   Date of birth: June 13, 1973
   
   Address: Neve Zoof, Mobile Post Modein, Halamish 71945
   
   Citizenship: Israel

   Membership on board committees: Human Resources and Organization Committee; Committee for Reviewing Financial Statements, Chairwoman of the Budget Financial Management and Risk Management Committee; Agreements and Assets Committee.

   External director: No.

   Independent director: No.

   Has accounting and financial expertise: Yes.

   Is she an employee of the company, of a subsidiary, of an Affiliated Company, of a stakeholder? No. Date of appointment: May 3, 2011.

   Education: B.A. Economics and Business Management, Bar Ilan University, M.A. Business Management and Economics, Bar Ilan University.

   Is he 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? Yes.

   Her employment over the past five (5) years: CEO Prico Management.

   List of corporations in which he serves as a director: Ms. Itzhaki does not serve as director in additional corporations.

8. **Dr. Vered Vivi Ziv**

   Name: Vered (Vivi) Ziv
   
   Identity card no.: 069641793
   
   Date of birth: August 25, 1962
   
   Address: 30a Sigalit Street, Mazkeret Batia.
   
   Citizenship: Israel and American

   Membership on board committees: Chairperson of Business Development Marketing and Service Committee; Compensation Committee; Corporate Liability Committee, Human Resources and Organization Committee.
**External director:** No.

**Independent director:** No.

**Has accounting and financial expertise:** No. Is she an employee of the company, of a subsidiary, of an Affiliated Company, of a stakeholder? No.

**Date of appointment:** August 15, 2011.


**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:** Deputy CEO Regulation at Emilia Cosmetics Company, COO, Development, Regulation and Clinical Experiments, Micromedic Technologies Ltd., Deputy CEO, Radio-Pharmaceutics, Nuclear Research Center Nahal Sorek (2008-2009).

**List of corporations in which she serves as a director:** Dr. Ziv does not serve as director in additional corporations.

9. **Mooki Ben Ami**

**Name:** Mooki Ben Ami

**Identity card no.:** 058832320

**Date of birth:** July 27, 1964

**Address:** 42, Gilboa Street, Nofit, P.O. Box 5100

**Citizenship:** Israel

Serves as a Director from among the employees of the Company

**Membership on board committees:** Strategy Committee; Structural Change and Image Committee, Business Development, Marketing and Service Committee; Human Resources and Organization Committee; Budget Committee; Financial Management and Risk Management Committee; Regulation Committee.

**External director:** No.

**Independent director:** No.

**Has accounting and financial expertise:** Yes. Is he an employee of the company, of a subsidiary, of an Affiliated Company, of a stakeholder? Yes Leader of the inventory and fuels operation budget of the Company and leader of the work team on the subject of management of budgetary control and command in the Company.

**Date of appointment:** February 21, 2012.

**Education:** B.A., Economics, majoring in Business Management, Haifa University; Knowledge Rich Plants Business Management Course, External Studies, Haifa 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:** Leader of the Operation Budget of the Company and Leader of the work team on the subject of management of budgetary control and command in the Company.

**List of corporations in which he serves as a director:** Mahog - Pension Administration of the Israel Electric Corporation Ltd., employees.
10. **Varda Samet**
   
   **Name:** Varda Samet  
   **Identity card no.:** 004317376  
   **Date of birth:** February 11, 1948  
   **Address:** 1 Hasadot Street, Neve Gan, Ramat Hasharon.  
   **Citizenship:** Israel  
   **Membership on board committees:** Strategy, Structural Change and Image Committee; Human Resources and Organization Committee; Regulation Committee.  
   **External director:** No.  
   **Independent director:** No.  
   **Has accounting and financial expertise:** No.  
   **Is she an employee of the company, of a subsidiary, of an Affiliated Company, of a stakeholder?** No.  
   **Date of appointment:** March 5, 2012.  
   **Education:** B.Sc., Chemistry, Tel Aviv University; M.Sc., Biochemistry, Tel Aviv University; B.A., Law, Tel Aviv University; Mediator Certificate from Gome Institute.  
   **Is she a relative of another party at interest in the corporation?** 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:** Judge in the Tel Aviv District Labor Court.  
   **List of corporations in which she serves as a director:** Ms. Samet does not serve as director in additional corporations.

11. **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:** Rewards Committee; Audit Committee; Chairman of Committee for Reviewing the Financial Statements; Budget, Financial Management and Risk Management Committee; Agreements and Assets Committee; Corporate Responsibility Committee.  
   **External director:** Yes.  
   **Independent director:** No.  
   **Has accounting and financial expertise:** Yes.  
   **Is he an employee of the company, of a subsidiary, of an Affiliated Company, of a stakeholder?** No.  
   **Date of appointment:** December 2, 2009.  
   **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; Member of the Advisory Committee of the Financial Institutions’ Center for Ethics, member of the Advisory Committee for Supervision of Financial Institutions in the Ministry of Finance; Chairman of the National Training and Advanced Studies Committee of the Institute of Internal Auditors; CEO of The Ramle Foundation for Education, Culture and Development; member of the managing committee in the enterprise promotion center; member of the advisory committee on regulation to the Securities Authority and President of the Internal Auditing Institution.

List of corporations in which he serves as a director: External Director in A. B Trans Ltd.; External Director in Shlomo Insurance Company; director in GTI - Jerusalem Technology Investment; External Director in B. Yair Ltd.; Public Representative in the Advance Study Fund for Pharmacists; Chairman of the Institute of Internal Auditors in Israel.

12. Dr. Itzhak Lax

Name: Itshak Lax

Identity card no.: 059757708

Date of birth: July 21, 1965

Address: 75a Maccabim Street, PO Box 2185, Shoham

Citizenship: Israel

Membership on board committees: Rewards Committee; Strategy Organizational Chairman of the Audit Committee; Committee for Reviewing the Financial Statements; Budge, Financial Management and Risk Management Committee; Agreements and Assets Committee; Corporate Responsibility Committee.

External director: Yes.

Independent director: No.

Has accounting and financial expertise: Yes.

Is he an employee of the company, of a subsidiary, of an Affiliated Company, of a stakeholder? No.

Date of appointment: May 12, 2011.

Education: L.L.B in Law, Bar Ilan University; M.B.A. in Business Management, Bar Ilan University, Ph.D. Economics, IUBL University.

Other Education and Public Certificates: Member of the Israeli Bar Association, Certificate of a Senior Authorized Teacher; Graduate, Mediation Course, studied History and Philosophy at the Open 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: Joint Founder of Biomedical "Investments", Seed Fund; CEO Shalem Center (2008-2010); Lecturer for Bachelor’s and Master’s degrees at Bar Ilan University, Management Department; Lecturer of Insurance Law at the Netanya College; Owner of "Ishon" Consulting, Management and Holdings Ltd., Arbitrator in the Arbitration Institute of the Israel Bar Association.

List of corporations in which he serves as a director: Chairman Maccabi Health Services Fund; Chairman Maccabident Ltd., dental clinics chain of Maccabi Health Services; Liberty Properties, External Director; member of MASA Project – for encouraging long term plans in Israel for Jewish Youth Ltd.; Member of the Public Committee for determining appropriation of legacies bequeathed to the State; Ishon Consultation, Management and Holding Ltd., since 2010; Chairman Weitz Center Ltd.; Management member of Gehser, educational projects society; Director, Maccabi Holdings Ltd.; External Director I.T.V Medical Ltd.; member of the National Court of the Israel Bar Association.
13. **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; Strategy Organizational Restructuring and Image Committee; Audit Committee; Committee for Reviewing the Financial Statements; Budget, Financial Management and Risk Management Committee; Agreements and Asset Committee.

External director: Yes.  
Independent director: No.  

Has accounting and financial expertise: Yes.  

Is he an employee of the company, of a subsidiary, of an Affiliated Company, of a stakeholder? No.  
Date of appointment: August 2, 2011.  

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  


14. **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: Strategy, Organizational Restructuring and Image Committee; Business Development, Marketing and Service Committee; Committee for Reviewing Financial Statements; Budget, Financial Management and Risk Management Committee; Corporate Responsibility Committee.

External director: No.  
Independent director: No.  

Has accounting and financial expertise: Yes.  

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: Consultant to the Ministry of Industry, Trade and Labor in 2008; Director in the “Atalef” non-profit organization until 2009; Director in Assets M.I until 2012; partner in three private companies: Tal-Yam Process Advantage Ltd., IREM Holdings and Placidus LLC; Head of Capital market and Economics Section of a web site; Court expert for economic disputes between organizations and companies.

List of corporations in which he serves as a director: director in the Israel Military Industries; chairman of the safety and environmental protection committee, member of the finance committee, director in the “Adopt a Child’s Heart” non-profit organization at the Wolfson Hospital.
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:** Bachelor’s degree 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. **Yakov Hain**
   - **Name:** Yakov Hain
   - **Identity card no.:** 011373461
   - **Date of birth:** December 8, 1955.
   - **Date on which he began his term:** February 1, 2013.
   - **Position in the corporation:** Deputy CEO and VP Customers and Business Development.
   - **Is he a relative of another senior officeholder or a party at interest?** No.
   - **Education:** BA in electrical engineering from Riga Polytechnic, MBA Business Management from University of Derby.
   - **Business experience over the past five (5) years:** VP Engineering Projects (from January 2007 to May 2012), Deputy CEO and VP production and Transmission (from June 2012 to February 2013).
   - **Position in a subsidiary of the corporation, its affiliated company, or in a stakeholder in the company:** Chairman of the Board of Directors of the National Coal Supply 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.

3. **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.
   - **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 13.1.7 in the Description of the Company's Business Affaris): Burning Solar Ltd., P.V. NanoCell Ltd., Metricom Communication Ltd., Bright Led Ltd., Bird Vision.

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.

4. **David Yahav**

   **Name:** David Yahav  
   **Identity card no.** 050258946  
   **Date of birth:** October 12, 1950.  
   **Date on which he began his term:** September 3, 1995.  
   **Position in the corporation:** Legal advisor and secretary of the company and its subsidiaries (Deputy CEO).  
   **Is he a relative of another senior officeholder or a party at interest?** No.  
   **Education:** L.L.B in Law, Tel Aviv University, MA from military prosecutor’s school of the US Armed Forces at the University of Virginia.  
   **Business experience over the past five (5) years:** General Counsel and Company Secretary of the company and its subsidiaries.  
   **Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company:** Company Secretary and General Counsel of the subsidiaries of the Company: Jordan Investment Company Ltd., and Migrashei Hakablanim Ltd., shareholder in Jordan Investment Company Ltd., Land of Israel Construction Ltd., and Ma’abarot HaYarden Ltd.

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. **Zvi Harpak**

   **Name:** Zvi Harpak  
   **Identity card no.** 006642243  
   **Date of birth:** February 17, 1948.  
   **Date on which he began his term:** January 8, 2009.  
   **Position in the corporation:** VP Organization, Logistics, Security and Emergency.  
   **Is he a relative of another senior officeholder or a party at interest?** No.  
   **Education:** B.Sc., Nature Sciences, the Hebrew University, Jerusalem; M.Sc., Technology and Information Systems Management, Tel Aviv University.  
   **Business experience over the past five (5) years:** VP Organization, Logistics, Security and Emergency.  
   **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. **Eitzhak “Ika” Yakin**

   **Name:** Eitzhak Yakin  
   **Identity card no.:** 951384  
   **Date of birth:** December 15, 1946
Date on which he began his term: January 1, 2010

Position in the corporation: Senior Vice President of Human Resources

Is he a relative of another senior officeholder or a party at interest? No.

Education: BA in Business Management, Champlain University, M.Sc. in Behavioral Sciences, Polytechnico University.

Business experience over the past five (5) years: Manager of Jerusalem District (September 2006 – January 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.

Note: Mr. Yakin reached compulsory retirement age on December 31, 2013 and, with the approval of the Board of Directors of the Company, will continue to work until June 30, 2014.

7. 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: 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. Amir Livne

Name: Amir Livne

Identity card no.: 023725740

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.
9. **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:** Acting Head Engineering Projects and Business Development until January 31, 2013. VP Generation and Transmission from February 1, 2013.  
   **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).  
   **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. **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.

12. **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.

12. 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.

13. 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 and Head of Information Systems and Teleprocessing Division.

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.

Office holders whose term of office has ended by the date of publication of the report:

<table>
<thead>
<tr>
<th>Name</th>
<th>Position in the Company</th>
<th>Date of beginning of term</th>
<th>Date of termination of term</th>
</tr>
</thead>
</table>
Regulation 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 February 21, 2013, see immediate report of February 21, 2013 (reference No. 2013-01-045363).

Regulation 29A (4): Exemption, insurance, or liability for indemnity in respect of officeholders in effect on the date of this report

Insurance for Directors and Office Holders

In (separate) decisions of the compensation committee and the Board of Directors of the Company of December 5, 2013, which were approved by the general meeting of January 9, 2014, the terms for the Company's contractual engagement for liability insurance for directors and office holders with the Harel Insurance Company Ltd. were approved for a period of one year, commencing on January 16, 2014 and ending on January 15, 2015, including.

In addition, the Company insured the directors with a personal accident insurance and third party insurance.

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).

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, 2014.
CORPORATE GOVERNANCE QUESTIONNAIRE

As part of this questionnaire, note that -

(1) The questionnaire is arranged in a format in which the answer “correct” for each of the questions constitutes a positive indication of the existence of a proper corporate governance, and vice versa. The answer “correct” will be marked in the relevant box by a √ and an answer of “not correct” will be marked by an X; for the removal of doubt, it is clarified that the questionnaire does not exhaust all the aspects of corporate governance that are relevant to the corporation, and deals with a number of aspects only; for further information (if required), see the current reports of the corporation.

(2) “Reporting year” means from 1.1.13 until 31.12.13 that preceded the date of publication of the periodic report, unless explicitly stated otherwise;

(3) The normative framework is stated beside each question. In case the question relates to a mandatory provision, it is explicitly stated;

(4) If the corporation desires to add information that may be important to a reasonable investor with respect to its answers in the questionnaire, it will do so within the end notes to the questionnaire, with referral from the relevant question.

INDEPENDENCE OF THE BOARD OF DIRECTORS

<table>
<thead>
<tr>
<th></th>
<th></th>
<th>Correct</th>
<th>Not Correct</th>
<th>Normative Framework</th>
</tr>
</thead>
</table>
| 1. | Throughout the reporting year two or more external directors served in the corporation. **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:**
|   | Director A: Mr. Arie Rapoport
|   | Director B: Mr. Ziv Reich
|   | Director C: Mr. Izhak Lax
|   | Number of external directors serving in the corporation as of the date of publication of this questionnaire: 3 | ✓ |   | Mandatory provisions
|   |   |   |   | Section 239 of the Companies Law |
| 2. | a. Number of independent directors¹ serving in the corporation as of the date of publication of this questionnaire: 0 |   |   | Companies Law- Article 1 of the First Amendment |

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¹ Except for an “external director” according to its definition in the Companies Law.
## b. As of the date of publication of this questionnaire:
- In a corporation with a **controlling shareholder** or a controlling block holder (in this section – **controlling shareholder**) – at least one-third of the board members are independent.
- In a corporation with no controlling shareholder – a majority of the board members are independent.

## c. The corporation's articles provide that minimum proportion\(^2\)/number of independent directors are to serve in it.

If your response is "correct," indicate:

The proportion/number of independent directors set in the articles: ______

The corporation actually complied with the provision of the articles in the reporting year (regarding the service of independent directors):

- [ ] Yes
- [ ] No

\(^2\) "Proportion" in this questionnaire - a certain number out of all the directors. Thus, for example, in a corporation in which a proportion of a third of independent directors is set, 1/3 will be noted.
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.

3. If your response is "correct" – indicate the party who conducted the said examination: Attn Shlomi Zarfaty, Secretary of the Board of Directors

All the directors who served in the corporation in the course of the reporting year are not subordinate to the CEO, directly or indirectly (other than a director representative of employees, if the corporation has an employees' representative body).

4. If your response is "not correct" (i.e. any director is subordinate to the CEO, as stated) – indicate the number of directors who did not satisfy this restriction: ______

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):

5. If your answer is “Not correct”-
   a. 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.
   b. 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.

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3 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.
A controlling shareholder (including his relative and/or anyone acting on his behalf), who is not a director or other senior officer in the corporation, was not present 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 the additional person at such meetings of the board of directors:

<table>
<thead>
<tr>
<th>Identity:</th>
<th>Position in the corporation (if exists):</th>
</tr>
</thead>
<tbody>
<tr>
<td>Details of the relation to the controlling shareholder (if the person present was not the controlling shareholder himself):</td>
<td></td>
</tr>
<tr>
<td>Was it for the purpose of presenting a particular subject by him:</td>
<td></td>
</tr>
<tr>
<td>☐ Yes</td>
<td></td>
</tr>
<tr>
<td>☐ No</td>
<td></td>
</tr>
</tbody>
</table>

*(Mark an X in the appropriate box)*

Rate of his presence\(^4\) at meetings of the board of directors held in the reporting year:

For presenting a certain subject by him: ____. Other presence: participation in a meeting on behalf of the controlling shareholder.

☐ Not relevant (the corporation has no controlling shareholder).

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\(^4\) While separating between the controlling shareholder and his relative and/or anyone on his behalf.
### DIRECTORS’ COMPETENCE AND QUALIFICATIONS

<table>
<thead>
<tr>
<th></th>
<th>Correct</th>
<th>Not Correct</th>
<th>Normative Framework</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>7.</strong></td>
<td></td>
<td></td>
<td>Sections 85 and 222 of the Companies Law, section 46b of the Securities Law</td>
</tr>
<tr>
<td>The corporation's articles do not 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 (<em>in this regard – a determination by a simple majority is not considered a restriction</em>)</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>If your response is &quot;not correct&quot; (i.e. such a restriction exists), indicate –</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. The period of time set in the articles for the service of a director:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>b. The required majority set in the articles for the termination of service of the directors:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>c. The quorum set in the articles for a general meeting for terminating the service of the directors:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>d. The required majority for changing these provisions in the articles:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>8.</strong></td>
<td>✓</td>
<td></td>
<td>Mandatory Provision</td>
</tr>
<tr>
<td>All directors who served in the corporation in the course of the reporting year declared, prior to the date of convening of the general meeting in which their appointment was on the agenda (including re-appointments), that they have the necessary qualifications (listing them) and the ability to devote the appropriate time for the performance of their function, and that the restrictions specified in Sections 226 and 227 of the Companies Law do not apply to them, and regarding an independent director – they also satisfy paragraphs (1) and (2) of the definition of &quot;independent director&quot; in Section 1 of the Companies Law.</td>
<td></td>
<td>Sections 224a and 224b of the Companies Law</td>
<td></td>
</tr>
<tr>
<td>If your response is &quot;not correct&quot; – indicate the names of the directors who did not fulfill the above:</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
9. The corporation has 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, as well as a continuation program for training serving directors, that is adapted, *inter alia*, 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

☐ No

(Mark an X in the appropriate box)

10. The chairman of the board of directors (or another person appointed by the board of directors) is responsible for the implementation of the corporate governance provisions applying to the corporation, and acted to update the directors on subjects connected with corporate governance during the reporting year.

If the board of directors appointed another person in this capacity (instead of the chairman of the board of directors), indicate his name and position: **Chairman of the Corporate Liability Committee, Attn Shlomit Barnea Farago, member of the Board of Directors**

11. 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: 5

b. Throughout the reporting year, apart from the external director with accounting and financial expertise, additional directors with accounting and financial expertise served in the corporation, in the number determined by the board of directors.

A response of "correct" may be given on this question if the period of time during which additional directors with accounting and financial expertise did not serve does not exceed 60 days. However, whatever the response (correct/not correct), the period of time (in days) during which such directors did not serve in the corporation must be indicated: _____

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: _____

---

Companies law – section 4(a) of the first amendment (recommended corporate governance provisions)

Companies Law – section 4(b) of the first amendment (recommended corporate governance provisions)

Mandatory Provision Section 92(a)(12) of the Companies Law

Mandatory Provision Section 219(d) of the Companies Law

Section 92(a (12), 219(d), 240(a1) of the Companies Law, regulation 10(b)(9)(a) and 48(c)(9) of the Financial Regulations
<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>12.</strong></td>
<td><strong>a.</strong></td>
<td>Upon the appointment of an external director in the reporting year, the provision of Section 239(d) of the Companies Law regarding gender diversity in the composition of the board of directors was satisfied.</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td></td>
<td>☐ Not applicable (no external director was appointed in the reporting year).</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>b.</strong></td>
<td>Throughout the reporting year the board of directors was composed of members of both genders.</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>If your response is &quot;not correct&quot; – indicate the period of time (in days) during which the above was not fulfilled: ______</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>A response of &quot;correct&quot; 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 of time (in days) during which directors of both genders did not serve in the corporation must be indicated: ______</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>c.</strong></td>
<td>The number of directors of each gender serving on the corporation's board of directors as of the date of publication of this questionnaire:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Men: 8</td>
<td>Women: 6</td>
<td></td>
</tr>
</tbody>
</table>

**Mandatory Provision**

Section 239(d) of the Companies Law

**Companies Law** - section 2 of the first supplement (Recommended Corporate Governance Provisions)
### MEETINGS OF THE BOARD OF DIRECTORS  (CONVENING A GENERAL MEETING)

<table>
<thead>
<tr>
<th>Correct</th>
<th>Not Correct</th>
<th>Normative Framework</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>13.</td>
<td>Sections 97, 98 and 224a of the Companies Law</td>
</tr>
</tbody>
</table>

#### a. Number of meetings of the board of directors held in each quarter of the reporting year:

- First quarter (2013 year): 23
- Second quarter: 35
- Third quarter: 28
- Fourth quarter: 42

#### b. Indicate next to the name of each of the directors who served in the corporation during the reporting year the rate 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):

(Add lines according to the number of directors)

<table>
<thead>
<tr>
<th>Director’s name</th>
<th>Rate of his attendance at meetings of the board of directors</th>
<th>Rate of his attendance at meetings of the audit committee (for a director who is a member of this committee)</th>
<th>Rate of his attendance at meetings of the committee for examining the financial statements (for a director who is a member of this committee)</th>
<th>Rate of his attendance at meetings of the compensation committee (regarding a director who is a member of this committee)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Iris Stark</td>
<td>78.6%</td>
<td>50%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Raiek AbuRish</td>
<td>92.9%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Name</td>
<td>Percentage</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>-----------------------------</td>
<td>------------</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ram Erlichman</td>
<td>85.5%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dvorah Chen</td>
<td>81.8%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rochelle Don-Yechiya</td>
<td>94.7%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yaffa Vigodsky</td>
<td>76.3% 80%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vered Vivi Ziv</td>
<td>82.9% 100%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mordechai Muki Ben Ami</td>
<td>996.4%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vered Itzhaki</td>
<td>75.6%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Michael Lazer</td>
<td>93.5% 75% 100%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yzhak Lax</td>
<td>94.3% 100% 100% 100%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Varda Samet</td>
<td>76.8%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Name</td>
<td>Attendance</td>
<td>Package</td>
<td>Attendance</td>
<td>Package</td>
</tr>
<tr>
<td>-----------------------------</td>
<td>------------</td>
<td>---------</td>
<td>------------</td>
<td>---------</td>
</tr>
<tr>
<td>Gideon Frank</td>
<td>77.3%</td>
<td>67%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ziv Reich</td>
<td>95%</td>
<td>95%</td>
<td>89%</td>
<td>100%</td>
</tr>
<tr>
<td>Arie Rapoport</td>
<td>83.8%</td>
<td>95%</td>
<td>89%</td>
<td>100%</td>
</tr>
<tr>
<td>Shlomit Barnea Farago</td>
<td>67.3%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ofir Bashan</td>
<td>96.2%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yehuda Adler</td>
<td>100%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yiftah Ron Tal</td>
<td>83.1%</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

14. 1. 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, after they were given the opportunity to state their position. ✔

Companies Law – Section 5 of the First Amendment (Recommended Corporate Governance Provision)

15. 2. In the reporting year, a general meeting was convened (not later than fifteen months after the last annual meeting). ✔

Mandatory Provision
Section 60 of the Companies Law
### SEPARATION BETWEEN THE FUNCTIONS OF CEO AND CHAIRMAN OF THE BOARD OF DIRECTORS

<table>
<thead>
<tr>
<th></th>
<th>Correct</th>
<th>Not Correct</th>
<th>Normative Framework</th>
</tr>
</thead>
<tbody>
<tr>
<td>16.</td>
<td>Throughout the reporting year a chairman of the board of directors served in the corporation. &lt;br&gt; <em>A response of &quot;correct&quot; 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: 17 days [Mr. Yiftah Tal-Ron ended his service as chairman of the board of directors on September 15, 2013, and on October 2, 2013, the Minister of Finance and the Minister of National Infrastructures, Energy and Water approved the decision of the board of directors of the company to reappoint Mr. Yiftah Ron-Tal as chairman of the board of directors].</em></td>
<td>✓</td>
<td>Mandatory Provision &lt;br&gt; Section 94(a) of the Companies Law</td>
</tr>
<tr>
<td>17.</td>
<td>Throughout the reporting year a CEO served in the corporation. &lt;br&gt; <em>A response of &quot;correct&quot; 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: 90</em></td>
<td>✓</td>
<td>Mandatory Provision &lt;br&gt; Section 119 of the Companies Law</td>
</tr>
<tr>
<td>18.</td>
<td>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. &lt;br&gt; If your response is &quot;correct&quot; – refer to the immediate report on the general meeting that approved the dual office and/or the exercise of powers as stated: &lt;br&gt; ✓ Not applicable (if no such dual office exists in the corporation).</td>
<td></td>
<td>Mandatory Provision &lt;br&gt; Sections 95 and 121 of the Companies Law</td>
</tr>
<tr>
<td>19.</td>
<td>The CEO is not a relative of the chairman of the board of directors. &lt;br&gt; If your response is &quot;not correct&quot; (i.e. the CEO is a relative of the chairman of the board of directors) – □ Not relevant, see section 18 above.</td>
<td></td>
<td>Sections 95 and 121 of the Companies Law</td>
</tr>
<tr>
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<tr>
<td>---</td>
<td>---</td>
<td>---</td>
<td></td>
</tr>
<tr>
<td>a.</td>
<td>Indicate the family relationship between the parties: ______</td>
<td>[ ]  [ ]</td>
<td></td>
</tr>
</tbody>
</table>
| b. | The service of the CEO was approved in accordance with Section 121(c) of the Companies Law.  
☐ Yes  
☐ No  
*(Mark an X in the appropriate box)* | [ ]  [ ] |
|   | The controlling shareholder or his relative does not serve as CEO or as a senior officer in the corporation other than a director.  
☐ Not applicable (there is no controlling shareholder in the corporation). | [ ] |

Section 106 of the Companies Law
<table>
<thead>
<tr>
<th></th>
<th></th>
<th>Correct</th>
<th>Not Correct</th>
<th>Normative Framework</th>
</tr>
</thead>
</table>
|21. | All the external directors were members of the audit committee in the course of the reporting year. | ✓ | | Mandatory Provision  
Section 115 of the Companies Law |
|22. | The chairman of the audit committee is an external director. | ✓ | | Mandatory Provision  
Section 115 of the Companies Law |
|23. | The following **did not serve** on the audit committee in the reporting year: |   |   | Mandatory Provision  
Section 115 of the Companies Law |
|   | a. The controlling shareholder or his relative. | ✓ | | |
|   | 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).*
<p>| | | | | |</p>
<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>24.</td>
<td>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.</td>
<td>✓</td>
<td>Mandatory Provision</td>
<td>Section 115(e) of the Companies Law</td>
</tr>
<tr>
<td>25.</td>
<td>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 &quot;not correct&quot; – indicate the rate of meetings at which this requirement was not fulfilled: _____</td>
<td>✓</td>
<td>Mandatory Provision</td>
<td>Section 116a of the Companies Law</td>
</tr>
<tr>
<td>26.</td>
<td>The audit committee held in the reporting year at least one meeting attended by the internal auditor and the independent auditor, as the case may be, 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.</td>
<td>✓</td>
<td>Mandatory Provision</td>
<td>Section 6 of the First Amendment (Recommended Corporate Governance Provision)</td>
</tr>
<tr>
<td>27.</td>
<td>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).</td>
<td>✓</td>
<td>Mandatory Provision</td>
<td>Section 115(e) of the Companies Law</td>
</tr>
</tbody>
</table>
## FUNCTIONS OF THE COMMITTEE FOR EXAMINING THE FINANCIAL STATEMENTS (HEREINAFTER – THE COMMITTEE) IN ITS WORK PRIOR TO APPROVAL OF THE FINANCIAL STATEMENTS

<table>
<thead>
<tr>
<th></th>
<th></th>
<th>Correct</th>
<th>Not Correct</th>
<th>Normative Framework</th>
</tr>
</thead>
<tbody>
<tr>
<td>28.</td>
<td></td>
<td></td>
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</tr>
<tr>
<td></td>
<td>a.</td>
<td>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 meeting of the board of directors at which the periodic or quarterly reports are to be approved: 2</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>b.</td>
<td>The number of days that actually elapsed between the date of submission of the recommendations to the board of directors and the date of approval of the financial statements:</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>First quarter report (2013 year):</td>
<td>2</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Second quarter report:</td>
<td>2</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Third quarter report:</td>
<td>2</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Annual report:</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>c.</td>
<td>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 approval of the financial statements:</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>First quarter report (2013 year):</td>
<td>14</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Second quarter report:</td>
<td>14</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Third quarter report:</td>
<td>14</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Annual report:</td>
<td>18</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

29. The corporation's independent auditor was invited to 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 was discussed, and the internal auditor was given notice of the holding of such meetings. ✓  

**Mandatory Provision**  
Regulation 2(3) of the Approval of Financial Statements Regulations  
Section 168 of the Companies Law Regulation 2(2) of the Regulations for Approval of Financial Statements
<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>30.</td>
<td>Throughout the reporting year and until publication of the annual report, the committee complied with all the conditions set out below:</td>
<td></td>
</tr>
<tr>
<td>a.</td>
<td>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).</td>
<td>✓</td>
</tr>
<tr>
<td>b.</td>
<td>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).</td>
<td>✓</td>
</tr>
<tr>
<td>c.</td>
<td>The chairman of the committee is an external director.</td>
<td>✓</td>
</tr>
<tr>
<td>d.</td>
<td>All its members are directors and a majority of its members are independent directors.</td>
<td>✓</td>
</tr>
<tr>
<td>e.</td>
<td>All its members are able to read and understand financial statements, and at least one of the independent directors possesses accounting and financial expertise.</td>
<td>✓</td>
</tr>
<tr>
<td>f.</td>
<td>The members of the committee submitted a declaration prior to their appointment.</td>
<td>✓</td>
</tr>
<tr>
<td>g.</td>
<td>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.</td>
<td>✓</td>
</tr>
</tbody>
</table>

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: ______

**Mandatory Provision**
Regulation 3 of the regulations for approval of financial statements
<table>
<thead>
<tr>
<th>INDEPENDENT AUDITOR</th>
<th>Correct</th>
<th>Not Correct</th>
<th>Normative Framework</th>
</tr>
</thead>
<tbody>
<tr>
<td>31. The audit committee (and/or the committee for examining the financial statements) was satisfied, prior to the approval of the periodic report, that the scope of the independent auditor's work and fees in the reporting year, were sufficient for the performance of proper auditing and reviewing work of the financial statements in the reporting year.</td>
<td>x</td>
<td></td>
<td>Section 117(5) of the Companies Law</td>
</tr>
<tr>
<td>32. Prior to the appointment of the independent auditor, the audit committee (and/or the committee for examining the financial statements) submitted its recommendations to the relevant organ in the corporation regarding the scope of the independent auditor's work and his terms of employment.</td>
<td>____</td>
<td>____</td>
<td>Section 117(5) of the Companies Law</td>
</tr>
<tr>
<td>√ Not applicable (no independent auditor was appointed in the reporting year).</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>If your response is &quot;correct&quot; – indicate whether the relevant organ in the corporation acted in accordance with the recommendations of the audit committee (and/or the committee for examining the financial statements):</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>□ Yes</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>□ No (if the answer is &quot;no,&quot; describe in the end comments to this questionnaire how the relevant organ (identifying the name) satisfied itself in connection with the scope of the independent auditor's work and his fee)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Mark an X in the appropriate box)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>33. The audit committee (and/or the committee for examining the financial statements) verified in the reporting year that there was no restriction on the work of the independent auditor.</td>
<td>✔</td>
<td>____</td>
<td>The Securities Law and Regulations (regarding “Legal Auditing Statements”)</td>
</tr>
<tr>
<td>34. The audit committee (and/or the committee for examining the financial statements) discussed during the reporting year with the independent auditor the audit findings and their implications.</td>
<td>✔</td>
<td>____</td>
<td>Regulation 2 of the Regulations for Approval of Financial Statements, Companies Law – Section 6 to the First Amendment (Recommended Corporate Governance Provision)</td>
</tr>
<tr>
<td></td>
<td>The audit committee (and/or the committee for examining the financial statements) was satisfied, prior to the appointment of the independent auditor, regarding his suitability and competence to audit the corporation, considering the nature and complexity of the corporation's activity.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>√ Not relevant (an independent auditor was not appointed during the reporting year).</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>The Securities Law and Regulations regarding “legal auditing statements”</td>
<td></td>
<td></td>
</tr>
<tr>
<td>35.</td>
<td>Specify the number of years in which the handling partner in the independent auditor's office has been serving in the capacity of independent auditor of the corporation: <strong>3.5</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>The Securities Law and regulations regarding “Legal Auditing Statements”</td>
<td></td>
<td></td>
</tr>
<tr>
<td>36.</td>
<td>The independent auditor attended in the reporting year all the meetings of the committee for examining the financial statements to which he was invited.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Section 168(b) of the Companies Law Regulation 2 of the Regulations for Approval of Financial Statements</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## INTERESTED-PARTY TRANSACTIONS

<table>
<thead>
<tr>
<th></th>
<th>Correct</th>
<th>Not Correct</th>
<th>Normative Framework</th>
</tr>
</thead>
<tbody>
<tr>
<td>38.</td>
<td>The corporation adopted a procedure dealing with interested-party transactions, which was approved by the audit committee, in order to ensure that such transactions are duly approved.</td>
<td>✓</td>
<td>Sections 117, 253, 255, 270-278 of the Companies Law</td>
</tr>
</tbody>
</table>
| 39. | The controlling shareholder or his relative (including companies controlled by them) 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 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): 1 (a director on behalf of Access Industries).  
   - Were such employment agreements and/or management services approved by the organs stipulated by law:  
     - Yes  
     - No  
     (Mark an X in the appropriate box)  
     - Not applicable (the corporation has no controlling shareholder). | ✓ | Section 270(4) of the Companies Law |
| 40. | 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  
   (Mark an X in the appropriate box)  
   - Not applicable (the corporation has no controlling shareholder). | X | Section 254 of the Companies Law, Section 36 of the Securities law (an important detail for the reasonable investor) |
End Notes:

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. On March 7, 2011 amendment number 16 to the Companies law was accepted, through which, inter alia, the definition of “Independent Director” according to which an external director would also be considered independent. Accordingly, all three external directors in the company today are 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 15: An annual and special general meeting was held on November 22, 2012; a special general meeting was held on February 21, 2013, an annual general meeting was held on January 9, 2014.

Note to question 23 c and e: The Yafa Vigodski and Gideon Frank, who served on the Audit Committee during the year of this report, were at the time employed by the controlling shareholder, under the mitigating condition in section 115(b)(1) of the companies law and according to provisions of section 115(b)(1) these will not apply to a state employee regarding membership I the auditing committee of a government company or a government subsidiary company, as long as the minister responsible for the company is not the minister responsible for the office through which the employee of the state is employed.

Note to question 24: 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 28: The Board of Directors of the Company approved that, although the final recommendation of the committee for reviewing the financial statements was delivered to the Board of Directors on the date of approval of the financial statements, in view of the in-depth discussion on the subject of the financial statements held by the Board of Directors of the Company prior to this date, and after the discussions held on this subject at the committee for reviewing the financial statements, the recommendations of the committee for reviewing the financial statements as of December 31, 2013 were delivered to the Board of Directors reasonably in advance.

Note to question 31: 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. In any case, following the debate that was held on this subject in 2012, the representative of the Government Companies Authority requested the secretary of the board of directors of the company not to hold a discussion on the subject at this stage.

Note to question 32: The external Auditor appointed and the general meeting as of November 1, 2011, in accordance with section 154(b) of the Companies law, the external Auditor will continue to serve in his position until conclusion of the annual meeting and after it. In 2012-2013 no general meeting was held in which the appointment of the external Auditor was on the agenda, and therefore, and in accordance with the position of the Authority of Government Companies, the current external Auditor will continue in the position until the discussion on the topic of appointing an external Auditor at the postponed meeting.

Note to question 35: In 2013 no external Auditor was appointed. See note to question 32 above.

Note to question 40: 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.

<table>
<thead>
<tr>
<th>Chairman of the Board of Directors</th>
<th>Chairman of the Audit Committee</th>
<th>Chairman of the Committee for Reviewing the Financial Statements</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Date of Signature: 24 March 2014</td>
<td></td>
</tr>
</tbody>
</table>
ANNEX 1

Actuarial Liabilities of the Israel Electric Corporation
At December 31, 2013
March 24, 2014

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, 2013 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.
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.

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.

On January 31, 2011, a collective agreement was signed between the Company, the general trade union of workers (Histadrut) and the Company employees' committee, which, among other things, modifies the manner of updating the pension (by linking the pension to the Israeli Consumer Price Index (“CPI”) instead of updates based on rank promotion and salary agreements). On February 27, 2012, the Knesset approved a law that allows the implementation of this agreement. This agreement has significant implications for the amounts of projected benefit payments in this valuation. This agreement was first taken into consideration in the valuation as at March 31, 2012.

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 different assumptions regarding future salary increases. According to the most recent actuarial valuation of the Fund (as of December 31, 2013), the liabilities were higher than those calculated in this valuation, and there were no surplus assets over liabilities.

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.

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.

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.
This report has been prepared in accordance\(^1\) 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 October 2010 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.

1.12 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, 2013
- "linked pensions agreement" – the agreement as stated in section 1.6 above

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, 2013, 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 and supplementary benefits consisting 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 salary\(^2\), shift work, home service, Arava additions, convalescence pay (one 12\(^{th}\) of salary), 13\(^{th}\) salary (one 12\(^{th}\) of salary) 14\(^{th}\) salary (one 12\(^{th}\) of salary) and "CPI increment";
- disability pension;
- survivors' pension in respect of employees who die during service\(^3\) or following retirement (including employees who died after retirement on

\(^{1}\) 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).

\(^{2}\) 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.
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;  
- 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, benefits consisting 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 In the past, the pensions were updated in relation to the salary scale (according to advances in rank), general salary agreements applicable to all of the Company’s employees and cost-of-living allowance agreements (see Appendix F for details). With effect from January 1, 2012, the pensions update mechanism changed. The update 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).

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 guidelines as detailed in sections 3.3-3.10 below.

3.3 Accrued rights are calculated for each benefit in the following way:

<table>
<thead>
<tr>
<th>The benefit</th>
<th>Method of calculating the past liability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Post-employment pension (including disability pension) and social welfare activities</td>
<td>Based on the benefit formula in the pension plan, namely, at the rate of accruing the plan's pension percentages.</td>
</tr>
<tr>
<td>Grant of post employment discounted electricity rates and holiday gifts, including tax grossing up (and VAT on the electricity benefit)</td>
<td>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.</td>
</tr>
<tr>
<td>Death in service survivors' pension</td>
<td>The liability is recognized in full.</td>
</tr>
<tr>
<td>Severance pay upon leaving without entitlement to pension, and grant of &quot;up to 35 years&quot;</td>
<td>Based on eligibility on the valuation date. Eligibility is accrued based on accrued service. For the &quot;up to 35 years of employment&quot; grant, there is a 35-year accumulation maximum.</td>
</tr>
<tr>
<td>Grant for additional years</td>
<td>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.</td>
</tr>
<tr>
<td>Grant for unutilized sick leave</td>
<td>According to the number of unutilized sick leave days as of the valuation date.</td>
</tr>
<tr>
<td>Grant for disability retirement</td>
<td>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).</td>
</tr>
<tr>
<td>20-year grant</td>
<td>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).</td>
</tr>
<tr>
<td>Increased severance pay for non-permanent employees employed under special agreement</td>
<td>Using the straight-line method from commencement of work through the end of the maximum work period or retirement age (67), whichever is sooner.</td>
</tr>
</tbody>
</table>

4 Namely, the manner of attributing the benefits to the period of employment
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.

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 fully linked 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 2.28% (the uniform discount rate inherent in the liability as of December 31, 2012).

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, 2013. 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 pensioner\(^5\) data – we received files on January 6, 2014 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 instructions\(^6\):

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.

4.2.3 Increase of salary to active employees only (excluding convalescence pay, holiday gifts and discounted electricity rates) by 1.0% to reflect the effect of the future salary agreement which relates to the period up to the valuation date.

4.2.4 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.

4.3 Below is a summary of the aforementioned data, before and after the adjustments mentioned in section 4.2:

\(^5\) 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.
### Before the adjustments in section 4.2 above

<table>
<thead>
<tr>
<th>Group</th>
<th>Number</th>
<th>Monthly salary/pension in NIS – regular salary, taken from data</th>
<th>Average age</th>
<th>Average service (years)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Defined benefit pension plan</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employees</td>
<td>8,008</td>
<td>114,371,992</td>
<td>53.5</td>
<td>26.9</td>
</tr>
<tr>
<td>Pensioners – former employees</td>
<td>3,467</td>
<td>44,109,373</td>
<td>73.4</td>
<td></td>
</tr>
<tr>
<td>Pensioners – survivors (including children)</td>
<td>1,898</td>
<td>13,530,520</td>
<td>73.2</td>
<td></td>
</tr>
<tr>
<td><strong>Generation C</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employees</td>
<td>1,845</td>
<td>14,717,731</td>
<td>42.3</td>
<td>12.6</td>
</tr>
<tr>
<td>Pensioners – former employees</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Pensioners – survivors (including children)</td>
<td>15</td>
<td>2,148</td>
<td>54.1</td>
<td></td>
</tr>
<tr>
<td><strong>Employees under special agreements (non-permanent employees)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employees</td>
<td>1,006</td>
<td>5,502,122</td>
<td>40</td>
<td>3.9</td>
</tr>
</tbody>
</table>

### After the adjustments in section 4.2 above

<table>
<thead>
<tr>
<th>Group</th>
<th>Number</th>
<th>Monthly salary/pension in NIS – regular salary, calculated by formula based on salary components</th>
<th>Average age</th>
<th>Average service (years)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Defined benefit pension plan</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employees</td>
<td>7,985</td>
<td>116,493,959</td>
<td>53.5</td>
<td>26.9</td>
</tr>
<tr>
<td>Pensioners – former employees</td>
<td>3,490</td>
<td>44,623,245</td>
<td>73.4</td>
<td></td>
</tr>
<tr>
<td>Pensioners – survivors (including children)</td>
<td>1,898</td>
<td>13,659,029</td>
<td>73.2</td>
<td></td>
</tr>
<tr>
<td><strong>Generation C</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employees</td>
<td>1,843</td>
<td>15,051,581</td>
<td>42.3</td>
<td>12.6</td>
</tr>
<tr>
<td>Pensioners – former employees</td>
<td>7</td>
<td>1,002</td>
<td>67.5</td>
<td></td>
</tr>
<tr>
<td>Pensioners – survivors (including children)</td>
<td>10</td>
<td>1,432</td>
<td>47.0</td>
<td></td>
</tr>
<tr>
<td><strong>Employees under special agreements (non-permanent employees)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employees</td>
<td>1,006</td>
<td>5,502,122</td>
<td>40</td>
<td>3.9</td>
</tr>
</tbody>
</table>

* 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 salary, 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.

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**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):

<table>
<thead>
<tr>
<th>Data item</th>
<th>NIS '000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets as at the valuation date</td>
<td></td>
</tr>
<tr>
<td>4.4.1 Balance of plan assets for post-employment benefits</td>
<td>25,037,919</td>
</tr>
<tr>
<td>4.4.2 Balance of assets according to Section 116A (of IAS 19) benefits</td>
<td>1,728,101</td>
</tr>
<tr>
<td>Payments during the reporting period</td>
<td></td>
</tr>
<tr>
<td>4.4.3 Increased severance pay to employees under special agreements</td>
<td>3,611</td>
</tr>
<tr>
<td>4.4.4 Supplemented severance pay (2.33%) to generation C employees</td>
<td>–</td>
</tr>
<tr>
<td>4.4.5 &quot;20-year grant&quot;</td>
<td>5,433</td>
</tr>
<tr>
<td>4.4.6 Termination benefits – for paid benefits by the fund, and for benefits not paid by the fund (electricity, holiday gifts)</td>
<td>69,958</td>
</tr>
<tr>
<td>4.4.7 Termination benefits – for paid benefits by the fund</td>
<td>67,453</td>
</tr>
<tr>
<td>4.4.8 Unutilized sick leave grant</td>
<td>15,179</td>
</tr>
<tr>
<td>4.4.9 Post-employment benefits (excluding termination benefits)</td>
<td>696,196</td>
</tr>
<tr>
<td>4.4.10 &quot;up to 35 years&quot; grant</td>
<td>5,065</td>
</tr>
<tr>
<td>4.4.11 Discounted electricity benefit and holiday gifts</td>
<td>38,472</td>
</tr>
<tr>
<td>4.4.12 Withdrawals from plan assets for payment of benefits</td>
<td>681,299</td>
</tr>
<tr>
<td>Contributions during the reporting period</td>
<td></td>
</tr>
<tr>
<td>4.4.12 Company's contributions to plan assets or assets according to Section 116A (of IAS 19)</td>
<td>792,290</td>
</tr>
<tr>
<td>4.4.13 Employees' contributions to plan assets or assets according to Section 116A (of IAS 19)</td>
<td>–</td>
</tr>
</tbody>
</table>
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. Our involvement in, and approach to, the material assumptions are as follows:

- The financial assumptions (see section 5.1 below) are based on generally accepted market data as published by an external party.

- The demographic assumptions such as mortality, disability and marriage (see sections 5.3 and 5.5 below) were established by the Company in consultation with us. We examined these assumptions during the past two years at the Company's request and in our opinion they are reasonable.

- The assumed salary increase associated with general salary agreements (see sections 5.2.2.1 and 5.2.2.2 below) was determined by the Company on the basis of independent, professional evaluation and/or consultation with its advisors. We have not been asked to investigate this subject or to make recommendations regarding these assumptions. On the basis of the general knowledge available to us, we are unable to express a professional opinion on these assumptions. In our opinion, the knowledge and ability of the Company's professionals are more reliable and relevant than ours, for the purpose of determining these assumptions, because of their familiarity with the Company, the public sector and the electricity sector, and with the relevant labor relations with the employee and pensioner groups.

The remaining assumptions were determined by the Company, most of them in consultation with another advising actuary. In our opinion, on the basis of our review of the work of the Company or the other actuary, these assumptions are reasonable. Regarding the assumed early retirement rate, for employees in the defined benefit pension plan, which are not defined as "terminations", our examination is subject to the accounting determination with regards to the approach to early retirement, and is limited due to a lack of relevant past experience, as explained in section 5.4.4 below.

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 Government bonds) and the real spot interest rate (on indexed Government bonds) for a period of 15 years, which is the longest period for which Mervach Hogen Ltd quotes a nominal interest rate. 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 2.41%.
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 – according to the accounting policy of the Company, the discount rates used in the valuation are taken from the "risk-free" yield curve based on market data for Government bonds tied to inflation as of December 31, 2013, as established by Mervach Hogen Ltd. 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 absence of a deep market in high quality corporate bonds in Israel (see Section 83 of IAS 19).

The valuation discount rates reflect the returns that can be achieved, according to "market" expectations, on risk-free assets (excluding the risk of the country’s insolvency). 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 2.28% pa, as described in section 3.7 above.

5.2 Salary and pension increases

5.2.1 As was communicated to us, the salary increase assumptions (as detailed in section 5.2.2) were determined by the Company based on, among other things, the analysis of the past increases in the various salary components, subject to the principles of IAS 19.

5.2.2 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). The supplementary assumptions applied to this framework are as follows:

5.2.2.1 The future annual increase in respect of general salary and cost-of-living allowance agreements (the general update in the salary scale) is the rate of the actual increase in the CPI less 1.38% per year (a 1.38% erosion each year in real terms). This increase affects all of the salary components. This increase does not affect the pension, discounted electricity, holiday gifts and convalescence (it is assumed that the Arava and home service components will be included in future salary agreements).
5.2.2.2 As stated in sections 4.2.2 to 4.2.3 above, it is assumed that the salaries (that were in force in December 2013) will increase by 0.9456% to reflect the effect of the new salary agreement from July 2013, and by 1.0% to reflect the effect of the future salary agreement which relates to the period up to the valuation date, in addition to the assumption described in section 5.2.2.1.

5.2.2.3 It is assumed that, in respect of promotions, salaries will rise on average by the following annual rates:

<table>
<thead>
<tr>
<th>Age group</th>
<th>Salary increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 – 28</td>
<td>1.43%</td>
</tr>
<tr>
<td>29 – 33</td>
<td>0.63%</td>
</tr>
<tr>
<td>34 – 38</td>
<td>0.33%</td>
</tr>
<tr>
<td>39 – 43</td>
<td>0.29%</td>
</tr>
<tr>
<td>44 – 48</td>
<td>0.19%</td>
</tr>
<tr>
<td>49 – 53</td>
<td>0.14%</td>
</tr>
<tr>
<td>54 – 58</td>
<td>0.15%</td>
</tr>
<tr>
<td>59 – 63</td>
<td>0.39%</td>
</tr>
<tr>
<td>64 – 67</td>
<td>0.00%</td>
</tr>
</tbody>
</table>

5.2.2.4 Regarding the job classification increment for employees, which comprises a rate of base salary, it is assumed to increase each year at a rate of 0.04% of base salary. The job classification increment shall be no more than 21% of base salary (for senior employees, it is assumed that the job classification increment shall remain unchanged). This assumption is also in effect for employees who at the valuation date were not receiving the job classification increment.

5.2.2.5 In respect of non-senior employees, a cumulative salary growth of 0.60% is assumed up to reaching age 60, which represents promotion to senior ranks.

5.2.2.6 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.

5.2.2.7 It is assumed that the discounted electricity rate (including VAT and tax grossing up) will increase at a real rate of increase of 0% in April 2014, then decrease at a real rate of 26.4% in April 2015, will grow at a real rate of 17.78% in April 2016, will grow at a real rate of 4.57% in April 2017, and then, from April 2018 will grow at a real rate of 0.25% per year. The discounted electricity rate will be updated in line with CPI once a year each April.

It is assumed that for the payment of discounted electricity and holiday gifts before retirement age, the cost in respect of grossed up tax at a rate of 18.31% will be added.
It is assumed that 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 fixed monthly fee before VAT at the valuation date is NIS 13.69 and the variable rate per kilowatt-hour before VAT is NIS 0.5403.

It is assumed that a proportion of pensioners do not receive discounted electricity, where the proportion assumed varies 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.

5.2.2.8 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).

5.2.2.9 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.

5.2.2.10 For employees who are not entitled to continuing education payment A, it is assumed that half of them will be entitled to the payment in another 10 years’ time from the valuation date (if they have not left beforehand).

5.2.2.11 For employees who are not entitled to continuing education payment B, it is assumed that they will not be entitled to this payment in the future.

5.2.2.12 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).

5.2.2.13 It is assumed that employees without a master's degree will not receive one in future (the service increment for those with a master's degree is higher).
5.2.2.14 It is assumed that employees who are entitled to Arava, home service and shift work salary additions will be entitled to these additions to pensions, and employees who are not entitled to these salary additions, at the valuation date, will not be entitled to these additions to pensions. 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.

5.2.2.15 It is assumed that, except for employees who at the valuation date were entitled to an additional grade at Eilat (including employees who left Eilat after 7 years and transferred their grade), there are no employees who will in future receive the additional grade at Eilat.

5.2.3 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 Section 6 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 Annuityisation 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")

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).

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" ("the study").

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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.
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:

<table>
<thead>
<tr>
<th>Age</th>
<th>up to 67</th>
<th>68</th>
<th>69</th>
<th>70</th>
<th>71</th>
<th>72</th>
<th>73</th>
<th>74</th>
<th>75</th>
<th>76</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate of increase</td>
<td>18.00%</td>
<td>17.04%</td>
<td>16.10%</td>
<td>14.96%</td>
<td>14.06%</td>
<td>13.20%</td>
<td>12.38%</td>
<td>11.61%</td>
<td>10.62%</td>
<td>9.95%</td>
</tr>
<tr>
<td>Age</td>
<td>77</td>
<td>78</td>
<td>79</td>
<td>80</td>
<td>81</td>
<td>82</td>
<td>83</td>
<td>84</td>
<td>85</td>
<td>86</td>
</tr>
<tr>
<td>Rate of increase</td>
<td>9.35%</td>
<td>8.52%</td>
<td>7.46%</td>
<td>8.01%</td>
<td>7.39%</td>
<td>6.84%</td>
<td>6.36%</td>
<td>5.95%</td>
<td>5.62%</td>
<td>5.37%</td>
</tr>
<tr>
<td>Age</td>
<td>87</td>
<td>88</td>
<td>89</td>
<td>90</td>
<td>91</td>
<td>92</td>
<td>93</td>
<td>94</td>
<td>95</td>
<td>96 and on</td>
</tr>
<tr>
<td>Rate of increase</td>
<td>5.20%</td>
<td>4.84%</td>
<td>4.53%</td>
<td>3.91%</td>
<td>3.25%</td>
<td>2.58%</td>
<td>1.88%</td>
<td>1.15%</td>
<td>0.39%</td>
<td>0.00%</td>
</tr>
</tbody>
</table>

Below is a sample of the remaining life expectancy of pensioners, based on this assumption and combined with the assumed improvement in life expectancy.

<table>
<thead>
<tr>
<th>Age and year</th>
<th>Female</th>
<th>Male</th>
</tr>
</thead>
<tbody>
<tr>
<td>67 at the end of 2010</td>
<td>21.92</td>
<td>20.19</td>
</tr>
<tr>
<td>67 at the end of 2020</td>
<td>22.89</td>
<td>20.78</td>
</tr>
<tr>
<td>67 at the end of 2030</td>
<td>23.63</td>
<td>21.41</td>
</tr>
</tbody>
</table>

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:

<table>
<thead>
<tr>
<th>Age</th>
<th>up to 67</th>
<th>68</th>
<th>69</th>
<th>70</th>
<th>71</th>
<th>72</th>
<th>73</th>
<th>74</th>
<th>75</th>
<th>76</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate of increase</td>
<td>13.00%</td>
<td>12.31%</td>
<td>11.63%</td>
<td>10.80%</td>
<td>10.16%</td>
<td>9.53%</td>
<td>8.94%</td>
<td>8.38%</td>
<td>7.67%</td>
<td>7.19%</td>
</tr>
<tr>
<td>Age</td>
<td>77</td>
<td>78</td>
<td>79</td>
<td>80</td>
<td>81</td>
<td>82</td>
<td>83</td>
<td>84</td>
<td>85</td>
<td>86</td>
</tr>
<tr>
<td>Rate of increase</td>
<td>6.75%</td>
<td>6.16%</td>
<td>5.39%</td>
<td>5.78%</td>
<td>5.34%</td>
<td>4.94%</td>
<td>4.59%</td>
<td>4.30%</td>
<td>4.06%</td>
<td>3.88%</td>
</tr>
<tr>
<td>Age</td>
<td>87</td>
<td>88</td>
<td>89</td>
<td>90</td>
<td>91</td>
<td>92</td>
<td>93</td>
<td>94</td>
<td>95</td>
<td>96 and on</td>
</tr>
<tr>
<td>Rate of increase</td>
<td>3.75%</td>
<td>3.50%</td>
<td>3.27%</td>
<td>2.82%</td>
<td>2.35%</td>
<td>1.86%</td>
<td>1.36%</td>
<td>0.83%</td>
<td>0.28%</td>
<td>0.00%</td>
</tr>
</tbody>
</table>
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:

<table>
<thead>
<tr>
<th>For generation C</th>
<th>Leaving rates (resignations) (not entitled to benefits)</th>
<th>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.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age</td>
<td>Women and Men</td>
<td>Women</td>
</tr>
<tr>
<td>up to 59</td>
<td>0.16%</td>
<td>0.24%</td>
</tr>
<tr>
<td>60</td>
<td>–</td>
<td>0.40%</td>
</tr>
<tr>
<td>61</td>
<td>–</td>
<td>0.85%</td>
</tr>
<tr>
<td>62</td>
<td>–</td>
<td>0.85%</td>
</tr>
<tr>
<td>63</td>
<td>–</td>
<td>1.62%</td>
</tr>
<tr>
<td>64</td>
<td>–</td>
<td>4.76%</td>
</tr>
<tr>
<td>66</td>
<td>–</td>
<td>4.76%</td>
</tr>
</tbody>
</table>
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:

<table>
<thead>
<tr>
<th>Employees in defined benefit pension plan</th>
<th>Early retirement rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age</td>
<td>Female</td>
</tr>
<tr>
<td>Up to 40</td>
<td></td>
</tr>
<tr>
<td>40</td>
<td>0.03%</td>
</tr>
<tr>
<td>41</td>
<td>0.03%</td>
</tr>
<tr>
<td>42</td>
<td>0.03%</td>
</tr>
<tr>
<td>43</td>
<td>0.03%</td>
</tr>
<tr>
<td>44</td>
<td>0.03%</td>
</tr>
<tr>
<td>45</td>
<td>0.09%</td>
</tr>
<tr>
<td>46</td>
<td>0.09%</td>
</tr>
<tr>
<td>47</td>
<td>0.09%</td>
</tr>
<tr>
<td>48</td>
<td>0.09%</td>
</tr>
<tr>
<td>49</td>
<td>0.09%</td>
</tr>
<tr>
<td>50</td>
<td>0.20%</td>
</tr>
<tr>
<td>51</td>
<td>0.20%</td>
</tr>
<tr>
<td>52</td>
<td>0.20%</td>
</tr>
<tr>
<td>53</td>
<td>0.20%</td>
</tr>
<tr>
<td>54</td>
<td>0.20%</td>
</tr>
<tr>
<td>55</td>
<td>0.24%</td>
</tr>
<tr>
<td>56</td>
<td>0.24%</td>
</tr>
<tr>
<td>57</td>
<td>0.24%</td>
</tr>
<tr>
<td>58</td>
<td>0.24%</td>
</tr>
<tr>
<td>59</td>
<td>0.24%</td>
</tr>
<tr>
<td>60</td>
<td>0.24%</td>
</tr>
<tr>
<td>61</td>
<td>0.24%</td>
</tr>
<tr>
<td>62</td>
<td>1.70%</td>
</tr>
<tr>
<td>63</td>
<td>1.70%</td>
</tr>
<tr>
<td>64</td>
<td>1.70%</td>
</tr>
<tr>
<td>65</td>
<td>3.23%</td>
</tr>
<tr>
<td>66</td>
<td>9.52%</td>
</tr>
</tbody>
</table>
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:

<table>
<thead>
<tr>
<th>Service</th>
<th>Leaving rates (terminations) (eligible for benefits)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>3.0%</td>
</tr>
<tr>
<td>1</td>
<td>1.5%</td>
</tr>
<tr>
<td>2+</td>
<td>0.0%</td>
</tr>
</tbody>
</table>

* 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 increases in pensions based on the minimum pension rate;
• 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; and
• the following additional benefits for pensioners / survivors were not taken into account:
  o bonuses on marriage and birth (including tax grossing up);
  o gifts for children of pensioners and survivors serving in the IDF (including grossing up);
  o 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;
  o compensation in cases of death as a result of a work accident, to the amount of 36 months' salaries;
  o meals partially subsidized by the Company at Company facilities – up to 10 meals per month;
  o Higher Education grants for children of widows of employees who died while working for the Company;
  o an outing for widows of workers who died while working for the Company; and
  o 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.

- 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 this quarter 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 this valuation 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 this valuation was set accordingly. The impact of the change in assumption was a decrease in the liability of about NIS 78 million.

In the year of this report, there were no changes to the assumptions or methodology used, except for that which is stated above and except for changes to the discount rate (occurring every quarter).
7. **Valuation results**

The values of the liabilities (in million NIS) as at September 30, 2013, 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 | 15,534.5 |
| Pensioners and survivors | 10,238.3 |
| Total | 25,772.8 |

<table>
<thead>
<tr>
<th>7.2 Liability for special agreements on early retirement – in respect of the past:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pensioners and survivors</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>7.3 Liability for 20 year grant:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Active employees</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>7.4 Liability for increased severance payments for (non-permanent) employees under special agreement – in respect of the past:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Active employees</td>
</tr>
</tbody>
</table>

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.

<table>
<thead>
<tr>
<th>Sensitivity analysis:</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) If the discount rate falls by 1%, the liability will increase by NIS 4,912 million (18.9%).</td>
</tr>
<tr>
<td>b) If the discount rate falls by 0.1%, the liability will increase by NIS 436 million.</td>
</tr>
<tr>
<td>c) If the discount rate increases by 0.1%, the liability will decrease by NIS 425 million.</td>
</tr>
</tbody>
</table>

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. This assumption is currently -1.38% (on a real basis, namely, that the pensionable salary will erode for employees who reached the maximum rank).

<table>
<thead>
<tr>
<th>Sensitivity analysis:</th>
</tr>
</thead>
<tbody>
<tr>
<td>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 2,095 million (8.1%).</td>
</tr>
<tr>
<td>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 722 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 674 million.</td>
</tr>
</tbody>
</table>
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 assumed\(^9\), 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 have been understated by approximately NIS 1,237 million (4.8%).

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 have been understated by approximately NIS 1,260 million (4.9%).

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 have been understated by approximately NIS 314 million (1.2%).

Yours truly,

Ernst & Young (Israel) Ltd.

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\(^{9}\) 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

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of plan assets</td>
<td>25,038</td>
<td>24,151</td>
<td>21,992</td>
</tr>
<tr>
<td>Present value of the obligation - gross</td>
<td>(22,899)</td>
<td>(22,801)</td>
<td>(17,000)</td>
</tr>
<tr>
<td>Surplus assets</td>
<td>2,139</td>
<td>1,350</td>
<td>4,992</td>
</tr>
</tbody>
</table>

2. Funds in trust – designated for actuarial obligations (116A assets)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Funds in trust to cover actuarial obligations (assets per Section 116A)</td>
<td>1,728</td>
<td>1,976</td>
<td>2,118</td>
</tr>
</tbody>
</table>

3. Liability at the end of the period for other post-employment benefits (including special agreements for early retirement)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Present value of obligation for other post-employment benefits</td>
<td>2,922</td>
<td>3,048</td>
<td>2,636</td>
</tr>
</tbody>
</table>
4. Movement in the present value of the obligation

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Present value of the obligation –beginning of period</td>
<td>22,801</td>
<td>17,000</td>
<td>16,282</td>
</tr>
<tr>
<td>Interest cost</td>
<td>520</td>
<td>534</td>
<td>465</td>
</tr>
<tr>
<td>Current service cost</td>
<td>307</td>
<td>258</td>
<td>207</td>
</tr>
<tr>
<td>Prior service cost – changes in plan conditions due to decisions by MOF</td>
<td>-</td>
<td>-</td>
<td>80</td>
</tr>
<tr>
<td>Prior service cost – changes in plan conditions due to linking pensions to CPI</td>
<td>-</td>
<td>2,816</td>
<td>-</td>
</tr>
<tr>
<td>Benefits paid</td>
<td>(637)</td>
<td>(617)</td>
<td>(554)</td>
</tr>
<tr>
<td>Losses (gains) on remeasurement:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Actuarial losses (gains) from demographic assumption changes</td>
<td>(151)</td>
<td>(6)</td>
<td>-</td>
</tr>
<tr>
<td>Actuarial losses (gains) from financial assumption changes</td>
<td>(108)</td>
<td>2,366</td>
<td>325</td>
</tr>
<tr>
<td>Experience adjustments</td>
<td>167</td>
<td>450</td>
<td>195</td>
</tr>
<tr>
<td>Total actuarial losses (gains) on remeasurement</td>
<td>(92)</td>
<td>2,810</td>
<td>520</td>
</tr>
<tr>
<td>Present value of the obligation – end of period</td>
<td>22,899</td>
<td>22,801</td>
<td>17,000</td>
</tr>
</tbody>
</table>

5. Movement in the present value of the obligation for post-employment benefits (including obligation for special agreements for early retirement)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Present value of the obligation – beginning of period</td>
<td>3,048</td>
<td>2,636</td>
<td>2,375</td>
</tr>
<tr>
<td>Interest cost</td>
<td>70</td>
<td>72</td>
<td>67</td>
</tr>
<tr>
<td>Current service cost</td>
<td>61</td>
<td>50</td>
<td>47</td>
</tr>
<tr>
<td>Cost of new retirements – early retirement</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Prior service cost – changes in plan conditions due to linking pensions to CPI</td>
<td>-</td>
<td>42</td>
<td>-</td>
</tr>
<tr>
<td>Change in liability due to special agreements for early retirement</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Benefits paid</td>
<td>(66)</td>
<td>(63)</td>
<td>(53)</td>
</tr>
<tr>
<td>Losses (gains) on remeasurement:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Actuarial losses (gains) from demographic assumption changes</td>
<td>(24)</td>
<td>(1)</td>
<td>-</td>
</tr>
<tr>
<td>Actuarial losses (gains) from financial assumption changes</td>
<td>(160)</td>
<td>508</td>
<td>20</td>
</tr>
<tr>
<td>Experience adjustments</td>
<td>(7)</td>
<td>(196)</td>
<td>180</td>
</tr>
<tr>
<td>Total actuarial losses (gains) on remeasurement</td>
<td>(191)</td>
<td>311</td>
<td>200</td>
</tr>
<tr>
<td>Present value of the obligation – end of period</td>
<td>2,922</td>
<td>3,048</td>
<td>2,636</td>
</tr>
</tbody>
</table>
6. Movement in the fair value of plan assets

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of plan assets –</td>
<td>24,151</td>
<td>21,992</td>
<td>21,767</td>
</tr>
<tr>
<td>beginning of period</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest income on plan assets</td>
<td>553</td>
<td>608</td>
<td>626</td>
</tr>
<tr>
<td>Company contributions –</td>
<td>797</td>
<td>614</td>
<td>686</td>
</tr>
<tr>
<td>including employee</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>contributions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Benefits paid</td>
<td>(687)</td>
<td>(676)</td>
<td>(722)</td>
</tr>
<tr>
<td>Gains (losses) on remeasurement:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Return on plan assets (excluding amounts included in interest income)</td>
<td>224</td>
<td>1,613</td>
<td>(365)</td>
</tr>
<tr>
<td>Fair value of plan assets –</td>
<td>25,038</td>
<td>24,151</td>
<td>21,992</td>
</tr>
<tr>
<td>end of period</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

7. Movement in the fair value of the funds in trust to cover actuarial obligation (116A assets)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of trust assets –</td>
<td>1,976</td>
<td>2,118</td>
<td>2,049</td>
</tr>
<tr>
<td>beginning of period</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest income on trust assets</td>
<td>40</td>
<td>55</td>
<td>59</td>
</tr>
<tr>
<td>Company contributions</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Benefits paid</td>
<td>(254)</td>
<td>(356)</td>
<td>-</td>
</tr>
<tr>
<td>Gains (losses) on remeasurement:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Return on trust assets (excluding amounts included in interest income)</td>
<td>(34)</td>
<td>159</td>
<td>10</td>
</tr>
<tr>
<td>Fair value of trust assets –</td>
<td>1,728</td>
<td>1,976</td>
<td>2,118</td>
</tr>
<tr>
<td>end of period</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

8. Components of the costs for the period of all the post-employment benefits

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Current service cost</td>
<td>368</td>
<td>308</td>
<td>254</td>
</tr>
<tr>
<td>Employee participation</td>
<td>(27)</td>
<td>(26)</td>
<td>(25)</td>
</tr>
<tr>
<td>Net current service cost</td>
<td>341</td>
<td>282</td>
<td>229</td>
</tr>
<tr>
<td>Interest cost</td>
<td>590</td>
<td>606</td>
<td>532</td>
</tr>
<tr>
<td>Prior service cost – changes in plan conditions due to decisions by MOF</td>
<td>-</td>
<td>-</td>
<td>80</td>
</tr>
<tr>
<td>Prior service cost – changes in plan conditions due to linking pensions to CPI</td>
<td>-</td>
<td>2,858</td>
<td>-</td>
</tr>
<tr>
<td>Interest income from plan assets</td>
<td>(553)</td>
<td>(608)</td>
<td>(626)</td>
</tr>
<tr>
<td>Interest income from trust assets (116A assets)</td>
<td>(40)</td>
<td>(55)</td>
<td>(59)</td>
</tr>
<tr>
<td>Total costs for the period</td>
<td>338</td>
<td>3,083</td>
<td>156</td>
</tr>
</tbody>
</table>
9. Actual return on assets

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest income on plan assets</td>
<td>553</td>
<td>608</td>
<td>626</td>
</tr>
<tr>
<td>Return on plan assets (excluding amounts included in interest income)</td>
<td>224</td>
<td>1,613</td>
<td>(365)</td>
</tr>
<tr>
<td>Actual return on plan assets</td>
<td>777</td>
<td>2,221</td>
<td>261</td>
</tr>
</tbody>
</table>

10. Actual return on assets in trust to cover actuarial obligation (116A assets)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest income on trust assets</td>
<td>40</td>
<td>55</td>
<td>59</td>
</tr>
<tr>
<td>Return on trust assets (excluding amounts included in interest income)</td>
<td>(34)</td>
<td>159</td>
<td>10</td>
</tr>
<tr>
<td>Actual return on trust assets</td>
<td>6</td>
<td>214</td>
<td>69</td>
</tr>
</tbody>
</table>

11. Obligation for special agreements for early retirement (termination benefits)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Obligation at end of period - pensions</td>
<td>119</td>
<td>171</td>
<td>217</td>
</tr>
<tr>
<td>Obligation at end of period – other benefits**</td>
<td>8</td>
<td>11</td>
<td>14</td>
</tr>
<tr>
<td>Obligation at end of period – total</td>
<td>127</td>
<td>182</td>
<td>231</td>
</tr>
</tbody>
</table>

(**) These obligations are included in Tables 3 & 5 above.

12. Obligation for 20 year grant (other long-term employee benefits)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Obligation at end of period</td>
<td>18</td>
<td>22</td>
<td>25</td>
</tr>
</tbody>
</table>
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)

<table>
<thead>
<tr>
<th></th>
<th>Period ending</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weighted average real discount rate</td>
<td>2.77%</td>
</tr>
<tr>
<td>used to compute liabilities *</td>
<td></td>
</tr>
<tr>
<td>Real interest rate used to compute</td>
<td>2.88%</td>
</tr>
<tr>
<td>the interest cost on pension</td>
<td></td>
</tr>
<tr>
<td>liabilities *</td>
<td></td>
</tr>
<tr>
<td>Real interest rate used to compute</td>
<td>2.88%</td>
</tr>
<tr>
<td>the interest cost on other post-</td>
<td></td>
</tr>
<tr>
<td>employment liabilities</td>
<td></td>
</tr>
<tr>
<td>Expected real return on plan assets</td>
<td>2.88%</td>
</tr>
<tr>
<td>(116A assets)</td>
<td></td>
</tr>
<tr>
<td>Expected real return on trust assets</td>
<td>2.88%</td>
</tr>
<tr>
<td>(116A assets)</td>
<td></td>
</tr>
<tr>
<td>Expected inflation rate</td>
<td>2.60%</td>
</tr>
</tbody>
</table>

* 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. "ong1213" – 15,233 records – data including all employees / retirees / survivors (permanent workers only).
2. "actuarpizuisug13411213" - 1,006 records – data including all non-permanent workers (special agreement).
4. "change102013", "change112013", "change122013", "change122013g" – files that describe status changes of employees / retirees in the months September to December 2013.
5. "חשמל דצembro 2013" – data regarding electricity rates, rate of VAT and grossing up of tax.
Appendix E – changes to the valuation that took effect before the current year due to the implementation date of International Financial Reporting Standards (January 1, 2007)

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 Ribit 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).
Changes that took effect in the course of 2010

<table>
<thead>
<tr>
<th>Section</th>
<th>New Assumptions</th>
<th>Old Assumptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marriage rate and age difference between spouses</td>
<td>According to Tables P9 and P10 of Circular 2007-3-6, with an adjustment to Table P10, for male employees and pensioners, in order that the expected age difference between spouses for an employee or pensioner will be according to the table for an employee until age 35, 2 years for an employee aged 36 until 46, and 1 year less than the table for an employee / pensioner older than 46.</td>
<td>According to Tables P9 and P10 of Circular 2007-3-6</td>
</tr>
<tr>
<td>Leaving assumption for generations A and B, and for employees under special agreements</td>
<td>It is assumed that there will be no leavers, besides for early retirements.</td>
<td>See the table in the actuarial report at 31.12.2009</td>
</tr>
<tr>
<td>Leaving assumption for employees under special agreements</td>
<td>See section 5.4.5 of this report. The rates were fixed according to an up-to-date study.</td>
<td>See the table in the actuarial report at 31.12.2009</td>
</tr>
<tr>
<td>Early retirement assumption for generations A and B</td>
<td>See section 5.4.4 of this report. The rates were fixed according to an up-to-date study.</td>
<td>See the table in the actuarial report at 31.12.2009</td>
</tr>
<tr>
<td>Grant for increased severance pay at early retirement</td>
<td>At early retirement entitlement to this grant does not exist.</td>
<td>At early retirement entitlement to this grant exists.</td>
</tr>
</tbody>
</table>

The section that follows was written by the former actuary and has not been checked by us. It was copied, without changes, from the valuation report as of December 31, 2009.
Changes that took effect in June 2007

<table>
<thead>
<tr>
<th>Section</th>
<th>New Assumptions</th>
<th>Old Assumptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mortality rate for pensioners</td>
<td>According to Table 3P, in the Finance Ministry circular of May 17, 2007</td>
<td>On the basis of 90% of Table 1.A.4. in the Finance Ministry circular of February 29, 2000.</td>
</tr>
<tr>
<td>Mortality rate for survivors</td>
<td>From age 60 for men and age 55 for women, according to Table 5P in the Finance Ministry circular of May 17, 2007. Until age 60 (55) according to Table 1.A.4. in the Finance Ministry circular of February 29, 2000.</td>
<td>According to Table 1.A.4. in the Finance Ministry circular of February 29, 2000.</td>
</tr>
<tr>
<td>Mortality rate for active employees</td>
<td>According to Table 1P in the Finance Ministry circular of May 17, 2007.</td>
<td>On the basis of 60% of Table 1.A.4. in the Finance Ministry circular of May 17, 2007.</td>
</tr>
<tr>
<td>Disability rate</td>
<td>According to Table 8P in the Finance Ministry circular of May 17, 2007.</td>
<td>According to Table 2B in the Finance Ministry circular of February 29, 2000.</td>
</tr>
<tr>
<td>Mortality rate for the disabled</td>
<td>2% until age 60. After age 60, according to Table 3P in the Finance Ministry circular of May 17, 2007.</td>
<td>2% until age 60. After age 60, according to Table 1.A.4. in the Finance Ministry circular of February 29, 2000.</td>
</tr>
<tr>
<td>Marriage rate</td>
<td>According to Table 9P in the Finance Ministry circular of May 17, 2007.</td>
<td>According to Table 3 in the Finance Ministry circular of February 29, 2000.</td>
</tr>
</tbody>
</table>

Reasons for the changes:
In light of the publication of the final Finance Ministry circular letter of May 17, 2007, concerning the updated actuarial assumptions for computing the actuarial obligation of the pension funds, examinations were conducted for computing the effect of adopting the actuarial tables as per the instructions of the circular, compared with the tables according to which the computations of the Company’s actuarial obligation had been made until that time, which had been based on specific studies of the Company.

The effect of the adoption of the actuarial tables, according to the instructions of the aforementioned Finance Ministry circular, on the actuarial obligation of the Company in respect of the past as of June 30, 2007, was an increase in the obligation of the sum of about NIS 265 million (NIS 289 million when adjusted for inflation to December 31, 2009).

The adoption of the actuarial tables according to the instructions of the aforementioned Finance Ministry circular, starting with the financial reports of June 30, 2007 is necessary due to the mortality tables set in the circular being based on studies that were conducted on pension funds in the arrangement, these being more credible than the study that was conducted on the smaller population of the Company.
The marriage rates according to which the actuarial obligation had been computed until that time were based on tables that appeared in the Finance Ministry circular of 2000/1. With the change in the table of marriage rates in the new circular, adjustment of these rates was required.

The rates of leaving work because of disability according to which the actuarial obligation had been computed until that time were based on the table that appeared in the Finance Ministry circular of 2000/1 and related to the definition, ‘He is not able to do any work’. In the new circular of the Finance Ministry, a single table is given, which relates to the definition, ‘He is not able to do his work or any other work appropriate to his level of education, training, or abilities’. The changed table for the rate of leaving work because of disability had virtually no effect on the actuarial obligation and therefore the computation of the obligation from that time onwards is based on the table that appears in the current Finance Ministry circular, despite the fact that this table is geared to a definition of disability that does not match precisely the definition of disability used by the Company.

Other assumptions that are taken into account in the determination of the actuarial obligation and that are not mentioned in the Finance Ministry circular (e.g. rates of early retirement, rates of resignation, salary increase table etc.) are according to forecasts or specific studies conducted in the Company.

**Changes that took effect in June 2008**

<table>
<thead>
<tr>
<th>Section</th>
<th>New Calculation Methods and Assumptions</th>
<th>Old Calculation Methods and Assumptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Past obligation for pension payments after ending employment (because of old-age, because of disability or because of death while employed), including convalescence</td>
<td>The past service obligation is calculated according to the plan’s benefit formula, i.e. according to the accumulation of percentage pension rights in the pension plan.</td>
<td></td>
</tr>
<tr>
<td>Early retirement rates</td>
<td>25 workers a year according to the existing mix of the relevant population (this number of workers is equivalent to the Early Retirement table in Appendix F).</td>
<td>The new methods and assumptions were applied retroactively with the transition to full application of IAS19.</td>
</tr>
<tr>
<td>Discounted electricity and holiday presents, grossed-up for income tax</td>
<td>Full obligation is recognized for workers who have at least 10 years service and have reached age 40. For those workers who have not yet served for 10 years or have not yet reached age 40, the past service obligation is calculated as the past service divided by the service required until both conditions will be fulfilled.</td>
<td></td>
</tr>
<tr>
<td>Additional Years Benefit</td>
<td>This obligation is not recognized until 35 years of service in the Company. The obligation is computed only for employees with service in excess of 35 years,</td>
<td></td>
</tr>
</tbody>
</table>
### The reasons for the changes:

All of the above changes result from full application of the methodology of IAS19.

The updated assumptions for the early retirement rate are according to the best estimate of the number of early retirees in the future (not including early retirees in special early retirement programs and ignoring the influence of such programs on early retirement rates) which was set by the Board of Directors at its meeting on September 1, 2008 and also at its meeting of April 30, 2009.

The estimate which was set by the Board of Directors is 25 retirees a year given the mix of the relevant population. This estimate is reflected in the early retirement table in section 5 in the body of the report.

**Changes that took effect in June 2009**

The changes that apply to this report regarding salary and pension increases result from changes in accounting practice (according to the letter from the Company dated December 20, 2009). Therefore it is not relevant to this Appendix.

**Changes that took effect in December 2009**

1. Specific calculation for discounted electricity and holiday gifts: the obligation is recognized for whoever completes 10 years of service and has reached age 40 (age 60 for generation C). For whoever has not reached age 40 (age 60 for generation C) or has not accumulated 10 years of service, the obligation is based on the years worked relative to the amount of time left until the fulfillment of the 2 conditions above. In the past, the obligation was recognized for generation C in the same vein as for generations A and B. This change resulted in a decrease in the obligation of NIS 26.6 million.

2. Assumption of increased salaries for employees with special agreements – 1.5% per year on a real basis.
   In December 2009, I conducted an investigation to determine an assumption for these employees. It was found that the salary increase for these employees was lower than the salary increase in wages for permanent employees. This change had an impact of NIS 2.5 million.
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):**

\[
\text{Normal salary} = \frac{\text{Extra} + \text{Continuing} + \text{Personal}}{\text{Effort} + \text{Education} + \text{Extra}} + (1.01)^N \times \frac{\text{Job classification}}{\text{Increment} + 1} \times \frac{\text{(Cost of Living)}}{\text{Salary}} \times \frac{\text{Allowance Rate} + 1}{\text{Grade}}
\]

\(N\) – 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 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%) (there are no 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 - members of the management of the Company, ranking at Heads of Divisions and 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.

On October 22, 2013, the Court ruled that the stated decision by the Supervisor of Wages will not enter into force. This will be until a decision is reached in the main case that will be filed in this matter. That relates to the decision of the Supervisor of Wages that was set for March 10, 2014.

(a) **Service increment:**

1. The annual service increment rate is 1% for each year of service.

2. **The Service Increment Calculation Formula:**

   \[
   \text{Service Increment Amount for Payment} = [(1.01)^N - 1] \times \text{job classification increment + salary grade}.
   \]

   \(N\) – number of service years for payments where \(N =< 40\) (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%.
Appendix F – Details of Benefits

(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:

<table>
<thead>
<tr>
<th>Service years in the field of occupation/ profession</th>
<th>Required study hours related to the occupation or the profession</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to one year</td>
<td>800</td>
</tr>
<tr>
<td>Up to two years</td>
<td>700</td>
</tr>
<tr>
<td>Up to four years</td>
<td>600</td>
</tr>
<tr>
<td>Up to six years</td>
<td>500</td>
</tr>
<tr>
<td>Up to eight years</td>
<td>400</td>
</tr>
<tr>
<td>Up to ten years</td>
<td>300</td>
</tr>
<tr>
<td>Up to twelve years</td>
<td>200</td>
</tr>
<tr>
<td>Twelve years and up</td>
<td>100</td>
</tr>
</tbody>
</table>

**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.
Appendix F – Details of Benefits

(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).

On October 10, 2013, the Company received a letter from the Supervisor of Wages with respect to his decision regarding the salary irregularities including on the subject of command increment paid to various groups of entitled employees of command ranks at various rates. 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. On October 22, 2013, the Court ruled that the decision by the Supervisor of Wages will not enter into force. This will be until a decision is reached in the main case that will be filed in this matter. The hearing has been scheduled for March 10, 2014.

(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 13\textsuperscript{th} Salary

1. Employees from their 2\textsuperscript{nd} year of employment and pensioners/survivors are entitled to 13\textsuperscript{th} salary payment.
2. The 13\textsuperscript{th} salary consists of a normal salary for the payment month, divided by 12 and multiplied by 6 months, generally payable in two parts: the 1\textsuperscript{st} part before Passover and the 2\textsuperscript{nd} part before the Jewish New Year (Rosh Hashana).
3. The 13\textsuperscript{th} salary is paid to pensioners/survivors according to the pension rate.

3. 20/25 years Salary Payment (14\textsuperscript{th} 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 be the Company for the purpose of time periods specified in this section.
Appendix F – Details of Benefits

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. Convalescence Days Quota (to permanent employees, pensioners and survivors):

<table>
<thead>
<tr>
<th>Number of work years</th>
<th>Number of Convalescence days per year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. After one year of work (for the 2nd year)</td>
<td>13</td>
</tr>
<tr>
<td>2. After two years of work</td>
<td>14</td>
</tr>
<tr>
<td>3. After three years of work</td>
<td>16</td>
</tr>
<tr>
<td>4. After eight years of work</td>
<td>18</td>
</tr>
<tr>
<td>5. After twelve years of work</td>
<td>20</td>
</tr>
</tbody>
</table>

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 employees' 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).
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 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:

<table>
<thead>
<tr>
<th>Grade before retirement date</th>
<th>Granting retirement grade on the retirement date (after 12 months at least in the former grade)</th>
</tr>
</thead>
<tbody>
<tr>
<td>+43 / 22</td>
<td>44 / 23</td>
</tr>
<tr>
<td>44 / 23</td>
<td>+44 / 24</td>
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<tr>
<td>+44 / 24</td>
<td>45 / 25</td>
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<tr>
<td>+45 / 26</td>
<td>46 / 27</td>
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<td>46 / 27</td>
<td>+46 / +27</td>
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<tr>
<td>(f) 46 / (f) 27</td>
<td>+ (f) 46 / + (f) 27</td>
</tr>
<tr>
<td>*46 / *27</td>
<td>+*46 / +*27</td>
</tr>
<tr>
<td>*(f) 46 / *(f) 27</td>
<td>+ *(f) 46 / + *(f) 27</td>
</tr>
</tbody>
</table>

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.
Appendix F – Details of Benefits

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.
Appendix F – Details of Benefits

- 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.

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. 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**

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 Generation C employees (permanent employees who began work after June 10, 1996) 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 28% of their last salary 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 these 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, and a closed group of former members of the Army of South Lebanon – 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 least 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.
Appendix F – Details of Benefits

− **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*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*2% + 5*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.
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.
Appendix F – Details of Benefits

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*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 Dependents**

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 The law requires an employer to employ a widow/widower or a parent of soldier that was killed in action, 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 until they turn 70 years old.
Appendix F – Details of Benefits

7. **Pension to SurvivorsShortly 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.
Israel Electric Company Ltd.
Assets impairment examination study as of December 31, 2013

March 2014
March 24, 2014

To:
Mr. Tamir Poliker, VP, Finance and Economics
Mr. Gilad Hassid, Manager, Accounting and Economics Division
Israel Electric Company Ltd. ("the Company)

At your request and in conformity with the engagement letter dated July 23, 2013, Ernst & Young (Israel) Ltd. ("EY") pleased to present the following report (the "Report") assessing whether an impairment of assets for the Company’s electricity operations, including the generation, transmission and distribution segments is required as of December 31, 2013 ("the valuation date"). Our work was performed giving consideration to International Accounting Standard No.36 “Impairment of Assets” ("IAS 36")

The scope of our analysis included interviews with Company Management about Company background information, financial information, forecasts and information provided to us; analysis of financial information for the valued operations, understanding the business environment in which the Company operates, review of appropriate methodologies for valuation and preparation of the report listing our findings as well as the information and major assumptions used as basis for this valuation.

You may disclose this report (or any part or summary thereof) to anyone and may attach or refer to it in the Company’s financial statements.

In accordance with our engagement letter, our analysis is subject to the limiting conditions contained in the following Report. In particular, it should be noted that we have relied upon information provided by Management without carrying out any verification procedures.

The members of our engagement team have no direct or indirect financial interest in the property that is the subject of this assignment, nor do they have any direct or indirect personal interest with respect to the property or parties involved in the assignment. Neither our employment nor our compensation in connection with the report is in any way contingent on the recommendations reached or values estimated, and this report sets forth all of the assumptions and limiting conditions affecting the analysis, values, and recommendations contained herein. For Limiting Conditions see Appendix D.

We reserve the right to update this valuation based on any new information brought to our attention, which was not available when conducting this valuation.

We appreciate the opportunity to provide you with our valuation services. For any enquiry, please contact Alon Lugasi (see Appendix F for valuator résumé) or Tal Klein at +9724-8654018.

Sincerely yours,

Ernst & Young Israel
# Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>CAPM</td>
<td>Capital Asset Pricing Model</td>
</tr>
<tr>
<td>Cash generating unit (CGU) or Operating Segments</td>
<td>The Company's electricity operations assets, including generation, transmission and distribution segments</td>
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<td>Distribution segment</td>
<td>The Company's distribution grid, which transfers electric energy from sub-stations to consumption areas</td>
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<td>EY</td>
<td>Ernst &amp; Young (Israel) Ltd.</td>
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<td>Forecast years</td>
<td>2014 and the first half of 2015</td>
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<td>FY##A</td>
<td>Profit &amp; loss for the year ended 20##</td>
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<td>Generation segment</td>
<td>The Company's power generation system in Israel</td>
</tr>
<tr>
<td>Grid segments</td>
<td>Transmission and distribution segments</td>
</tr>
<tr>
<td>IAS 36</td>
<td>International Accounting Standard 36 &quot;Asset Impairment&quot;</td>
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<tr>
<td>IBC</td>
<td>IBC Israel Broadband Company (2013) Ltd.</td>
</tr>
<tr>
<td>IFRS</td>
<td>International Financial Reporting Standards</td>
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<tr>
<td>Integrated cycle</td>
<td>Integrated cycle technology, combining industrial gas turbines and steam turbines</td>
</tr>
<tr>
<td>KWh</td>
<td>Kilo Watt per hour</td>
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<tr>
<td>LNG</td>
<td>Liquefied Natural Gas</td>
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<tr>
<td>Management</td>
<td>Reference to Management shall include Company Management</td>
</tr>
<tr>
<td>MVA</td>
<td>Mega Volt Ampere</td>
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<tr>
<td>NIS</td>
<td>New Israeli Shekel</td>
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<tr>
<td>Operating expenses</td>
<td>Selling, marketing, general and administrative expenses</td>
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<td>PEP</td>
<td>Private Electricity Providers</td>
</tr>
<tr>
<td>Abbreviation</td>
<td>Description</td>
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<tr>
<td>-----------------------</td>
<td>-----------------------------------------------------------------------------</td>
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<tr>
<td>PUA</td>
<td>Public Utility Authority – Electricity</td>
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<td>Residual Value</td>
<td>Value upon full tariff allowance</td>
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<td>Tariff basis</td>
<td>Tariff basis book – allowed expenses for generation segment for 2010-2014</td>
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<tr>
<td></td>
<td>(including current updates)</td>
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<tr>
<td>The Company or IEC</td>
<td>Israel Electric Company Ltd.</td>
</tr>
<tr>
<td>The report</td>
<td>This report dated March 24, 2014</td>
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<td>Transmission segment</td>
<td>Transmission and transformation segment of electricity generated by the</td>
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<td></td>
<td>Company and by private electricity providers over the Company's transmission</td>
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<td></td>
<td>grid</td>
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<tr>
<td>Valuation Date</td>
<td>December 31, 2013</td>
</tr>
<tr>
<td>WACC</td>
<td>Weighted Average Cost of Capital</td>
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1. Executive summary

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<td>1.1</td>
<td>Valuation results</td>
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<td>1.2</td>
<td>Terms and conditions</td>
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</table>
1. Executive summary

1.1 Valuation results

The Company is 99.8% owned by the State of Israel and engages, pursuant to licenses granted to the Company by the State of Israel, in generation, transmission, distribution and provision of and trading in electricity. The Company also engages in construction of infrastructure required for its operations.

According to assumptions made by the Company and to the opinion provided to the Company by PUA, the generation, transmission and distribution segment constitutes a single cash-generating unit.

The objective of this engagement is to assist Management in review for impairment of assets of the cash-generating unit as of the valuation date.

Below are our recommended recoverable amount as of the valuation date:

<table>
<thead>
<tr>
<th>Currency: NIS millions</th>
<th>Recoverable amount</th>
<th>Carrying amount¹</th>
<th>Impairment</th>
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<tr>
<td>Operating Segments</td>
<td>68,599</td>
<td>68,464</td>
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Our valuation is based on information and financial data provided to us by Management and is subject to restrictive terms listed in Appendix E.

¹ The carrying amount was provided by the Company. For details see table C2.
1. Executive summary

1.2 Our Engagement

**Objective and purpose**

The purpose of our engagement is to assist the Company's Management in assessing whether an impairment of assets is required in accordance with IAS 36, as of the Valuation Date.

We understand that the results of our analysis are being used solely for financial reporting purpose.

The scope of our engagement included:

- Discussions with Management about the background of the cash-generating unit and the Company, financial data, forecasts and information provided to us.
- Discussions with PUA.
- Analysis of financial data for the cash-generating unit.
- Understanding the business environment in which the cash-generating unit operates.
- Review of appropriate methodologies for conducting the valuation.
- Preparation of a final report listing our findings.

**Standards and underlying assumptions for valuation**

According to IAS 36, the recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use. It is not always necessary to determine both an asset’s fair value less costs to sell and its value in use. If either of these amounts exceeds the asset’s carrying amount, the asset is not impaired and it is not necessary to estimate the other amount.

For more details, see Appendix A below.

Therefore, the recoverable amount should be reviewed. In this case, since IEC operates as a Government Corporation and has no quoted market price, we reviewed the value in use using the discounted cash flow approach for estimating the recoverable amount.
1. Executive summary

Sources of data

We considered audited historical consolidated financial statements, unaudited financial data, prospective financial information and other financial information necessary to conduct our valuation analysis. We also held conversations with several members of Management during the course of our engagement.

The primary sources of information on which our analysis was based include the following:

- Un-audited financial statements of IEC as of December 31, 2013;
- The Company's investment and operating cost budget for 2014;
- The Company's investment and operating cost forecast for 2015;
- Tariff basis book – allowed expenses for generation segment for 2010-2014;
- Various other data received from the Company;
- Internal information repositories of EY;
- Public information;
- Bloomberg information system.

Limitations

In accordance with our engagement letter and the transmittal letter that accompanies this Report, our analysis is subject to the limiting conditions contained in Appendix D. Additionally, this Report, the conclusions contained herein and the associated appendices should not be read or utilized in any way without consideration of these limiting conditions.
2. Background

2.1 Power utility market in Israel
2.2 Company description
2.3 Electricity tariff
2. Background

2.1 Power utility market in Israel

**Power Utility Market Act**

The Power Utility Market Act (1996) stipulates a regulatory framework designed to promote efficiency in the power utility market by achieving competition in the power utility market in Israel, by various means.

In recent years, several amendments were made to the Power Utility Market Act, stipulating separation of generation, transmission, distribution, delivery and system Management operations under terms and conditions set forth in the Power Utility Market Act, by distributing these operations to multiple separate entities (hereinafter: "the re-structuring"). The re-structuring would stipulate transition provisions and schedule for implementing the provisions so as to allow the Company to generate, transmit, distribute, deliver, sell and trade electric power and to continue acting as the power utility system administrator, in conformity with licenses granted to the Company pursuant to the Power Utility Market Act. In the years since the Power Utility Market Act was enacted, the Government of Israel and various Government entities have made several resolutions with regard to the re-structuring, some of which have been adopted in amendments to the Power Utility Market Act. As of the date of this valuation, actual implementation of the re-structuring has yet to start and its final outline is uncertain. Therefore, we did not account for any potential implications of the re-structuring in this review for impairment.

**Demand for electricity**

Demand for electricity in Israel is seasonal. For this matter, seasons are defined as summer (July-August), winter (December-February) and the transition seasons: spring (March-June) and autumn (September-November). Demand is higher during summer (due to use of air conditioning) and winter (due to use of heating), compared to the transition seasons. In summer and winter, the average power consumption is higher than in transition seasons and sees days of peak demand, due to extreme cold or heat conditions.

Demand for electricity in Israel is also influenced by economic activity. In years of vibrant economic activity and positive growth of Israel's economy, power consumption and demand for electricity increase. Conversely, in times of financial crisis or challenges, power consumption and demand for electricity decrease, accordingly.
2. Background

Reasons for increase in demand for electricity

According to forecasted demand for electricity, the upward trend in demand for electric power is expected to continue, with consumption doubling over the next 20 years due to several major reasons:

- Population growth – The annual population growth rate in Israel is higher than in other Western countries, due to higher birth rates and immigration waves at different times.
- Higher living standards – In some segments of Israel’s population, living standards are still lower than in some Western countries. Higher living standards include purchase of additional appliances (such as dish washer and dryer), resulting in increased power consumption.
- Climate change – The greenhouse effect appears to be contributing to extreme climate volatility, resulting in increased power consumption for heating and cooling. Peak demand for electric power is often recorded on the coldest or hottest days of the year; since electric power cannot be stored, this calls for construction and maintenance of larger generation capacity to avoid crashes in the power utility system during peak demand.

Electric power demand forecast in Israel

Electricity consumption is expected to grow from 57.2 billion KWh in 2013 to 60.5 billion KWh in 2015. Correspondingly, electricity generation is expected to grow from 61.3 billion KWh in 2013 to 64.7 billion KWh in 2015.

Electric power supply

IEC generates, transmits, distributes and delivers the majority of power consumption in Israel. In January 1999, IEC was declared a monopoly in the power utility market by the Anti-Trust Supervisor in the following areas, inter alia: Power supply – electric power generation and sale, electric power transmission and distribution and provision of backup services to electric power producers and consumers.

Since the Power Utility Market Act was enacted, the Government of Israel has maintained a policy to promote competition in the power utility market while increasing the power generation capacity of private electricity providers. To this end, the Government set a target for increasing power generation by private electricity providers from 4% to 20% of total power generation capacity in Israel by 2020.

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2 Source: Ministry of Energy and Water website
3 Source: Company data.
4 Source: Draft Barnea Report, 2013
2. Background

As of the report date, total potential generation capacity of the facilities, in accordance with contingent licenses granted to developers for construction of electricity generation facilities (including renewable energy) and of future generators scheduled to operate in conformity with the tender issued by the Government, is 6,281 MW. To the best of the Company's knowledge, as of the report date, three of the private electricity providers (who intend to construct a high-capacity power station, with capacity in excess of 400 MW) have reached financial closing, and two of these are in very advanced construction stages. Other private electricity providers, who plan to construct lower-capacity power stations, are in various stages of licensing, construction and operation of private power stations. There is also increasing activity in the market for power generation using renewable energy due, inter alia, to preferential tariffs paid to such producers.

According to PUA arrangements, the Company – being a vital service provider and holder of a transmission license – is required as follows:

- To purchase electricity from private electricity providers;
- To connect private electricity providers to its transmission and delivery grid and to provide them with infrastructure services so as to allow private electricity providers to contract with delivery companies or to deliver electricity to end consumers on their own;
- To provide backup services for electricity delivery to private electricity providers' consumers.

The installed generation capacity of private electricity providers who sell electricity to the Company, as of the end of 2013, is 885 MW, or 6.5% of the Company's total generation capacity of 13,483 MW. All private electricity providers operating as of the end of 2013, including independent generators, account for 7.5% of the Company's generation capacity.

In the year ended December 31, 2013, the Company purchased 1,048 million KWh from private electricity providers, compared to 376 million KWh in the year ended December 31, 2012. The policy of increasing competition in the power utility market is also reflected by provisions of the Power Utility Market Act, whereby ownership of various operations in the power utility market is to be diversified. Thus, for example, as for generation the Act stipulates that no generation license may be granted to anyone holding 30% or more of total generation capacity in the market, which would in effect require at least four companies to operate in power generation.
2. Background

Chart 1: Natural gas sources
Source: IEC website

Significant events in the power utility market in 2013

Entry of private electricity providers

On July 6, 2013, a private electricity provider, OPC, launched commercial operations; the maximum generation capacity of OPC’s integrated cycle is 448 MW. As of the valuation date, this integrated cycle only operates using natural gas. To the best of the Company's knowledge, OPC's commercial plan is to sell most of the power to end consumers (private consumers) and to sell excess power to IEC on competitive basis. In 2013-2015, additional private electricity providers of significant capacity are expected to be in operation, and their entry into the power utility market is expected to impact Company revenues.

Natural gas supply

- Gas supply from Egypt

Recent events and government instability in Egypt have affected the Company's contract for supply of natural gas by Egyptian company EMG, as reflected in recurrent damage to the gas pipeline, leading to complete discontinuation of gas flow from Egypt, as announced by EMG to the Company in April 2012. Upon this announcement, the Company launched an arbitration process with EMG and Egyptian gas providers. On June and December 2013, the Egyptian Government's gas companies filed their response to the Company's claim, and the arbitration hearing took place in January 2014. According to the arbitrators’ decision, the parties should file their written summations in early April 2014, with the final hearing scheduled to take place in Paris in May 2014. One of the steps taken by Company Management, as a result of discontinuation of gas supply from Egypt, was to increase cash on hand, to serve as a safety cushion.

- Gas supply from Israel
  - Yam Tethys deposit

As the forth quarter of 2011, the daily and hourly production from Yam Tethys’ MARI B deposit was gradually decreased due to exhaustion of this deposit and collapse of some production wells. Consequently, the Company was forced to consume ever growing volumes of liquid fuel which, together with discontinuation of gas supply from Egypt, resulted in higher fuel cost incurred by the Company. Concurrently, the Power Utility Administration of the Ministry of Energy and Water issued directives imposing monthly and annual limits on using gas from this field, so as to ensure continuous gas supply between depletion of the MARI B field and the expected start of gas production from Tamar field in 2013.
On June and July, 2012, commercial flow of natural gas from the Pinnacles 1 drilling and the Noa 1 drilling started, respectively, in conjunction with the Company’s gas agreements with Yam Tethys Group. The aggregate daily volume of natural gas provided to the Company at this stage by Yam Tethys Group from Noa North deposit, from Pinnacles 1 deposit and from Mari B deposit was 50% of daily contractual volume. On 3rd of December, 2012, a settlement agreement was signed between the Company and Yam Tethys, which ended the disagreement between the parties regarding the significant reduction in the volumes of gas provided by Yam Tethys to the Company as compared to the contractual volumes and the compensation for the Company due to the reduction. The settlement agreement includes the remuneration for the Company and an agreement regarding continuation of commercial flow from Yam Tethys. As of the end of March, 2013, commercial gas flow started from Tamar and in December, 2013, as the contractual volume agreed in the Yam Tethys agreement was used up, and a total volume of BCM 18 was provided during the years, the agreement with Yam Tethys ended.

- **Tamar deposit**

In March 2012, the Company signed an agreement with Tamar license holders, whereby the Company committed to purchase natural gas with a minimum volume of 42.5 billion m$^3$ (“BCM”) and up to a maximum volume of 77 BCM over 15 years, starting from mid-2013. The Company was also given an option, which may be exercised by April 2013, to increase the maximum volume up to 99 BCM. On April 11, 2013, the Company Board of Directors approved the exercise of this option.

On March 30, 2013, natural gas production from Tamar field commenced, as did gas supply to the Company’s generation facilities; on June 30, 2013 the contractual ramp-up period ended.

On June 23, 2013, the Government of Israel resolved to adopt the recommendations made by the committee appointed to review Government policy with regard to the natural gas market in Israel. The Government indicated that, in order to improve reliability of natural gas supply and to increase the volume supplied to the Israeli market, a natural gas transmission pipeline should be constructed from Tamar deposit to the Ashkelon area, and the MARI B deposit should be turned into an active storage deposit. To this end, the Minister of Energy and Water was tasked with requiring the partners who hold the Tamar field to construct a natural gas transmission pipeline should be constructed from Tamar deposit to the Ashkelon area by December 31, 2016.

- **Import of Liquefied Natural Gas (“LNG”)**

In order to bridge the period of natural gas shortage, until the start of gas production from Tamar field, and in response to peak demand and reliability of gas supply, even after the start of production, the Minister of Energy and Water authorized the Company, in February 2011, to promote an infrastructure project for purchase of LNG. The project is conducted
2. Background

through Israel Natural Gas Lines Ltd., who has constructed a floating facility and is responsible for its operation. On January 26, 2013, gas flow started from the floating facility at sea. The Company's increasing dependence on power generation using natural gas poses risk due to the limited number of natural gas suppliers as well as to restrictions associated with the natural gas transmission system. Disruptions to gas supply due to breach of purchase contracts by gas suppliers have caused the Company to operate its generation system using other fuels which are costlier and more polluting – in order to meet consumer demand for electricity.

**Cash flow stabilization**

In 2011-2012, several events in the Company's business environment resulted in a significant increase in fuel cost and imposed a significant cash flow burden on the Company in these years, primarily:

- Disruptions leading to total discontinuation of gas supply from Egypt;
- Significant decrease in gas supply from Yam Tethys deposit;
- The fact that, as an alternative to natural gas, the Company was forced to increase use of diesel rather than fuel oil, where diesel is less polluting but significantly more expensive than fuel oil;
- The fact that in March 2012, PUA decided to spread the increase in electricity tariff with respect to excess fuel cost over the period 2012-2014; consequently, a gap emerged between the date on which the Company incurred the expenses due to excess fuel cost and the date on which the tariff would be revised.

Following Company requests from Government ministries and relevant regulatory entities, the Government entities took some measures to help the Company's cash flow situation. Concurrently, the Company took some measures of its own to improve its cash flow.

As from the first half of 2013, the Company's cash flow has stabilized – particularly in view of start of natural gas flow from Tamar deposit in late March 2013, along with capital raised by the Company.

**Company's credit rating**

- On April 11, 2013, international rating agency Standard and Poor's and local rating agency Standard and Poor's Ma'alot announced they were revising the Company's domestic credit rating (ilAA-) and international credit rating (BB+) to Stable, removing it from the Credit Watch Negative list, on which it was placed on November 14, 2012;
- On May 9, 2013, international and local credit rating agency S&P announced the ratification of the Company's international (BB+) and domestic (ilAA-) credit rating;
- On December 5, 2013, local rating agency Midroog announced a revision of the outlook on the Company's local credit rating (Aa3) from negative to stable, removing it from the Credit Watch Negative list, on which it was placed on May 24, 2012;
On December 11, 2013, international rating agency Moody’s announced a revision of the outlook on the Company's international credit rating (Baa3) from negative to stable, removing it from the Credit Watch Negative list, on which it was placed on November 2, 2011.

Sector-specific risk factors

- Regulation of Company operating segments

Company operations are dependent, to a large extent, on regulation of its operations, including provisions of the Power Utility Market Act and regulations, pursuant to which the Company is granted licenses for its operations; Government policy and resolutions; PUA resolutions (including with regard to electricity tariff, which is set by PUA and charged to Company customers); provisions of the Government Corporation Act and regulations; and resolutions by the Government Corporation Authority; provisions of the Natural Gas Market Act and resolutions by the Natural Gas Authority.

- Geo-political situation in Israel and surroundings

The economic and geo-political situation in Israel directly impacts the Company – since most of its assets and operations are located in Israel. Major acts of war in the Middle East targeted at Israel, political instability in Israel or in surrounding countries, or deterioration in Israel's international commerce relationships may materially impact Company operations. In view of the geo-political situation in Israel and its relations with surrounding countries, in case of disaster or other disruption – Israel has no backup for the Company's power grid and in fact, the power grid in Israel is isolated with regard to power generation and delivery to residents, with no option to purchase electricity and/or backup from other providers in Israel or elsewhere. Due to the vital services provided by the Company to the State of Israel and to its residents, the Company may be at risk of having acts of hostility targeted at its facilities.

- Shortage of natural gas

For generation of electricity, the Company is dependent to a large extent on natural gas supply and, to a much lesser extent, on LNG delivery. Consequently, the Company is impacted by risk associated with the small number of gas providers and with disruption of natural gas supply. An additional risk lies in the fact that the Company is unable to store natural gas. Disruption of natural gas supply, including by deliberate explosions on the gas pipeline from Egypt, depletion of natural gas deposits in Israel and breach of purchasing contracts by gas providers have required, and will require in future, that the Company generate electricity using other, costlier fuels which significantly increase the cost of electricity generation. In general, the tariff coverage mechanism fully covers the Company...
2. Background

for its fuel cost – but since the tariff allowance is not immediate, a cash flow gap is created for the Company.

- Exchange rate fluctuations

Since nearly all Company revenues are NIS-denominated and some of its long-term financial liabilities are denominated in foreign currency, the Company is exposed to exchange rate fluctuations of these currencies. Exchange rate fluctuations impact Company expenses and its operating results. However, most of these liabilities are covered by hedging transactions and by a built-in hedging mechanism in electricity tariff.
2. Background

2.2 Company description

Historical background

IEC was incorporated in Israel on March 29, 1923 and is engaged in generation, transmission, distribution, sale and delivery of electricity to all consumers in Israel. The Company is 99.8% owned by the State of Israel and is therefore a Government corporation, subject to provisions of the Government Corporation Act

In 1926, the British Mandate Administration in Palestine granted the Company a franchise known as the HaYarden Franchise and also assigned to it the franchise known as HaYarkon Franchise (“the franchises”). Pursuant to the franchises, the Company was granted the exclusive right to generate, deliver, distribute and sell electricity throughout the area of the British Mandate Palestine, other than Jerusalem and its surroundings.

The franchises were valid for 70 years, through March 3, 1996 – and as from said date, Company operations are subject to provisions of the Power Utility Market Act and regulations based there upon. The Act is designed to govern activity in the power utility market for the benefit of the public, while ensuring reliability, availability, quality, efficiency and creating appropriate conditions for competition and for lowering costs.

The Company generates, transmits, distributes and delivers almost all of the electricity consumed in Israel pursuant to licenses granted to the Company for each such activity pursuant to the Power Utility Market Act and extended over time; the Company also acts as the power utility system administrator. As of the valuation date, the Company is the only holder of a distribution and delivery license in Israel. The Company also holds export licenses equal to 91% of total capacity of power stations in Israel's power utility market for which generation licenses were granted. In conjunction with Amendment 12 of the Power Utility Market Act, the Company’s licenses were extended through January 1, 2015.

Operating segments

The Company provides electricity to consumers – from generation to transmission, distribution, delivery and trading. The Company is also engaged in construction of infrastructure required for its operations and acts as the power utility system administrator. Company operations include three major operating segments:

- **Power generation** – This operating segment includes all operations involved with power generation at the Company’s generation facilities;
- **Power transmission and transformation** – This operating segment includes transmission of electricity from generation facilities through ultra high voltage and super high voltage lines to major switching stations and sub-stations – and from major

5 For the Company's financial data, see tables A and B.
stations and sub-stations to sub-stations using super high voltage transmission lines. It also includes transformation using connection transformers (from ultra high voltage to super high voltage) and step-down transformers (from super high voltage to high voltage).

- **Power distribution** – This segment consists of power transmission from sub-stations to consumers through high voltage and low voltage lines, delivery and sale of electricity to consumers.

Below are details of the Company’s operating segments:

**Generation segment**

As noted, the Company provides electricity to all consumers in Israel – from power generation to transmission, distribution, delivery and trading. The Company is also engaged in construction of infrastructure required for its operations and acts as the power utility system administrator.

The Company's power generation in Israel is based on five steam-powered power stations, which use steam power to turn turbines; these power stations are located along the coastline of Israel in Haifa, Hadera (“Orot Rabin”), Tel Aviv (“Reading”), Ashdod (“Eshkol”) and Ashkelon (“Ruthenberg”). The steam-powered power stations burn coal, natural gas or fuel oil. In addition to steam-powered power stations, other generation units use gas turbines, which burn diesel or natural gas.

As of December 31, 2013, the Company owned and operated 17 generation facilities (including the 5 aforementioned steam-powered power stations), with total installed generation capacity of 13,483 MW. These sites are located throughout Israel on land primarily owned by the Company or leased by the Company from the State. In addition to the aforementioned generation facilities, there are other facilities at Gezer, Hagit, Alon Tavor, Ramat Hovav, Tzafit and others.

As of December 31, 2013, the Company had 63 generation units, of which 18 steam-powered generation units, 13 gas turbine integrated cycle units, 16 jet gas turbine units, 15 industrial gas turbine units – one of which ("Eshkol") is designed to operate an integrated cycle.

Use of natural gas in power generation reduces air pollution and greenhouse gas emissions produced in the power generation process and reduces the generation cost. Despite the transition to use of natural gas for power generation and the conversion of steam-powered generation units to burn natural gas – which started in February 2004 – the Company decided to maintain the steam-powered power stations as dual-fuel burning (except for Reading power station which only burns natural gas) and they may generate electricity using both natural gas and liquid fuel, so as to maintain their power generation capacity even in case of shortage of natural gas or disruption to its supply.
2. Background

As of December 31, 2013, some 56% of the Company's total installed generation capacity uses units which exclusively burn natural gas.

Below are details of the Company's generation units:

- **Steam-powered generation units**
  
  The Company's steam-powered generation units use a steam turbine to generate electricity, burning coal as the primary fuel, or fuel oil or natural gas. Some of the generation units are dual-fuel, i.e. may be operated using coal (as the primary fuel) as well as fuel oil, or may be operated using natural gas (as the primary fuel) as well as diesel (liquid fuel) or fuel oil.
  
  The Company's steam-powered generation units are designed to provide the basic demand for electricity, with total installed generation capacity of 6,462 MW. The dual-fuel power stations, which are currently operated by coal, are associated with a larger investments and longer construction duration – but when operated by coal, they offer a low cost per generated KWh. The generation units which are operated by fuel oil were used for generating electricity under basic load until the energy crisis of the 1970s, after which a decision was made to diversify the use of fuel by constructing dual-fuel power stations which may also burn coal. After natural gas flow from Tamar deposit started, natural gas was used to operate another portion of the fuel-oil burning generation units, which were converted to burn natural gas.

- **Gas turbines**
  
  Gas turbines are of two types: Jet gas turbines and industrial gas turbines.
  
  As of December 31, 2013, the Company has sixteen (16) jet gas turbines with aggregate installed generation capacity of 504 MW and fifteen (15) industrial gas turbines with aggregate installed generation capacity of 1,570 MW. In addition, the Company has one industrial gas turbine which burns natural gas ("Eshkol"), which would be converted in future into an integrated cycle, with installed generation capacity of 260 MW. Adding this turbine to an integrated cycle unit by steam-powered add-on is planned by the end of the first quarter of 2014.
  
  Installation of industrial and jet gas turbines involves a relatively smaller investment and a shorter construction duration. However, generation using jet gas turbines is costlier than using steam-powered generation units – and operation of jet gas turbines is even costlier than operation of industrial gas turbines. However, gas turbines may be started and stopped within a shorter time compared to starting / stopping steam-powered generation units. Therefore, the Company usually operates its gas turbines in periods of peak demand.
Integrated cycle generation units

Integrated cycle is a combination of industrial gas turbine with a steam turbine – which significantly improves the utilization of combustion. Using integrated cycle technology, the residual heat from the industrial gas turbine is used to operate another steam turbine with no additional use of fuel, so instead of gas emissions, the warm gas is re-used. This operation provides savings on fuel utilization and is beneficial to environmental protection, because the generation capacity is increased with no increase to emission of pollutants into the air.

As of December 31, 2013, the Company had 13 integrated cycle units, all burning natural gas and diesel, with total generation capacity at 4,687 MW.

In addition to electricity generated by the Company's power stations, the Company purchases small volumes of electricity from private electricity providers – some of which sell all their output to the Company while others generate electricity for their own use and only sell their excess output to the Company.

Operations of the generation segment are subject to laws and regulations with regard to environmental protection, including air pollution, water sources, noise, storage, transportation and disposal of toxic materials, hazardous materials etc. The environmental protection statutes stipulate allowed levels of air pollution, noise, waste water and other waste material from power stations and other Company facilities as well as mechanisms for handling toxic materials (the Hazardous Material Act), restrictions and procedures with regard to construction (the Planning and Construction Act) etc.

The Company regularly applies measures for compliance with environmental protection statutes such as: use of low-sulfur fuel oil and low-sulfur coal, installation of measures for reducing nitrogen oxides when using natural gas or diesel, operation of environmental monitoring and control systems for emissions from Company facilities – on land, at sea and in the air.

Transmission and transformation segment

In this operating segment, the Company transmits the electric energy generated by its various generation units and by private electricity providers to switching stations and then to sub-stations all across Israel through its transmission grid which covers all of Israel and its occupied territories since 1967 (East Jerusalem, West Bank and Gaza Strip). From the sub-stations, electricity is transmitted to consumers through the distribution system. The transmission segment also provides electricity to customers who use high voltage, such as major industrial plants, Mekorot facilities etc.

As of December 31, 2013, the transformation system included 193 sub-stations (of which 42 sub-stations owned by consumers of high voltage). The installed transformation capacity
was 19,452 MVA (including 2,855 MVA for sub-stations owned by consumers of high voltage).

The electricity transmission operations are conducted in conformity with a license granted to the Company for transmission, distribution, delivery, selling and trading electricity ("the unified license"). This license was extended through January 1, 2015 for all of the operations included there in. The Company was not granted a separate license for its transmission operations, which are there for conducted based on the unified license, granted for multiple operations.

Distribution segment

The Company provides low-voltage power to most consumers and high-voltage power to major consumers (i.e. those consuming much electricity, such as large industrial plants).

The electricity distribution operations are conducted based on the unified license, which was extended through January 1, 2015 for all of the operations included there in. The Company was not granted a separate license for its distribution operations, which are there for conducted based on the unified license, granted for multiple operations.

The distribution segment consists of five regions: North, Dan, Jerusalem, Haifa and South regions, covering all of Israel and forming the back-bone of Company work and service for its 2.58 million customers.

Communications operations

The Company recently launched its communications operations by incorporating IBC, a company which would operate in the communications field and provide landline telephony services to telecom operators and to large business customers, as approved by the Minister of Communications, through an optical fiber infrastructure to be deployed, inter alia, over Company infrastructure.

On July 11, 2013, the Company concluded a transaction to establish a joint venture for an optical fiber network (hereinafter: "the telecom company") with a consortium consisting of the following companies: Via Europe Israel Ltd., BATM Advanced Communications Ltd., RAPAC Communication & Infrastructure Ltd., Tamares Holdings Sweden AB and Zisapel Assets (1992) Ltd. (hereinafter: "Via Europe Group") which would be owned 60% by Via Europe Group and 40% by the Company. On August 27, 2013, the Minister of Communications granted IBC a license to provide telecom services.

On July 14, 2013, the telecom company was incorporated in Israel, named IBC Israel Broadband Company (2013) Ltd. Subject to the grant of a license to provide telecom services by the Minister of Communications, IBC will provide landline telephony services to telecom operators and to large business customers, as approved by the Minister of
Communications, through an optical fiber infrastructure to be deployed, inter alia, over Company infrastructure.

On July 25, 2013, a services agreement was signed by the Company and by the telecom company; on July 28, 2013, an application was filed with the Ministry of Communications for a license to be granted to the telecom company.

As noted above and as instructed by the Company, the telecom segment is not part of the cash-generating unit reviewed in this document.

Customers

As of December 31, 2013, the Company had 2.6 million customers (an increase of 1.4% over 2012) and total electricity consumption was 53.6 billion KWh.

The Company classifies its customers under households, industry, public buildings, commercial and accumulation, water pumping and agriculture.

In the household segment, as of the end of 2012, the Company served 2.3 million households – virtually all of the households in Israel. In 2013, household consumption was 8% lower than in 2012.

The public sector – commerce, Palestinian Authority and East Jerusalem – includes power consumption by commercial establishments, shopping malls, various businesses, the Palestinian Authority – East Jerusalem and public sector entities, such as: municipalities, Government ministries and schools. In 2013, consumption in this sector was 2.1% lower than in 2012.

Concurrently, power consumption in the industrial sector in 2013 was 12.3% lower than in 2012.

Water pumping sector – this power consumption is used to provide water for drinking, irrigation and other purposes throughout Israel. In 2013, consumption in this sector was 2.4% lower than in 2012. Concurrently, in the agriculture sector, consumption in 2013 was 5.1% higher than in 2012.
2. Background

2.3 Electricity tariff

Background

Company revenues are based on the electricity tariff charged by the Company to consumers. According to the Power Utility Market Act, the electricity tariff and its updates are set by PUA. The principles applied by PUA to determine the electricity tariff should cover all costs incurred by the Company due to operating its assets and required to fulfill the Company’s obligations as a vital service provider. These costs primarily include fuel costs, operating and maintenance costs and capital costs (depreciation, financing and return on equity).

As indicated by PUA resolutions with regard to setting the tariff base, PUA should determine a tariff base, once every few years, for a specified evaluation period in which the tariff base would be in effect. The tariff base includes several components – some applicable to all operating segments and some only applicable to a specific segment. Electricity tariffs for various consumers are determined based on the consumption type and delivered voltage.

The major tariff types are: Uniform tariff (home, general, street lighting and accumulator – low voltage and high voltage) and TAOZ (load and time based tariff – low, high and super-high voltage). See below for more information about tariff bases for the various segments.

Tariff base for generation segment

On February 1, 2010, PUA decided on an update to the tariff base for the generation segment for 2010-2014. This decision, and the tariffs based there upon, became effective on February 15, 2010.

PUA based its decision to update the tariff base on balancing the need to allow the Company to construct and operate its generation system in coming years while maintaining financial robustness, against the right of consumers to benefit from lower rates due to lower fuel costs due to increased use of natural gas, on the other hand.

The new generation tariff base specified the allowed costs for the Company in the generation segment for 2010-2014, including capital costs, operating costs, fuel mix etc. The allowed costs were determined after PUA has conducted control of Company costs as carried on Company accounts.

Below are highlights of the new tariff base for the generation segment:

(1) Revenues with respect to capital services
  
  Recognized assets and depreciation

  The assets recognized in the new tariff base for the generation segment were determined based on the future outline for 2010-2014. The allowed cost with respect to
2. Background

generation units was based on a plan listing the allowed generation units and their normal operating schedule. PUA determined that the allowed cost for active assets would refer to two generation categories:

- "Legacy" units – generation units in operation since before December 31, 2002. Recognition of legacy unit costs is primarily based on the costs carried on Company accounts. Investments in conversion to natural gas would only be recognized after start of operation using natural gas, as from the annual update dates.

- "New" units – generation units in operation since December 31, 2002 or thereafter. Recognition of new unit costs is based on normative parameters, such as operation date, construction time and normative interest rates.

PUA stipulated that, should the Company deem the actual costs for unit construction to be excessive and outside the normative cost base, the Company may apply to PUA for recognition of these excessive costs after the unit is put into operation.

Normative operation schedule

PUA stipulated normative operation schedules for operation of generation units. These dates are applicable for tariff recognition of asset costs and depreciation, financing costs and fuel mix with respect to these generation units. Should the Company fail to meet the normative schedules stipulated for operation of its new generation units, the costs allowed in the tariff would be reduced based on a model stipulated by PUA.

Financing costs

The tariff includes an allowed rate of return for assets, in order to calculate the financing component of capital services derived from the value of the Company's allowed assets in the tariff. The allowed rate of return is used, as from the PUA decision date on the generation tariff base as the base for recognition of capitalized financing costs of assets during construction. The allowed rate of return in the tariff is based on three variables:

- Financial leverage – the leverage ratio allowed in the tariff is $\frac{1}{3}$ equity and $\frac{2}{3}$ external capital.
- Return on equity (gross) – return on equity for the generation segment, as of the valuation date, is 7.65% after tax (10.2% before tax).
- Interest on external capital
  - The allowed return for external capital is based on three components:
    - NIS-denominated financing component – reflects loans obtained in Israel, denominated in NIS and linked to the CPI. For this financing component, the allowed return is the average real NIS interest rate.
    - Hedged financing component – reflects external capital raised overseas in foreign currency which is hedged.
2. Background

- NIS-denominated financing component at higher interest – reflects capital raised in foreign currency.

ii. Hedging mechanism

The hedging mechanism for the tariff is designed to avoid sharp fluctuations in Company profitability in periods where a large gap exists between the change in CPI and the change in exchange rates, due to the fact that Company assets are adjusted for the CPI with a large portion of financing is in loans denominated in foreign currency. According to PUA, in recent years the local financial markets have evolved both for raising capital and for financial derivatives for hedging exchange rate risk – hence PUA decided to eliminate the hedging mechanism. Therefore, in the new tariff base book for the generation segment, the current hedging mechanism (as determined in the tariff base book for 2002-2005, dated July 1, 2002) was eliminated and a new hedging mechanism was put in place, to be phased out within 3 years (by 2013) in order to allow the Company to prepare for hedging its own exposure to exchange rate risk, which is currently hedged using the existing hedging mechanism. These are highlights of the new hedging mechanism:

1) The hedged principal amount would be updated upon each annual update date, based on recognized assets and the downward outline issued by PUA, until the mechanism is completely phased out.

2) Interest rate differences between foreign currency interest rate and real NIS-denominated interest rate would be part of the hedged amount, spread over the period through phasing out of the hedging mechanism.

3) The exchange rate for the effective basket and the foreign currency interest rate would be linked to USD and EUR.

4) The amounts accrued to the Company, in credit or debit, would be spread over the period through phasing out of the hedging mechanism in April 2013. However, the tariff base book for the generation segment stipulates that, in view of the expected re-structuring, PUA placed a freeze on the upward outline of the NIS-denominated financing basket through March 31, 2011 or through the launch date of the re-structuring, whichever is sooner. The aforementioned freeze expired in March 2011 and consequently, the percentage of NIS-denominated financing increased.

5) The hedged amount would not be subject to reduction factors.
Total allowed financing costs would be the product of the allowed weighted rate of
return (equity and external capital) and total recognized assets, after deduction of
reserve for deferred taxes.

According to the decision by PUA in the tariff base book for the generation
segment, accrued debt by consumers with respect to elimination of the former
hedging mechanism would be spread over 5 years. On September 16, 2013, PUA
decided to put a freeze on the outline for phasing out the hedging mechanism – as
stipulated in the PUA decision on the generation tariff base – and therefore the tariff
hedging rate would be frozen at 9% of external capital as set forth in the tariff base,
through the annual update for 2014.

(2) Revenues with respect to fuels

Fuel mix calculation

The fuel mix will be calculated in each calendar year, as part of the annual tariff
update, as the average fuel mix based on the forecasted typical load curve. At the
end of each year, the fuel mix would be retroactively calculated as actually used in
that year, and will be updated for any new relevant professional information. In the
annual update for the subsequent year, the difference between Company revenues
from the actual fuel mix and Company revenues from the pre-calculated fuel mix
would be settled. The difference would be reimbursed to consumers or to the
Company through the tariff mechanism, with interest and linkage.

(3) Revenues with respect to operating costs

Allowed operating costs for the evaluation period are derived from the average
operating costs based on the Company's financial statements for 2002-2006,
separating the cost of work from other costs and after certain adjustments for
increased sales. These allowed costs are subject to a 2% annual factor for
improved efficiency. Operating payroll costs are linked to the payroll benchmark for
salaried position in Israel. According to a PUA decision, only 50% of capital costs
for spare parts, as calculated by PUA in 2002-2006, would be allowed. This
component is allowed under allowed operating costs, hence it would be increased
annually, adjusted for increased sales and subject to a 2% annual factor for
improved efficiency, as stipulated by PUA.

Pension costs – as of the valuation date, the allowed operating cost for the
generation segment would include partial pension costs, in line with the
amendment issued in 2009. PUA has yet to complete its review of pension costs,
which are still under discussion between PUA and the Company.

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6 Resolution 4, meeting 413, held on September 16, 2013 with regard to “Continued freeze of IEC tariff hedging mechanism”. 
2. Background

- Development and assembly costs – the normative development and assembly costs are divided into two groups: (1) Company employee costs, linked to the payroll benchmark for salaried position in Israel; (2) sub-contractor costs, linked to the Residential Construction Input Price Index.

Company position with regard to the new generation segment tariff base

The Company has multiple reservations with regard to the new generation segment tariff base which, according to the Company, fails to fully cover all its expenses. According to the Company, the fact that PUA does not allow in the tariff for costs incurred by the Company results in significant impact to Company revenues. To the best of the Company's knowledge, the PUA professional team has reviewed, as part of their on-going work, Company reservations with regard to some of these components.

Tariff base for transmission and distribution segments

The electricity tariff for the transmission and distribution segments was determined based on the PUA decision which became effective as from July 5, 2002. If no new tariff base would be set by December 31, 2005 for the period as from January 1, 2006 – PUA decisions would be effective pending the publication of new tariff bases. As of the valuation date, PUA has yet to set new tariff bases for the transmission and distribution segments (having only done so for the generation segment) and therefore, the tariff base dated 2002 is still effective for the transmission and distribution segments.

Major components:

(1) Revenues with respect to capital services

- Recognized active assets and depreciation
  1. Asset base – the asset base in the transmission and distribution segments was calculated based on average net active assets in 2000.
  2. Depreciation – allowed depreciation costs are based on depreciation costs as carried on Company accounts in 2000.

- Financing costs
  Similar to the new tariff base for the generation segment, calculation of the allowed rate of return for assets is based on three variables: leverage ratio, return on equity and interest on external capital. The normative leverage ratio allowed in the tariff, as well as interest rate on external capital, are as set in the new tariff base book for the generation segment. Return on equity is based on the PUA decision dated July 1, 2002 – at 5.5% for the transmission segment and 6.2% for the high-voltage and low-voltage distribution segments. According to a PUA decision, the aforementioned rates of return
on equity reflect various risk levels associated with the various operating segments due, inter alia, to market risk associated with each segment. The hedging mechanism previously in place, in conformity with the 2002 tariff book, was eliminated and a new hedging mechanism applies to all Company operating segments.

(2) Revenues with respect to operating costs

- Allowed operating costs for the transmission and distribution segments are based on operating costs as carried on Company accounts in 2000, subject to certain adjustments.

- Pension costs – as part of operating costs in the tariff, as determined in the 2002 tariff base, payroll and pension costs for Company employees are allowed. PUA also allowed for changes in actuarial debt valuation for pension with respect to Generation II employees. Composition by segment is based on payroll composition.

- Reduction factors – reduction factors were specified per KWh sold, as part of tariff formulas reflecting the expected improved efficiency of the Company as well as economies of scale at a growing annual rate. As of the report date, the annual reduction factors are: 1.3% for inputs of the transmission and transformation segment; 2.5% for inputs of the high-voltage distribution segment; 3.7% for inputs of the low-voltage distribution segment; and 2% for consumer cost inputs included in the transmission and distribution segments (for all voltages).

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7 This excludes costs for super-high voltage consumers: Fixed payment on electricity bill and payment for extended services charged to consumers.
8 This excludes costs for high voltage consumers: Fixed payment on electricity bill and payment for extended services charged to consumers.
9 This excludes costs for low voltage consumers: Fixed payment on electricity bill and payment for extended services charged to consumers.
3. Testing for Impairment of Cash-Generating Units

3. Impairment examination of Cash-Generating Units

3.1 Testing for impairment of a cash-generating unit
3.2 Value-in-use of a cash-generating unit
3. Testing for Impairment of Cash-Generating Units

3.1 Impairment examination of a Cash-Generating Unit

Timing of impairment testing
At Management’s request the testing for impairment of a cash-generating unit was conducted in accordance with IAS 36.

Identification of a cash-generating unit
The Standard defined a cash-generating unit as the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets; for further details see Appendix A below.

In accordance with the Company’s guidelines and the opinion submitted by the Public Utilities Authority (Electricity), electricity operation, which includes generation, transmission and distribution constitute one cash-generating unit.

Recoverable amount of the cash-generating unit
According to IAS36, the recoverable amount of the cash-generating unit is its fair value less costs to sell or its value in use, whichever is higher; for further details see Appendix A below.

In order to assess the value in use of the cash-generating unit, we found the Income Approach, the Discounted Cash Flow Method, is the most suitable for valuation purposes. For additional details on valuation approaches and methodologies, see Appendix B below.

The carrying value of the cash-generating unit
According to IAS 36, the carrying amount of a cash-generating unit shall be determined on a basis consistent with the way the recoverable amount of the cash-generating unit. The carrying amount shall include the carrying amount of the assets and liabilities directly attributable to the cash-generating unit that will generate the future positive cash flows, which are used to determine the value in use of the cash-generating unit; for further details see Appendix A below.

The carrying amount of the cash-generating unit as at December 31, 2013, was obtained from the company’s Management. Since the carrying amount is determined based on the operating value (excluding financial liabilities, net and excess assets), the recoverable amount of the cash-generating unit is tested without deducting financial liabilities, net and excess assets.

According to the Company’s Management, the carrying amount of the cash-generating unit is NIS 68,464 million.
3. Testing for Impairment of Cash-Generating Units

Testing for impairment of a cash-generating unit (CGU)

According to IAS 36, the impairment of CGU is tested by comparing the carrying amount of the CGU to its recoverable amount. If the carrying amount of the CGU exceeds its recoverable amount, the entity shall recognize an impairment loss.
3. Testing for Impairment of Cash-Generating Units

3.2 Value-in-use of a Cash-Generating Unit

Below are Management’s assumptions that were used to assess the recoverable amount:

General assumptions

- **Cash-generating unit** – according to the Company’s guidelines and the opinion submitted by the Public Utilities Authority, electricity operation, which includes generation, transmission and distribution constitute one cash-generating unit.

- **Implementing the full coverage assumption** – in accordance with the provisions of the Electricity Sector Law, the Company assumes that once the tariff base is adjusted, the Company will receive full coverage for its operating costs, its fixed assets and its future investments, as of the date of the tariff adjustment.
  - *For the generation segment* – as of June 30, 2015 (Management’s assumption for the date in which the new electricity tariff will take effect);
  - *For the electricity chain (transmission and distribution segments)* – the Company’s Management estimates that the tariff base for the electricity chain will come into effect retroactively on April 1, 2012 (in accordance with the Public Utilities Authority’s resolution in Meeting 367 dated March 22, 2012). As aforesaid, in view of the provisions of the Electricity Sector Law, the Company assumes that once the tariff base is adjusted, the Company will receive full coverage for its operating costs, its fixed assets and its future investments, as of April 1, 2012. Therefore, the balance of fixed assets as of the date of valuation also represents the present value of future cash flows from the asset component in the framework of the new tariff base.

- **The forecast period for the electricity generation segment** – according to the Company’s assumptions, the forecast period is based on the projected life of the assets currently in use (and/or that will be used during the forecast period). The forecasts are for the period in which the full coverage assumption does not apply (2014 and the first half of 2015).

- **Regulatory assets / liabilities** – the Company’s assumption is that these assets/liabilities are recognized as financial balances and therefore do not...

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10 For the complete model of Generation Segment valuation model see table C-1
3. Testing for Impairment of Cash-Generating Units

Projected power production over the forecast years

<table>
<thead>
<tr>
<th>Source: Management</th>
</tr>
</thead>
<tbody>
<tr>
<td>Millions of kWh</td>
</tr>
<tr>
<td>IEC installed capacity less self-consumption</td>
</tr>
</tbody>
</table>

constitute part of the Company’s value-in-use nor part of the carrying amount as reported by the Company.

- **Interest rates and exchange rates** – these forecasts do not include assumptions on future changes in interest rates and exchange rates.

The electricity generation segment

General assumptions

- **Lack of full coverage in the electricity generation segment** – prior to the tariff update, the Company’s Management estimates that the full coverage assumption does not necessarily apply.
- **Coverage rates** – the Public Utilities Authority will determine coverage rates following the entry of independent power producers.
- **New production unit** – the Company estimates that its revenues from fuels due to the recognition of normative operation dates of production units will not be affected. This estimation is based on the assumptions that the Company is meeting normative operation dates in most cases and is coordinating new dates with the authorities due to exogenous delays.
- **Adjustments of pension revenues** – prior to the date of publication of the Public Utilities Authority’s final resolutions regarding pension, the recognized pension costs are as follows: old units receive tariff coverage in line with old actuarial estimates (prior to restatement). In the new units, the Public Utilities Authority does not provide tariff coverage for the pension costs of first-generation and second-generation employees due to free electricity, holiday gifts and third-generation bonuses, until the completion of the review of and final decision on the pension issue (by deducting the cost of normative pension, regardless of actuarial calculations for financial statements purposes). The wage costs included in the recognized operation costs, which were determined based on the Company’s costs in previous years, include the coverage of normative pension costs, in line with current actuarial assessments (following restatement). The Company’s Management estimates that the tariff coverage will cover the Company’s entire pension costs as reflected in the financial statements. Accordingly, the Company made the necessary adjustments in the revenue forecast vis-à-vis the pension coverage determined by the Public Utilities Authority.
3. Testing for Impairment of Cash-Generating Units

Projected income from the generation segment over the forecast years
Source: Management, tariff base provisions and EY analysis

<table>
<thead>
<tr>
<th>NIS millions</th>
<th>FY14</th>
<th>6mFY15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financing costs for active assets</td>
<td>1,485</td>
<td>640</td>
</tr>
<tr>
<td>Depreciation costs</td>
<td>2,086</td>
<td>976</td>
</tr>
<tr>
<td>Total income from capital services</td>
<td>3,571</td>
<td>1,616</td>
</tr>
</tbody>
</table>

- **Projected demand for electricity** – the projected demand for electricity is based on the Company’s current data, taking into account the dates of entry of independent power producers (hereinafter – “IPP”), climate and other trends, and the effect of economic forecasts.

- **Electricity purchases from independent producers** – the valuation does not include income and expenses in respect of electricity purchases from independent producers since the Company uses these transactions as a “channel” for the transfer of funds (timing differences are accounted for using regulatory assets).

Revenues

Income from capital services consist of return on equity, return on foreign capital for the financing of recognized assets and depreciation of recognized assets

**Adjustments to recognized assets** – the Company’s Management assumed additional recognition by the Public Utilities Authority only in circumstances where the Public Utilities Authority permits the Company to demand additional recognition. Below are the main adjustments made to recognized assets:

- Irregular costs incurred due to construction of production units, which are not included within the normative cost, will be recognized by the Public Utilities Authority, based on the Company’s calculation of expected value, the costs invested in the conversion of specific units to natural gas and connecting them to the gas pipeline will be adjusted and retroactively recognized, once the units start operating on natural gas.

- Liquidation reserves – assets created against the Company’s liabilities with respect to costs in old production units in Haifa and Reading (liquidation reserves) as well as a reserve for the liquidation of a smokestack in the Orot Rabin power plant, will be recognized by the Public Utilities Authority, since this is a statutory requirement.

- Investments in environmental projects – the costs of investing in environmental projects (such as the emissions reduction project) will be fully recognized by the Public Utilities Authority, since this is a statutory requirement.

- Consumer funding – in line with the provisions of the tariff base, the costs of depreciation and financing of special additions at the rate of 5%, which is attributed to the generation segment and charged in the period between 9.9.2007 and 8.7.2008, should be deducted from the cost of active assets, in accordance with the Public Utilities Authority’s resolution.
3. Testing for Impairment of Cash-Generating Units

Recognized operating costs over the forecast years

<table>
<thead>
<tr>
<th>Currency: NIS millions</th>
<th>FY14</th>
<th>6mFY15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recognized operating costs</td>
<td>2,385</td>
<td>1,088</td>
</tr>
</tbody>
</table>

Income from fuels, income from coverage of allowed operating expenses due to entry of PEP and other income over the forecast years

<table>
<thead>
<tr>
<th>Currency: NIS millions</th>
<th>FY14</th>
<th>6mFY15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fuel basket costs</td>
<td>7,967</td>
<td>3,723</td>
</tr>
<tr>
<td>Working capital – fuel inventory</td>
<td>108</td>
<td>50</td>
</tr>
<tr>
<td>Working capital trade receivable – fuels</td>
<td>34</td>
<td>16</td>
</tr>
<tr>
<td>Profit (loss) from fuels</td>
<td>145</td>
<td>73</td>
</tr>
<tr>
<td>Total income from fuels</td>
<td>8,254</td>
<td>3,862</td>
</tr>
<tr>
<td>Income from coverage of allowed operating expenses due to entry of PEP</td>
<td>345</td>
<td>223</td>
</tr>
<tr>
<td>Other income</td>
<td>134</td>
<td>62</td>
</tr>
</tbody>
</table>

Recognized rate of return – in line with the tariff for the generation segment, the breakdown of funding of recognized assets is 1/3 shareholders’ equity and 2/3 foreign capital. The recognized rate of return is the gross rate of return (before tax). The Company assumes full collection of the recognized cost of capital services in the electricity generation segment in the forecast years.

Recognized operating costs

The recognized operating costs were adjusted, in line with the provisions of the tariff base for the generation segment, based on the updated production forecast as submitted by the Company, plus a streamlining coefficient of 2%, in line with the provisions of the generation segment tariff. Following the entry of IPPs, this component is expected to decrease throughout the forecast period (see section on revenues from IPP back-up tariffs).

Income from fuels

Profit from the disposal of diesel oil inventory – according to Company Management, there is expected to be a gap between the recognized diesel oil and its carrying value at the valuation date.

Cost of fuel basket – according to the provisions of the tariff base, the Company’s fuel expenses are fully covered.

Working capital – fuel inventory – was calculated in line with the provisions of the tariff base. The income is used to cover the cost of maintaining the fuel inventory.

Working capital trade receivable – fuels – was calculated in line with the provisions of the tariff base. The income is the reimbursement for the fuel component in customer credit.

Income from coverage of allowed operating expenses due to entry of PEP

According to Company Management, in line with the Public Utilities Authority’s resolution dated May 6, 2013, with regard to setting an effective date for backup and related services rates, the Public Utilities Authority is expected to determine backup tariffs that will apply retroactively from June 1, 2013 on all the consumers in the country. The Company estimates an addition to the fixed recognized operating costs in the generation segment, so that the recognized income in respect of these costs will not decrease as a result of the entry of independent power producers. According to Management’s assumptions and the Public Utilities Authority’s provisions, the expected addition to the fixed recognized operating costs from the backup tariff for the forecast years was calculated as follows:

- Calculation of recognized operating cost per kilowatt/hour.
- Calculation of the decrease in production, in line with Company’s assumptions.
- Calculation of the addition in respect of the fixed costs – as of the valuation date, the fixed costs to total operating expenses rate was provided by Management.
3. Testing for Impairment of Cash-Generating Units

Projected expenses in the generation segment over the forecast years

Source: Management

<table>
<thead>
<tr>
<th>Currency: NIS millions</th>
<th>FY14</th>
<th>6mFY15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fuel basket costs</td>
<td>(7,967)</td>
<td>(3,723)</td>
</tr>
<tr>
<td>Total operating costs</td>
<td>(2,565)</td>
<td>(1,324)</td>
</tr>
<tr>
<td>Investment in power plants under construction</td>
<td>(162)</td>
<td>(98)</td>
</tr>
<tr>
<td>Cyclic renovations</td>
<td>(162)</td>
<td>(122)</td>
</tr>
<tr>
<td>Depreciation expenses</td>
<td>(2,187)</td>
<td>(1,067)</td>
</tr>
<tr>
<td>Total expenses</td>
<td>(13,043)</td>
<td>(6,334)</td>
</tr>
<tr>
<td>Operating profit</td>
<td>1,646</td>
<td>517</td>
</tr>
</tbody>
</table>

Projected and investment and changes in working capital in the generation segment over the forecast years

Source: Management

<table>
<thead>
<tr>
<th>Currency: NIS millions</th>
<th>FY14</th>
<th>6mFY15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investments in projects under construction</td>
<td>(104)</td>
<td>(106)</td>
</tr>
<tr>
<td>Investments in environmental projects</td>
<td>(1,412)</td>
<td>(633)</td>
</tr>
<tr>
<td>Conversions to gas</td>
<td>(30)</td>
<td>-</td>
</tr>
<tr>
<td>Investments in shared assets newly installed computer systems</td>
<td>(303)</td>
<td>(136)</td>
</tr>
<tr>
<td>Other investments</td>
<td>(140)</td>
<td>(205)</td>
</tr>
<tr>
<td>Total investments in fixed assets</td>
<td>(1,989)</td>
<td>(1,080)</td>
</tr>
<tr>
<td>Changes in working capital</td>
<td>883</td>
<td>132</td>
</tr>
</tbody>
</table>

Other income

Other income includes, among others, sales of vehicles, inventory, working capital and trade receivable.

Expenses

Information on expenses for the forecast years was furnished by the Company and included fuel expenses and operating expenses. Operating expenses include direct and indirect operating expenses and current investments.

Taxes on income

A theoretical tax expense at the statutory tax rate was assumed throughout the forecast period in order to estimate the free cash flow after tax.

Investments

- Investments in projects under construction – an investment for an additional steam unit in the Eshkol Site.
- Investment in the environmental projects – investments in projects for the reduction of emissions in coal plants in the Rotenberg and Orot Rabin sites.
- Conversions to natural gas – investments in connecting power plants to Israeli Gas Lines Ltd. in the Orot Rabin Site and in conversions to natural gas at the Hagit Site.
- Investments in shared assets and in newly installed computer systems – investments in assets that are shared by all the Israel Electric Corporation’s units, as well as investments in computer systems shared by all the Israel Electric Corporation’s units, which have not yet been operated as of the valuation date.
- Other investments – investments in completion works in operating units as of the valuation date.

Changes in working capital

Trade receivable – according to the Company’s assumptions, the balance of trade receivable is determined based on Company projections, and based on the historical number of days account receivable and the balance of operating trade receivables (net of overdue accounts receivable) as a percentage of annual turnover. The decrease in this balance primarily stems from the entry of IPPs and the decline in revenues from the electricity generation segment as a consequence.

Fuel inventory – the Company assumes a decrease in diesel oil and fuel oil inventories as a result of the expanded use of natural gas; other working capital balances remain constant on an annual level over the forecast period.
3. Testing for Impairment of Cash-Generating Units

<table>
<thead>
<tr>
<th>Currency: NIS millions</th>
<th>30.6 2015 onward</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residual value of recognized assets</td>
<td>28,461</td>
</tr>
<tr>
<td>Residual value of other operating balances</td>
<td>5,073</td>
</tr>
</tbody>
</table>

June 30, 2015 and thereafter

- As aforesaid, the Company assumes that once the tariff base is updated, the Company’s operating expenses, fixed assets and future investments will be fully covered, as of the date of the tariff adjustment.
- Discount rate – in line with the full coverage assumptions, it was assumed that the rate of returned to be determined by the Public Utilities Authority and the rate of discount of cash flows in the model would be equal. Accordingly, the estimated carrying amount of the assets at June 30, 2015 reflects its recoverable amount.
- Residual value of other operating balances
  - Working capital – according to the Company’s assumptions, operating current assets, except for trade receivable, will remain constant over the years. Given the full coverage assumption, it is assumed that the carrying amount of the working capital, net is its recoverable amount.
  - Residual value of joint assets – according to the Company’s assumptions, the balance of joint assets, including investment therein during the forecast period, should be added as residual value for the purpose of implementing the full coverage assumption.
  - Future income from the sale of lands that are not part of the activity – according to the Company’s assumption, future income from the sale of non-active lands should not be taken into account (since the Company believes that the Public Utilities Authority will include this consideration in the calculation of the tariff).

Discount rate

The calculation of the weighted cost of capital was based, among others, on the fair value of the total financial liabilities of the Company as of December 31, 2013 (except for those used to finance the fuel crisis in 2012, backed by Government guarantees) in line with the Company’s assumptions. As aforesaid, the discount rate after tax for the generation segment was estimated at 4.7% (rounded). This discount rate reflects a pre-tax discount rate of 5.8% (rounded). For additional details see Appendix C and Table D below.

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11 In order to estimate the pre-tax discount rate, in line with accepted practice, a model without tax expenses was built by resetting tax expenses to zero and striving to a discount rate so that the value in use in both models (a model with tax expenses and one without tax expenses) will be equal.
3. Testing for Impairment of Cash-Generating Units

### Excess operating assets, net

<table>
<thead>
<tr>
<th>Currency: NIS millions</th>
<th>FY14</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other operational assets, net</td>
<td>261</td>
</tr>
</tbody>
</table>

### Carrying amount of the electricity chain at the valuation date

<table>
<thead>
<tr>
<th>Currency: NIS millions</th>
<th>Transmission segment</th>
<th>Distribution segment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed assets in use, net</td>
<td>12,715</td>
<td>19,373</td>
</tr>
<tr>
<td>Fixed assets under construction</td>
<td>1,616</td>
<td>391</td>
</tr>
<tr>
<td>Other fixed assets</td>
<td>206</td>
<td>313</td>
</tr>
<tr>
<td>Working capital, net</td>
<td>4</td>
<td>(307)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>14,541</strong></td>
<td><strong>19,770</strong></td>
</tr>
</tbody>
</table>

Other operational assets, net

- **Rogozin Land** – according to Company Management, this land is included in the assets of the generation segment and the Company plans to build a production unit on it in the future. The value of the land was reported by the Company and is based on independent appraisal.

- **Project D** – according to Management’s assumption, the expected cash flows from this project will not be less than its carrying amount as of the valuation date. Therefore, for valuation purposes, the carrying amount is added to the value in use.

The Segments of the Electricity Chain

General assumptions

Management estimates that the tariff base for the electricity chain will come into force retroactively on April 1, 2012 (in line with the Public Utilities Authority’s resolution in Meeting 367 dated March 22, 2012). Management assumes that the net balance of assets on the tariff adjustment date will be covered in the tariff.

As aforesaid, pursuant to the provisions of the Electricity Sector Law, the Company assumes that once the tariff base is updated, the Company’s operating expenses, fixed assets and future investments will be fully covered, as of the date of the adjusted tariff, which is March 31, 2012, with respect to the different segments. Therefore, under the Company’s assumptions, the carrying amount reflects its recoverable amount. The composition of the carrying amount of the electricity chain’s segments at the valuation date is presented to the left.
Recoverable amount

In line with the aforementioned assumptions, the recoverable amount of the cash-generating unit is NIS 68,599 million, as follows:

<table>
<thead>
<tr>
<th>Currency: NIS millions</th>
<th>Recoverable amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recoverable amount of the generation segment</td>
<td>34,288</td>
</tr>
<tr>
<td>Recoverable amount of the transmission segment</td>
<td>14,541</td>
</tr>
<tr>
<td>Recoverable amount of the distribution segment</td>
<td>19,770</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>68,599</strong></td>
</tr>
<tr>
<td><strong>Carrying amount</strong>&lt;sup&gt;12&lt;/sup&gt;</td>
<td><strong>68,464</strong></td>
</tr>
</tbody>
</table>

Sensitivity analyses

For the purpose of testing the sensitivity of the recoverable amount, we conducted a sensitivity analysis for the discount rate of the generation segment:

<table>
<thead>
<tr>
<th>Discount rate (%)</th>
<th>4.3%</th>
<th>4.5%</th>
<th>4.7%</th>
<th>4.9%</th>
<th>5.1%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Change in value-in-use (NIS millions)</td>
<td>187</td>
<td>93</td>
<td>-</td>
<td>(93)</td>
<td>(185)</td>
</tr>
</tbody>
</table>

<sup>12</sup> The carrying amount was submitted by the Company’s management. For details see Table C-2
Appendixes

Appendix A – General approach to impairment testing
Appendix B – Valuation methods
Appendix C – Discount rate and pre-tax discount rate
Appendix D – Restrictive conditions
Appendix E – Details of the appraiser
Appendix A — General Approach to Impairment Testing

Impairment of Assets

Background

IAS 36 has prescribed rules that an entity has to implement in order to ensure that the carrying amount of its assets do not exceed their recoverable amount. An asset is stated at an amount higher than its recoverable amount when its carrying amount exceeds the amount to be received from use or sale of the asset. In this case, the asset has been impaired and the standard requires the entity to recognize an impairment loss.

Definitions

Below are the definitions used by IAS 36 and their meaning:

- Carrying amount – the amount at which the asset is recognized after deducting accumulated depreciation and accumulated impairment losses.
- Cash-generating unit – the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or other groups of assets.
- Value in use – the present value of future cash flows, which are expected to be generated from an asset or from a cash-generating unit.
- Fair value less costs to sell – the amount that obtainable from the sale of an asset or cash-generating unit between a willing buyer and a willing seller in an arm’s length transaction, wherein the parties had acted knowledgably, less costs to sell.
- Recoverable amount – the amount of an asset or a cash-generating unit, which is the higher of its fair value less costs to sell and its value in use.

Timing of impairment testing

At the end of each reporting period, an entity is required to assess whether there is any indication that an asset may be impaired. If such indication exists, the entity is required to estimate the assets’ recoverable amount.

Regardless of an indication of impairment, the entity must also:

A. Once a year, carry out impairment testing for intangible assets with an indefinite useful life or intangible assets not yet available for use, by comparing their carrying amount to their recoverable amount. Such impairment testing may be conducted at any time during the year, as long as it is carried out on the same date each year. Impairment of different intangible assets may be tested on different dates. However, if such intangible asset was initially recognized during
the current annual period, it will be tested for impairment prior to the end of the current annual period.

B. Once a year, carry out impairment testing of goodwill acquired in a business combination.

Indications of impairment of an asset

For the purpose of determining whether impairment indications exist for an asset, the entity must consider the following indicators:

External sources of information:

- During the period there has been a significant, more-than-projected decline in the market value of the asset as a result of the passage of time or ordinary use.
- Significant changes with negative impact on the entity have taken place during the period or will occur in the near future, in the technological, marketing, economic or legal environment in which the entity operates, or in the market to which the asset is designated.
- During the period there has been an increase in interest rates or other rates of return in the market and it is likely that these increases will affect the discount rate, which is used to calculate the value-in-use of the asset and will materially decrease the recoverable amount of the asset.
- The net carrying amount of the entity’s assets exceeds the entity’s market capitalization.

Internal sources of information:

- There is available evidence of ageing or physical damage to the asset.
- Significant changes of negative impact in the entity have taken place during the period or are likely to occur in the near future, in the scope or manner in which the asset was used or is likely to be used. Such changes include discontinued use of the asset, plans to discontinue operation or carry out a structural change in the operation, to which the asset belongs, plans to dispose of the asset prior to the projected date and re-assessment of the useful life of the asset as definite rather than indefinite.
- There is available evidence from the internal reporting system that the economic performance of the asset is, or will be, worse then predicted.
Recoverable amount

The standard defines recoverable amount as the higher of the fair value less costs to sell of an asset or a cash-generating unit and its value in use.

It is not always necessary to determine both the fair value less costs to sell of the asset and its value in use. If one of these amounts exceeds the carrying amount of the asset, the asset has not been impaired and the other amount need not be estimated.

It may be possible to determine fair value less costs to sell, even if the asset is not traded in an active market. However, sometimes it is not possible to determine fair value less costs to sell, since there is no basis for reliable estimation of the consideration from the sale of the asset in an arm’s length transaction between a willing buyer and a willing seller, acting knowledgably. In this case, the entity may use the value-in-use of the asset as its recoverable amount.

The recoverable amount is determined for a single asset, unless this asset does not generate cash inflows that are largely independent of the cash inflows from other assets or other groups of assets. If this is the case, the recoverable amount will be determined for the cash-generating unit to which the asset belongs.

Fair value less costs to sell

The best evidence of fair value less costs to sell of an asset is the price determined in a binding agreement in an arm’s length transaction, in respect of incremental costs that can be directly attributable to the sale of the asset.

When there is no binding agreement or an active market for the asset, the fair value less costs to sell is based on the best available information, in order to reflect the proceeds that an entity could have received, at the balance sheet date, if the asset were sold in an arm’s length transaction between a willing buyer and a willing seller, acting knowledgably, after deducting costs to sell. In determining this amount, an entity takes into account the results of transactions recently carried out in similar assets in the same industry.

If there is no reason to believe that the value-in-use of an asset materially exceeds its fair value less costs to sell, the fair value of the asset less cost to sell may be used as its recoverable amount. Often, this is the case when the asset is designated for sale. This is because the value-in-use of asset designated for sale is mainly based on the net consideration from the sale, since it is reasonable that the future cash flows from the continued use of the asset until it is sold, are negligible.
The following components are included in the calculation of the value in use:

- The estimated future cash flows than the entity expects to derive from the asset.
- Expectations about possible variations in the amount or timing of those future cash flows.
- The time value of money, represented by the current market risk-free rate of interest.
- The price for bearing the uncertainty inherent in the asset.
- Other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.

Estimation of the value in use of an asset includes the following stages:

- Estimating the future cash flows, both positive and negative, that will derive from continued use of the asset and disposal thereof.
- Use of a proper discount rate for these future cash flows.

In measuring the value-in-use, the entity shall:

- Base the cash flow forecasts on reasonable, supportable assumptions that represent Management’s best estimate of the set of economic conditions that will exist over the useful life of the asset.
- Base the cash flow forecasts on the most updated, budgets/financial projections, which were approved by Management. Forecasts, which are based on such budgets/projections, will cover a maximum period of 5 years, unless a longer period can be justified.
- Estimate the cash flow forecasts for the period, beyond the period covered by the most updated budgets/projections, by using a permanent or declining growth rate for subsequent years.

Future estimated cash flows should include:

- Cash inflows from the continued use of the asset.
- Cash outflows that will necessarily take place in order to generate cash inflows from the continued use of the asset (including cash outflows in preparing the asset for use), which can be directly attributed, or reasonably and consistently allocated to the asset.
- Net cash flows, if any, that will be received (or paid) when the asset is disposed of at the end of its useful life.
Future estimated cash flows shall not include inflows or outflows that may arise from:

- A future structural change that the entity is not committed to make
- Improvement or increase in the asset's performance

Future estimated cash flows shall not include:

- Inflows or outflows from financing activities
- Tax expenses or receipts on income

Future cash flows are estimated in the currency in which they are generated and are subsequently discounted using the proper discount rate for this currency. The entity translates the present value according to the exchange rate on the date of calculation of the value in use.

Discount rate

The discount rate should be the pre-tax rate that reflects current market assessment of:

- The time value of money
- The risks specific to the asset, in respect of which the estimated future cash flows were not adjusted

Recognition and measurement of impairment loss

The carrying amount of the asset should be reduced to its recoverable amount, if and only if, the recoverable amount of the asset is lower than its carrying amount. This reduction constitutes an impairment loss.

An impairment loss for a cash-generating unit (the smallest group of cash-generating units to which goodwill was allocated), if and only if, the recoverable amount of the unit (or group of units) is lower than its carrying amount.

Identification of the cash-generating unit to which the asset belongs

If there is any indication that an asset has been impaired, the recoverable amount of the asset should be calculated. If the recoverable amount of the single asset cannot be estimated, the entity must calculate the recoverable amount of the cash-generating unit to which the asset belongs.

Cash-generating units should be consistently identified from one period to another with the same assets or types of assets, unless a change is justified.
For the purpose of impairment testing, goodwill acquired in a business combination will be allocated from the date of acquisition to each of the buyer's cash-generating units or groups of cash-generating units, which are predicted to benefit from the synergy of the business combination, regardless of whether other assets or other liabilities of the acquired entity were allocated to these units or groups of units. Each unit or group of units to which goodwill is allocated as aforesaid, represents the lowest level in the entity which monitors goodwill for internal Management purposes.
Appendix B

Appendix B – Valuation Approaches

General Review

The valuation of a recoverable amount of an asset is based on the proper implementation of each of the three approaches: the Income Approach, the Market/Comparative Approach and the Cost Approach. Although each of the three approaches should be considered in the valuation, the nature of the assets and the availability of the information will dictate which approach, or approaches, should be selected in order to best assess the recoverable amount of the cash-generating unit.

Market Approach

The market approach uses prices and other relevant information generated by market transactions involving identical or comparable (similar) assets. That is, the value of an asset is measured based on the price paid by other buyers for comparable assets. Once information is collected, adjustments are made to these assets so they can adequately reflect the condition and manner of use of the assessed asset relative to similar assets in the market. Applying the market approach provides a price that is reasonably expected to be generated by the sale of the asset.

Income Approach

The income approach focuses on the ability to generate revenues from the identifiable asset. The underlying assumption of this approach is that the value of an asset is measurable by the present value of the net economic benefit (cash inflow against cash outflow) provided throughout the life of the asset. The measures involved in this approach include an assessment of the projected cash flows after tax, and the conversion of these cash flows to present value using a discount rate. The discount rate takes into account both the time value of money and the business risk. Finally, the present value of future cash flows after tax provides an indication of the fair value.

Cost Approach

The cost approach is based on the assumption that an informed purchaser would pay no more for a property than the cost of producing a substitute property with similar characteristics as the subject property. According to this approach, the asset is assessed based on the expected cost for substituting this asset with another. The cost of substituting the asset with a new one is estimated less depreciation which reflects functional of economic obsolescence. This approach is applied to assets the replacement of which with similar or identical assets is relatively simple.
Appendix C

Appendix C – Discount Rate and Pre-Tax Discount Rate

Risk and Uncertainty

The implementation of cash flow discounting methods requires setting an appropriate discount rate. Cash flow discounting methods are applied under conditions of uncertainty. Widely used, the word risk refers to any exposure to a situation of uncertainty, where exposure has a negative result. The assumption is that market participants are risk averse. A risk-loving market participant prefers a narrow range of uncertainty over a wider range of uncertainty in relation to an expected result. Market participants seek compensation, called “risk premium”, in return for uncertainty.

Therefore, setting a discount rate implies a comparison between the cash flows generated by an asset and the cash flows generated by the most preferable alternative investments. In this connection, note that the cash flows generated by the appraised asset and the alternative investments are equal in terms of risk and settlement dates.

Setting an risk-adjusted asset-specific discount rate is based on the Weighted Average Cost of Capital (WACC). The following formula is used to calculate the WACC:

\[ WACC = W_E \times K_E + W_D \times K_D \]

Where:
- \( W_E \) - Market value of the firm’s equity / market value of capital
- \( K_E \) - Required return on equity
- \( W_D \) - Market value of interest-bearing debt
- \( K_D \) - Required return on debt, after tax

Since the WACC reflects the risk specific to the industry, adjustments should be made that are based on the specific asset.

Required return on equity

In order to assess the cost of capital the CAPM model is applied. The CAPM assumes that the cost of capital equals the rate on a risk-free security plus a risk premium. The risk premium is the Company’s systemic risk (beta) multiplied by the market risk premium plus specific risks.
The following formula is used to calculate the required return on equity:

\[ K_E = RF + \beta \times MRP + SRP \]

Where:
- \( K_E \) = The required rate of return on equity
- \( RF \) = Risk-free interest rate
- \( \beta \) = The Company’s systemic risk
- \( MRP \) = Market risk premium
- \( SRP \) = Specific risk premium

The starting point for estimating the required rate of return on equity is a risk-free interest. It is customary to use the interest rate of a risk-free long-term investment, for instance, public debts with a fixed interest rate, to determine the risk-free interest rate.

The market risk premium (price of risk) is the difference between the expected rate of return on a portfolio and the risk-free interest rate. A historical review of the market shows that investment in stocks creates a return that is 4%-7% higher than investment in low-risk securities.

The average market risk premium should be adjusted to reflect the specific risk structure. The CAPM model takes into account the firm’s specific risk within the beta. The beta represents the sensitivity of a firm’s stock returns to the overall market risk. In fact, the beta is a tool for measuring the volatility of systemic risk. A beta greater than 1 reflects higher volatility; a beta less than 1 reflects smaller volatility than the market’s average. The beta is determined in relation to the overall market, since systemic risk and specific risk require that a single stock be measured in relation to the market portfolio.

In a situation where activities in different countries are taken into account is may be more appropriate to use a country-specific risk premium.

**Pre-tax Discount Rate**

According to IAS 36, estimated future cash flows do not include tax payments or tax receipts on income. Therefore, the discount rate has to be pre-tax. Theoretically, discounting post-tax cash flows using a post-tax discount rate and discounting pre-tax cash flows using a pre-tax discount rate should provide an identical result, as long as the pre-tax discount rate equals the post-tax discount rate, adjusted to reflect the specific amount and timing of future cash flows in respect of taxes. The pre-tax discount rate is not always equal to the post-tax discount rate, using a standard tax rate.
Below is model estimating the value in use of the generation segment without tax expenses and using a pre-tax discount rate:

<table>
<thead>
<tr>
<th></th>
<th>FY14</th>
<th>6mFY15</th>
<th>Residual value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total income from capital services</td>
<td>3,571</td>
<td>1,616</td>
<td>28,461</td>
</tr>
<tr>
<td>Recognized operating costs</td>
<td>2,385</td>
<td>1,088</td>
<td></td>
</tr>
<tr>
<td>Total income from fuels</td>
<td>8,254</td>
<td>3,862</td>
<td></td>
</tr>
<tr>
<td>Income from coverage of allowed operating expenses due to entry of PEP</td>
<td>345</td>
<td>223</td>
<td></td>
</tr>
<tr>
<td>Other income</td>
<td>134</td>
<td>62</td>
<td></td>
</tr>
<tr>
<td>Total income from generation segment</td>
<td>14,689</td>
<td>6,851</td>
<td></td>
</tr>
<tr>
<td>Total expenses</td>
<td>(13,043)</td>
<td>(6,334)</td>
<td></td>
</tr>
<tr>
<td>Operating profit</td>
<td>1,646</td>
<td>517</td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>2,187</td>
<td>1,067</td>
<td></td>
</tr>
<tr>
<td>EBITDA</td>
<td>3,833</td>
<td>1,584</td>
<td></td>
</tr>
<tr>
<td>Total investments in fixed assets</td>
<td>(1,989)</td>
<td>(1,080)</td>
<td></td>
</tr>
<tr>
<td>Changes in working capital</td>
<td>883</td>
<td>132</td>
<td></td>
</tr>
<tr>
<td>Residual value of other operating balances</td>
<td>5,073</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Free cash flow</td>
<td>2,727</td>
<td>636</td>
<td>33,534</td>
</tr>
<tr>
<td>Discounted cash flow</td>
<td>2,650</td>
<td>592</td>
<td>30,785</td>
</tr>
<tr>
<td>Other operational assets, net</td>
<td>261</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total value in use</td>
<td>34,288</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The following table displays the impacts on CGU's value in use of key assumptions mentioned in chapter 3:

<table>
<thead>
<tr>
<th>Assumption</th>
<th>Influence direction</th>
<th>Possible impact on value in use</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-recognition of investment cost in environmental projects</td>
<td>(-)</td>
<td>approx. NIS 4.4 billion</td>
</tr>
<tr>
<td>Non-recognition of investment cost in gas conversions</td>
<td>(-)</td>
<td>approx. NIS 153 million</td>
</tr>
<tr>
<td>Changes in assumptions regarding income from coverage of allowed operating expenses due to entry of PEP (5% change in recognized fixed expenses rate)</td>
<td>(+/-)</td>
<td>approx. NIS 25 million</td>
</tr>
<tr>
<td>Non-recognition of exceptional construction costs in &quot;new&quot; units</td>
<td>(-)</td>
<td>approx. NIS 275 million</td>
</tr>
<tr>
<td>Non-recognition of regulatory required costs related to Haifa and Reading</td>
<td>(-)</td>
<td>approx. NIS 355 million</td>
</tr>
<tr>
<td>Non realization of fuel profit forecast in 2014-2015</td>
<td>(-)</td>
<td>approx. NIS 211 million</td>
</tr>
<tr>
<td>Non realization of other income from spare parts in the generation segment</td>
<td>(-)</td>
<td>approx. NIS 42 million</td>
</tr>
<tr>
<td>Non-recognition of full pension costs for &quot;new&quot; units in the generation segment</td>
<td>(-)</td>
<td>approx. 136 million</td>
</tr>
<tr>
<td>Change in forecasted demand for electricity in 214-2015 (1% change)</td>
<td>(+/-)</td>
<td>approx. NIS 28 million</td>
</tr>
<tr>
<td>Using a single WACC in estimating the value in use (4.74%) calculated by using a sample of vertical companies</td>
<td>(-)</td>
<td>approx. NIS 37 million</td>
</tr>
</tbody>
</table>
Appendix E – Limitations

General limitations to our engagement

1. Subject to the other limitations set forth below, nothing has come to our attention to cause us to believe that the facts and data set forth in this Report are not correct.

2. This Report is based on, and limited to, our knowledge and experience with the valuation and other issues addressed herein. We did not conduct an audit, review or compilation of any historical or prospective financial information included in this Report in accordance with accounting standards. Accordingly, we do not express an opinion or offer any form of assurance as to such information. This Report is not a fairness opinion, investment advice, or legal advice. This Report is not intended to be used, and neither you nor any other taxpayer may use it, to avoid penalties that may be imposed under applicable tax laws.

3. We did not investigate title to the business or assets the subject of this Report. We have relied on representations of the owner with respect thereto and we may assume that (i) title is good and marketable, (ii) the business or assets are not subject to any liens or encumbrances, (iii) there is full compliance with all applicable laws and regulations (including, without limitation, those relating to usage, environmental, zoning and similar requirements), and (iv) all licenses, certificates of occupancy, consents, and legislative or administrative permits from any governmental authority or agency, private entity or organization required for any use of the property relating in any way to this Report or the services underlying it have been or can be obtained or renewed. We assume no responsibility for any legal description of any property.

4. This Report has been prepared solely for the purpose set forth in the applicable Statement of Work and may not be used for any other purpose. Neither this Report, nor any portion, abstract or summary hereof, may be disclosed publicly through any other public (or private) media without our prior written consent.

5. Our recommendations of fair value are as of the effective date specifically set forth in this Report. Changes in market conditions could result in substantially different valuations than those indicated at the effective date. We assume no responsibility for changes in market conditions after the effective date and we have no obligation to update the Report, or our recommendations, analyses, conclusions or other documents relating to our services after the effective date for any reason.

6. We assume no responsibility for the inability of the owner to locate a purchaser for its business or assets at the value set forth in this Report.
7. We have been provided with written and oral information, as well as data in electronic form, relating to the business or assets that we analyzed. We have relied upon this information to prepare this Report and have no responsibility to verify independently its accuracy or completeness. We assume no responsibility for the completeness or accuracy of information furnished by others, including your Management.

8. We may have derived certain historical financial data used in our valuation from audited and/or unaudited financial statements, which are the responsibility of Management. Financial statements may include disclosures required by generally accepted accounting principles. We have not verified independently the accuracy or completeness of the data we derived and do not express an opinion or offer any form of assurance as to it or the underlying financial statements.

9. The estimates of cash flow data included herein are solely for use in the valuation analysis and are not intended for use as forecasts or projections of future operations. We have not performed an examination or compilation, nor have we performed an agreed-upon procedures engagement, with respect to the cash flow data in accordance with any accounting standards, and, accordingly, do not express an opinion or offer any form of assurance as to that data or their underlying assumptions. Furthermore, estimated and actual results will usually differ because events and circumstances frequently do not occur as expected, and those differences may be material.

10. We assume no responsibility for any financial or tax reporting judgments, which are the responsibility of Management.

11. We are not required to furnish additional work or services, or to give testimony, or be in attendance in court with reference to the business or assets we analyzed or this Report.

12. We have not made any determination whether there have been any violations of fraud and abuse laws or regulations or any other law. We assume no responsibility to provide any legal advice and recommend that you consult your legal counsel with respect to legal matters.
Appendix F – Details of the Appraiser

Alon Lugassi, Partner, Head of the Economic Division

Alon Lugassi is a partner that manages the economic division of Ernst & Young Haifa, with 14 years of experience in the firm. Alon has a BA in economics, business administration and accounting from the Haifa University and an MBA from the Haifa University. Alon specializes in valuations, accounting audits, pricing and managerial accounting, transaction support, financial counselling, due diligence, business development and government incentives. Alon is a senior lecturer on financial issues, among others, in the CFO forum, the Israel Manufacturers Association and the Institute of Certified Public Accountants and was a lecturer in financial Management courses as part of the Haifa University MBA program.
Tables

Table A – Historical data – profit and loss
Table B – Historical data – balance sheet
Table C – Recoverable amount recommendation
Table D – WACC calculation
## Table A – Historical Data – Profit and Loss

<table>
<thead>
<tr>
<th>Currency: NIS millions</th>
<th>2011(*)</th>
<th>2012(*)</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenues</strong></td>
<td>25,386</td>
<td>28,320</td>
<td>27,656</td>
</tr>
<tr>
<td><strong>Cost of operating the electricity system</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wages</td>
<td>(1,743)</td>
<td>(2,366)</td>
<td>(1,938)</td>
</tr>
<tr>
<td>Fuels</td>
<td>(13,151)</td>
<td>(19,910)</td>
<td>(10,962)</td>
</tr>
<tr>
<td>Transfer of regulatory asset to fuels</td>
<td>-</td>
<td>5,269</td>
<td>(4,333)</td>
</tr>
<tr>
<td>Purchases of electricity</td>
<td>(486)</td>
<td>(879)</td>
<td>(1,006)</td>
</tr>
<tr>
<td>Transfer of regulatory asset to electricity purchases</td>
<td>-</td>
<td>-</td>
<td>(311)</td>
</tr>
<tr>
<td>Operation of the generation system</td>
<td>(779)</td>
<td>(841)</td>
<td>(709)</td>
</tr>
<tr>
<td>Operating of the transmission and distribution system</td>
<td>(372)</td>
<td>(307)</td>
<td>(335)</td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>(4,354)</td>
<td>(4,414)</td>
<td>(4,662)</td>
</tr>
<tr>
<td>Provision</td>
<td>129</td>
<td>6</td>
<td>-</td>
</tr>
<tr>
<td><strong>Profit from operating the electricity system</strong></td>
<td>4,630</td>
<td>4,878</td>
<td>3,400</td>
</tr>
<tr>
<td>Sales and marketing expenses</td>
<td>(910)</td>
<td>(1,067)</td>
<td>(905)</td>
</tr>
<tr>
<td>Administrative and general expenses</td>
<td>(739)</td>
<td>(871)</td>
<td>(1,113)</td>
</tr>
<tr>
<td>Expenses for liabilities to pensioners, net</td>
<td>(155)</td>
<td>(1,547)</td>
<td>(20)</td>
</tr>
<tr>
<td><strong>Income from current operations</strong></td>
<td>2,826</td>
<td>1,393</td>
<td>1,362</td>
</tr>
<tr>
<td>Financing expenses, net</td>
<td>(2,260)</td>
<td>(2,691)</td>
<td>(2,170)</td>
</tr>
<tr>
<td><strong>Profit (loss) before income taxes</strong></td>
<td>566</td>
<td>(1,298)</td>
<td>(808)</td>
</tr>
<tr>
<td>Taxes on income</td>
<td>(1,399)</td>
<td>294</td>
<td>(126)</td>
</tr>
<tr>
<td>Company's share in the profits of associates, net</td>
<td>-</td>
<td>-</td>
<td>(2)</td>
</tr>
<tr>
<td><strong>Profit (loss) for the year</strong></td>
<td>(833)</td>
<td>(1,004)</td>
<td>(936)</td>
</tr>
<tr>
<td>Other comprehensive income (loss) for the period, after tax</td>
<td>(627)</td>
<td>(786)</td>
<td>280</td>
</tr>
<tr>
<td><strong>Total comprehensive loss for the year</strong></td>
<td>(1,460)</td>
<td>(1,790)</td>
<td>(656)</td>
</tr>
</tbody>
</table>

Source: unaudited consolidated financial statements of the IEC for the year ended December 31, 2013

(*) retroactive implementation of IAS 19 (2011)
### Table B – Historical Data – Balance Sheet

<table>
<thead>
<tr>
<th>Currency: NIS millions</th>
<th>Dec 2012 (*)</th>
<th>Dec 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and cash equivalents</td>
<td>4,226</td>
<td>3,401</td>
</tr>
<tr>
<td>Short-term investments</td>
<td>-</td>
<td>493</td>
</tr>
<tr>
<td>Trade receivable for sales of electricity</td>
<td>4,127</td>
<td>4,345</td>
</tr>
<tr>
<td>Other current assets</td>
<td>539</td>
<td>377</td>
</tr>
<tr>
<td>Inventory – fuel</td>
<td>2,681</td>
<td>1,067</td>
</tr>
<tr>
<td>Inventory – stores</td>
<td>149</td>
<td>144</td>
</tr>
<tr>
<td>Regulatory assets, net</td>
<td>3,325</td>
<td>2,972</td>
</tr>
<tr>
<td><strong>Total current assets</strong></td>
<td><strong>15,047</strong></td>
<td><strong>12,799</strong></td>
</tr>
<tr>
<td>Inventory – fuel</td>
<td>-</td>
<td>1,736</td>
</tr>
<tr>
<td>Long-term receivables</td>
<td>1,049</td>
<td>1,176</td>
</tr>
<tr>
<td>Investment in an investee company</td>
<td>-</td>
<td>98</td>
</tr>
<tr>
<td>Regulatory assets</td>
<td>4,875</td>
<td>696</td>
</tr>
<tr>
<td>Assets with respect to benefits after employment termination</td>
<td>3,155</td>
<td>3,748</td>
</tr>
<tr>
<td>Fixed assets, net</td>
<td>64,673</td>
<td>64,721</td>
</tr>
<tr>
<td>Intangible assets, net</td>
<td>921</td>
<td>948</td>
</tr>
<tr>
<td><strong>Total non-current assets</strong></td>
<td><strong>74,673</strong></td>
<td><strong>73,125</strong></td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td><strong>89,720</strong></td>
<td><strong>85,924</strong></td>
</tr>
<tr>
<td>Credit from banks and other credit providers</td>
<td>5,680</td>
<td>7,118</td>
</tr>
<tr>
<td>Short-term debentures</td>
<td>4,772</td>
<td>-</td>
</tr>
<tr>
<td>Trade payable</td>
<td>2,008</td>
<td>1,726</td>
</tr>
<tr>
<td>Other current liabilities</td>
<td>1,581</td>
<td>1,742</td>
</tr>
<tr>
<td>Customer advances, net of work in progress</td>
<td>468</td>
<td>398</td>
</tr>
<tr>
<td>Provisions</td>
<td>732</td>
<td>730</td>
</tr>
<tr>
<td><strong>Total current liabilities</strong></td>
<td><strong>15,241</strong></td>
<td><strong>11,714</strong></td>
</tr>
<tr>
<td>Debentures</td>
<td>32,834</td>
<td>32,770</td>
</tr>
<tr>
<td>Liabilities to banks</td>
<td>6,945</td>
<td>8,572</td>
</tr>
<tr>
<td>Liabilities with respect to other benefits after employment termination</td>
<td>3,050</td>
<td>2,924</td>
</tr>
<tr>
<td>Regulatory liabilities</td>
<td>2,384</td>
<td>1,397</td>
</tr>
<tr>
<td>Provisions for refunding amounts to consumers</td>
<td>2,449</td>
<td>2,565</td>
</tr>
<tr>
<td>Deferred taxes, net</td>
<td>4,909</td>
<td>5,088</td>
</tr>
<tr>
<td>Debentures to the State of Israel</td>
<td>2,534</td>
<td>2,536</td>
</tr>
<tr>
<td>Liabilities to the State of Israel</td>
<td>3,406</td>
<td>2,856</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>501</td>
<td>691</td>
</tr>
<tr>
<td><strong>Total long-term liabilities</strong></td>
<td><strong>59,012</strong></td>
<td><strong>59,399</strong></td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td><strong>74,253</strong></td>
<td><strong>71,113</strong></td>
</tr>
<tr>
<td><strong>Shareholders’ equity</strong></td>
<td>15,467</td>
<td>14,811</td>
</tr>
<tr>
<td><strong>Total liabilities and equity</strong></td>
<td><strong>89,720</strong></td>
<td><strong>85,924</strong></td>
</tr>
</tbody>
</table>

Source: unaudited consolidated financial statements of the IEC for the year ended December 31, 2013

(*) retroactive implementation of IAS 19 (2011)
Table C – Recommendation for recoverable amount

Table C1 – Model for estimating the value-in-use of the generation segment

<table>
<thead>
<tr>
<th>Source: value-in-use valuation and Company Management</th>
</tr>
</thead>
<tbody>
<tr>
<td>Currency: NIS millions</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Financing costs for active assets</td>
</tr>
<tr>
<td>Depreciation costs</td>
</tr>
<tr>
<td>Total income from capital services</td>
</tr>
<tr>
<td>Recognized operating costs</td>
</tr>
<tr>
<td>Fuel basket costs</td>
</tr>
<tr>
<td>Working capital – fuel inventory</td>
</tr>
<tr>
<td>Working capital trade receivables – fuels</td>
</tr>
<tr>
<td>Profit (loss) from fuels</td>
</tr>
<tr>
<td>Total income from fuels</td>
</tr>
<tr>
<td>Income from coverage of allowed operating expenses due to entry of PEP</td>
</tr>
<tr>
<td>Other income</td>
</tr>
<tr>
<td>Total income from the generation segment</td>
</tr>
<tr>
<td>Total expenses</td>
</tr>
<tr>
<td>Operating profit</td>
</tr>
<tr>
<td>Depreciation</td>
</tr>
<tr>
<td>EBITDA</td>
</tr>
<tr>
<td>Tax expenses</td>
</tr>
<tr>
<td>Total investments in fixed assets</td>
</tr>
<tr>
<td>Changes in working capital</td>
</tr>
<tr>
<td>Residual value of other operating balances</td>
</tr>
<tr>
<td>Free cash flow</td>
</tr>
<tr>
<td>Discounted cash flow</td>
</tr>
<tr>
<td>Other operational assets, net</td>
</tr>
</tbody>
</table>
### Table C2 – Book Value

Source: Company Management

<table>
<thead>
<tr>
<th>Currency: NIS millions</th>
<th>Generation segment</th>
<th>Transmission segment</th>
<th>Distribution segment</th>
<th>Activity segments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed assets in use, net</td>
<td>26,543</td>
<td>12,715</td>
<td>19,373</td>
<td>58,631</td>
</tr>
<tr>
<td>Fixed assets under construction</td>
<td>4,067</td>
<td>1,616</td>
<td>391</td>
<td>6,074</td>
</tr>
<tr>
<td>Other fixed assets</td>
<td>424</td>
<td>206</td>
<td>313</td>
<td>943</td>
</tr>
<tr>
<td>Working capital, net</td>
<td>3,384</td>
<td>4</td>
<td>(307)</td>
<td>3,081</td>
</tr>
<tr>
<td><strong>Net of:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Alon Tabor Emergency stages A+B</td>
<td>(16)</td>
<td></td>
<td>(16)</td>
<td></td>
</tr>
<tr>
<td>Net &quot;generation A&quot; and &quot;generation B&quot; pension costs included in the fixed assets balance due to &quot;new&quot; units</td>
<td>(136)</td>
<td></td>
<td>(136)</td>
<td></td>
</tr>
<tr>
<td>Effect of implementing IAS 19</td>
<td>(113)</td>
<td></td>
<td>(113)</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>34,153</strong></td>
<td><strong>14,541</strong></td>
<td><strong>19,770</strong></td>
<td><strong>68,464</strong></td>
</tr>
</tbody>
</table>

### Table C3 – Recoverable amount recommendation

Source: assessment of value in use and Company Management

<table>
<thead>
<tr>
<th>Currency: NIS millions</th>
<th>Recoverable amount</th>
<th>Carrying amount</th>
<th>Impairment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating Segments</td>
<td>68,599</td>
<td>68,464</td>
<td>-</td>
</tr>
</tbody>
</table>
### Table D1 – Calculation of the discount rate for the generation segment

<table>
<thead>
<tr>
<th>Calculation of the cost of capital</th>
<th>Calculation of the cost of debt</th>
<th>Calculation of the weighted average cost of capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) net debt/enterprise value</td>
<td>74.7%</td>
<td>(e) Cost of Debt 3.6%</td>
</tr>
<tr>
<td>(b) Risk-free interest rate</td>
<td>1.7%</td>
<td>Cost of equity 8.0% 25%</td>
</tr>
<tr>
<td>(c) Leveraged beta</td>
<td>1.05</td>
<td>Cost of debt 3.6% 75%</td>
</tr>
<tr>
<td>(d) Market risk premium (Rm-Rf)</td>
<td>6.0%</td>
<td></td>
</tr>
<tr>
<td><strong>Cost of Equity</strong></td>
<td><strong>8.0%</strong></td>
<td><strong>Cost of Debt 3.6%</strong></td>
</tr>
<tr>
<td><strong>WACC (rounded)</strong></td>
<td></td>
<td><strong>4.7%</strong></td>
</tr>
</tbody>
</table>

**Source:**

(a) Estimated based on the fair value of the net financial liabilities of the entity
(b) The yield on Galil bonds which is consistent with the average life of the generation segment’s assets, as reported by the company’s Management – 13.5 years.
(c) Based on the model of power generating companies
(d) EY’s estimate of market risk premium in 2014
(e) Based on the post-tax rates of return, as at the valuation date, on bonds and loans taken by the Company. These returns were adjusted to the average life of the generation segment’s assets. The calculation of the Company’s cost of debt (and the leverage ratio) did not take into account bonds and loans backed by government guarantees in the amount of NIS 7.46 billion, as stated in chapter 3.